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BANKS' RESPONSE TO MONETARY POLICY NORMALISATION: WHAT TO EXPECT IN TERMS OF FUNDING STRATEGIES AND MONEY MARKET DEVELOPMENTS ?

**PRESENTATION TO THE ECB MONEY MARKET
CONTACT GROUP**

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BANKS' FUNDING PLANS ARE DETERMINED LARGELY IN ADVANCE

- **FUNDING PLANS ARE STRATEGICALLY DETERMINED IN TERMS OF FORECASTED PATHS OF VARIOUS INDICATORS OVER SEVERAL QUARTERS AND YEARS**
 - REGULATORY LIQUIDITY RATIOS SUCH AS LCR AND NSFR
 - CAPITAL REQUIREMENTS, LEVERAGE RATIOS
 - BUSINESS NEEDS AND DEVELOPMENT PLANS
 - INTERNAL LIQUIDITY RISK MODELS
 - OTHER BANKS' OWN INTERNAL CONSIDERATIONS, RISK APPETITE, BUSINESS MIX ETC

- **IN THE PARTICULAR CASE OF THE TLTRO RELATED IMPACTS, THE MATURITY OF THE TLTRO AND ESPECIALLY THE JUNE 2023 ONE WAS ANTICIPATED AND LARGELY DISCUSSED IN THE FINANCIAL SPHERE :**
 - EXPECTED IMPACT ON THE BANKS' NSFR IN JUNE 2022, AS THE EFFICIENCY OF TLTRO DRAWINGS DROPPED FROM 100% TO 50%
 - EXPECTED FULL IMPACT ON THE BANKS' NSFR IN DECEMBER 2022, AS THE EFFICIENCY DROPPED FURTHER FROM 50% TO 0%
 - EXPECTED FULL IMPACT ON THE BANKS' LCR IN APRIL 2023

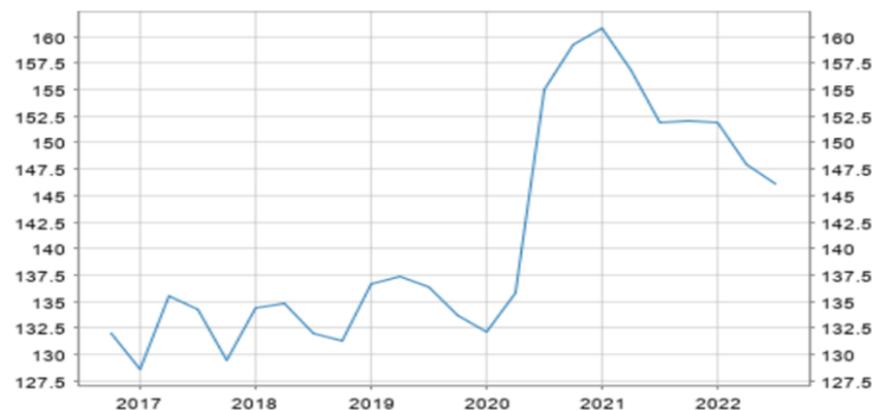
- **THERE IS NOT A LOT OF EVIDENCE THAT BANKS' FUNDING IS DEPENDENT ON SHORT TERM AND LAST MINUTE DEVELOPMENTS, AT LEAST ON THE UNSECURED SEGMENT. HOWEVER, SOME ADJUSTMENTS CAN BE INDEED SEEN FOR INSTANCE :**
 - AFTER INFLATION NUMBERS SURPRISED ON THE HIGH SIDE AND THE ECB DECIDED LARGE RATE HIKES IN JULY AND SEPTEMBER, BANKS WERE INDUCED TO DELAY ANY EARLY REPAYMENTS
 - AFTER ECB ANNOUNCED THE CHANGE IN TLTRO CONDITIONS IN OCTOBER, BANKS WERE INDUCED TO RECONSIDER EARLY REPAYMENTS ACCORDING TO THE PREVIOUS SCHEDULE

- **THIS EVIDENCE IS ALL THE MORE SO DIFFICULT TO DEMONSTRATE AS BANKS OPERATE IN AN ENVIRONMENT OF GEOPOLITICAL UNCERTAINTIES AND ENERGY PRICES DRIVEN VOLATILITY**

BANKS' IMMEDIATE RESPONSE TO TLTRO DEVELOPMENTS MAY HAVE BEEN TO ACCEPT LOWER LIQUIDITY REGULATORY RATIOS

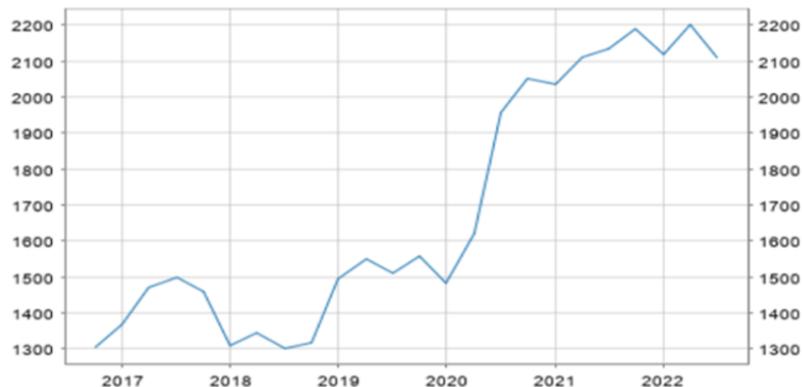
- **BANKS SEEM TO ACCEPT SLIGHTLY LOWER LIQUIDITY RATIOS LEVELS, HOWEVER WELL ABOVE THE REGULATORY REQUIREMENT TARGETS.**
- **THE INFLEXION POINT IN THE NSFR FOR G-SIB SEEMS TO BE RELATED TO THE LARGE TLTRO MATURITY IN JUNE 2023.**
- **THE DROP IN LCR STARTED MUCH EARLIER AND MAY HAVE BEEN LINKED TO THE REBOUND IN ECONOMIC ACTIVITY AND IN CREDIT PRODUCTION IN 2021 FOLLOWING THE COVID CRISIS.**
- **HOWEVER, LIQUIDITY BUFFERS REMAIN, IN LINE WITH THE EUROZONE EXCESS LIQUIDITY SITUATION.**

LCR for G-SIBs in EU countries participating in the Single Supervisory Mechanism, percentage



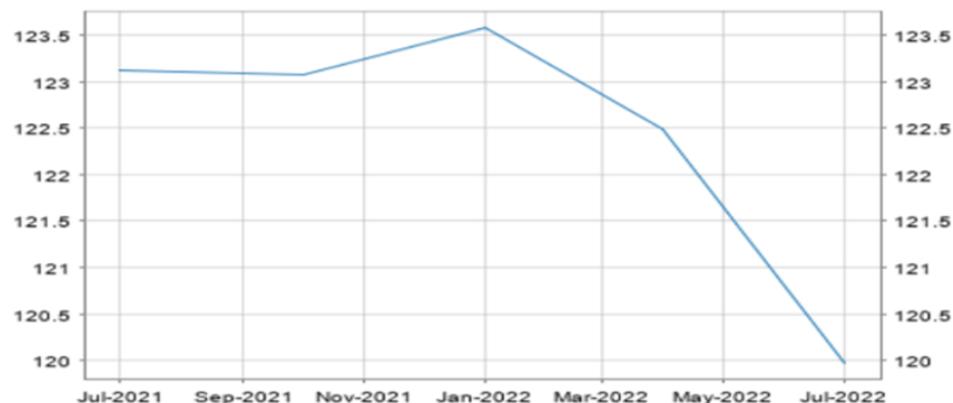
Source: ECB data warehouse

Liquidity buffer for G-SIBs in EU countries participating in the Single Supervisory Mechanism, in EUR billions



Source: ECB data warehouse

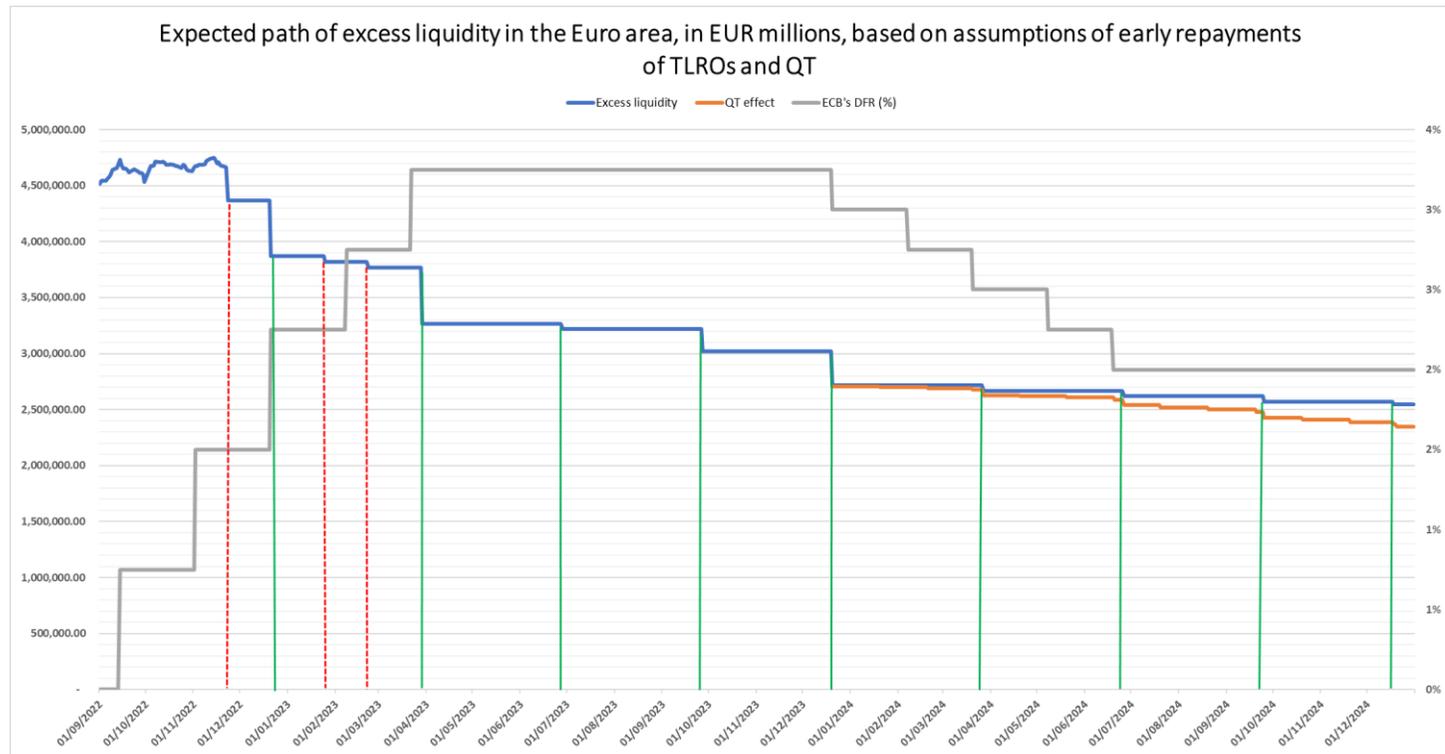
NSFR for G-SIBs in EU countries participating in the Single Supervisory Mechanism, percentage



Source: ECB data warehouse

EXPECTED PATH OF ECB DFR AND EXCESS LIQUIDITY IN THE EUROZONE SHOULD ENCOURAGE BANKS TO SUBSTITUTE REMAINING SHORT-TERM TLTRO MATURITIES BY UNSECURED SHORT-TERM FUNDING

- ACCORDING TO MARKET PRICING, RATES SHOULD PEAK EARLY 2023 THEN DECREASE TO 2% IN H2 2024.
- ASSUMING THAT BANKS EARLY REPAY TLTRO IN ACCORDANCE WITH ITS EFFICIENCY IN TERMS OF REGULATORY RATIOS AND THAT THE ECB WILL LAUNCH A CAREFUL QT OF € 10 BLN PER MONTH EARLY 2024 INCREASED TO € 20 BLN BY MID 2024, EXCESS LIQUIDITY IN THE EUROZONE SHOULD STILL REMAIN IN THE VICINITY OF € 2,500 BLN
- IT IS VERY UNLIKELY THAT BANKS SHOULD MAINTAIN TLTRO FUNDING ONLY FOR THE PURPOSES OF SHORT-TERM LIQUIDITY AND SHOULD PREFER TO USE THE BALANCE SHEET CAPACITY TO FUND DIRECTLY IN THE UNSECURED MARKET AT LOWER LEVELS THAN DFR



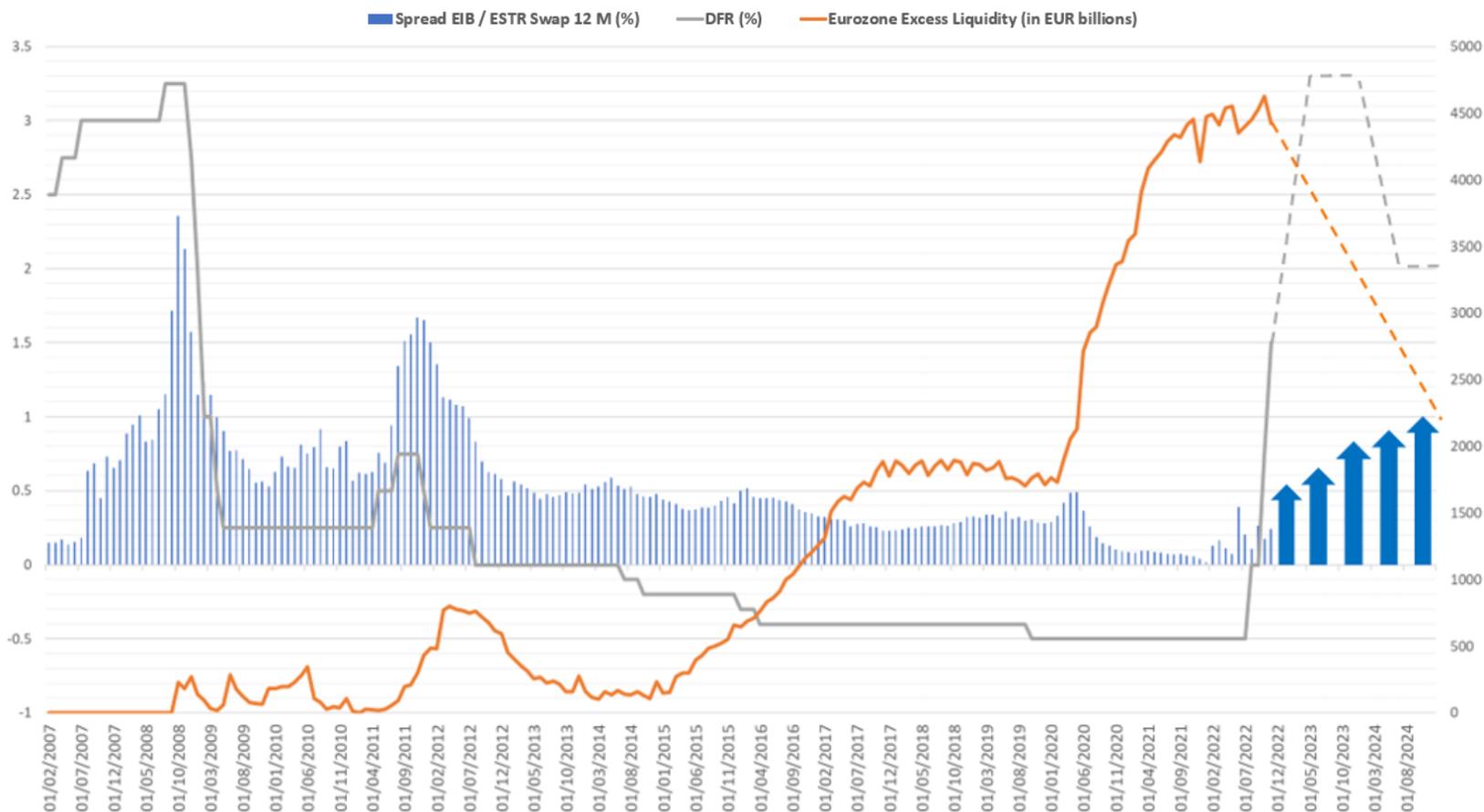
--- Additional early repayment dates

— Maturity dates for TLTROs

Source: ECB liquidity analysis

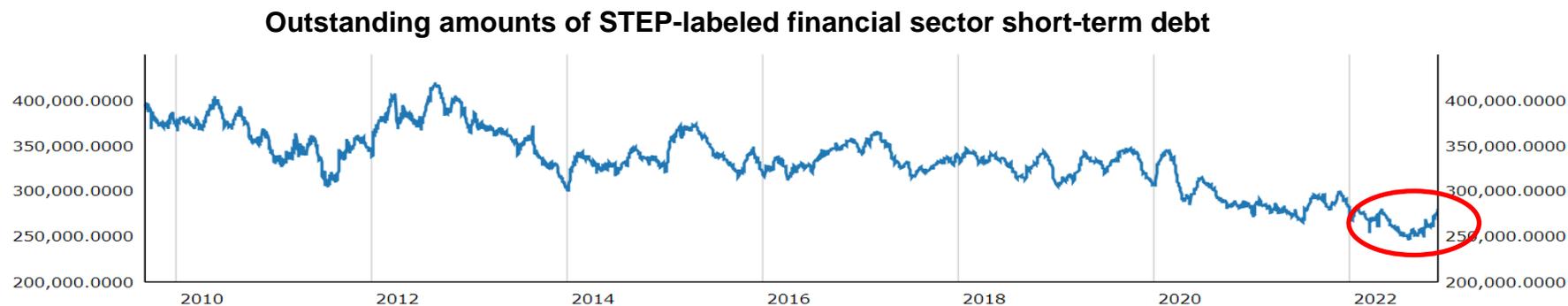
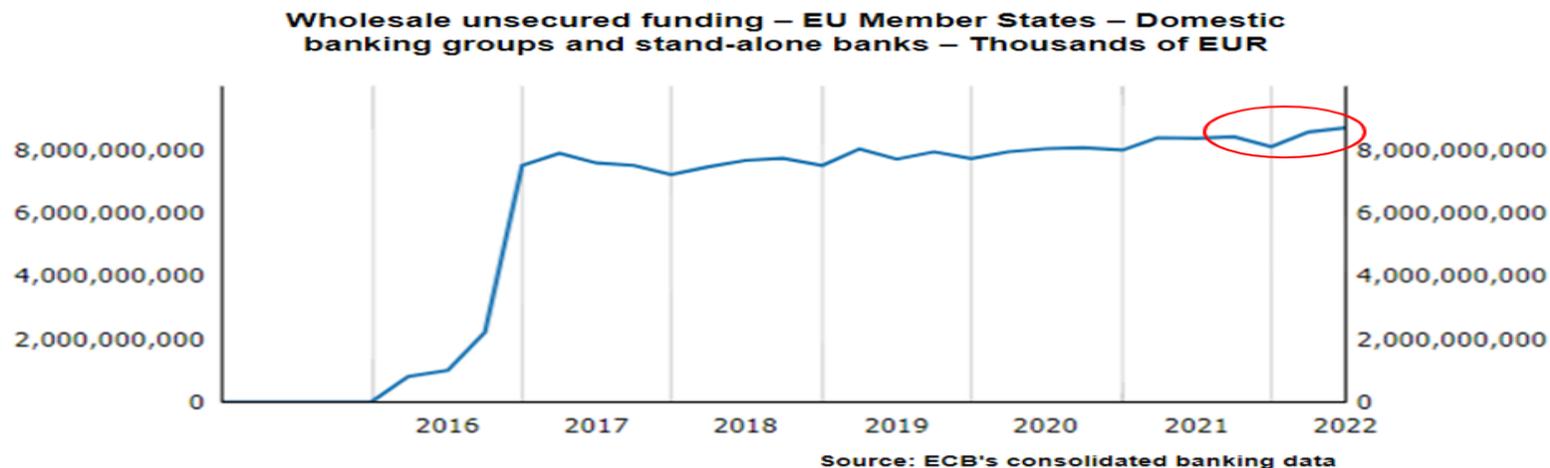
THIS EFFECT HAS ALREADY STARTED, DRIVING LIQUIDITY PRICE HIGHER, AND SHOULD CONTINUE FURTHER IN THE NEAR FUTURE, ESPECIALLY IF THE CURRENT MARKET ASSUMPTIONS MATERIALIZE

Eurozone excess liquidity, DFR and Spread Euribor 12 M vs ESTR 12 M swap forecast



Source: Bloomberg

THE UNSECURED SHORT TERM MARKET SHOW INCREASING VOLUMES ESPECIALLY ON THE SHORT-TERM DEBT ISSUANCE



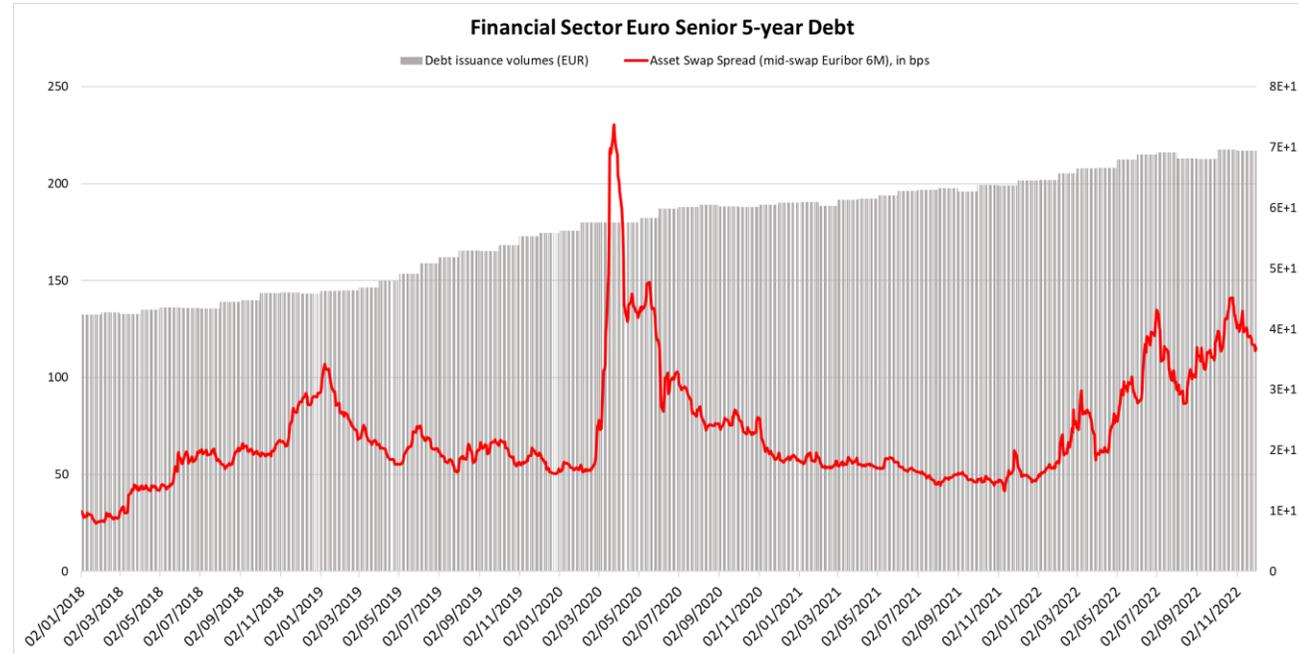
World (all entities), issuing sector MFIs, All rates (fixed, variable, zero coupon) rate - Unspecified floating rate base, Residual maturity Total, All ratings, Outstanding amounts at the end of the period (stocks), All collaterals - All currencies combined - Euro million equivalent (STEP and ECB data)

BANKS HAVE MAINTAINED INCREASING VOLUMES IN THE MEDIUM AND LONG-TERM ISSUANCE, NO EVIDENCE OF CHANGE IN BEHAVIOUR DUE TO TLTRO DEVELOPMENTS

➤ **ANALYZING THE ASSET SWAP SPREAD FOR FINANCIAL DEBT, WE NOTICE A SHARP INCREASE IN BANKS' MEDIUM -TERM FUNDING COST BETWEEN LATE 2021 AND THE END OF OCTOBER 2022 (+90 BPS).**

➤ **HOWEVER, THIS INCREASE IS LIMITED COMPARED TO THE COVID PERIOD AND IT REMAINS DIFFICULT TO ASSESS WHETHER IT IS DRIVEN BY HIGHER DEMAND OR BY EXTERNAL SHOCKS AND GLOBAL CREDIT REPRICING**

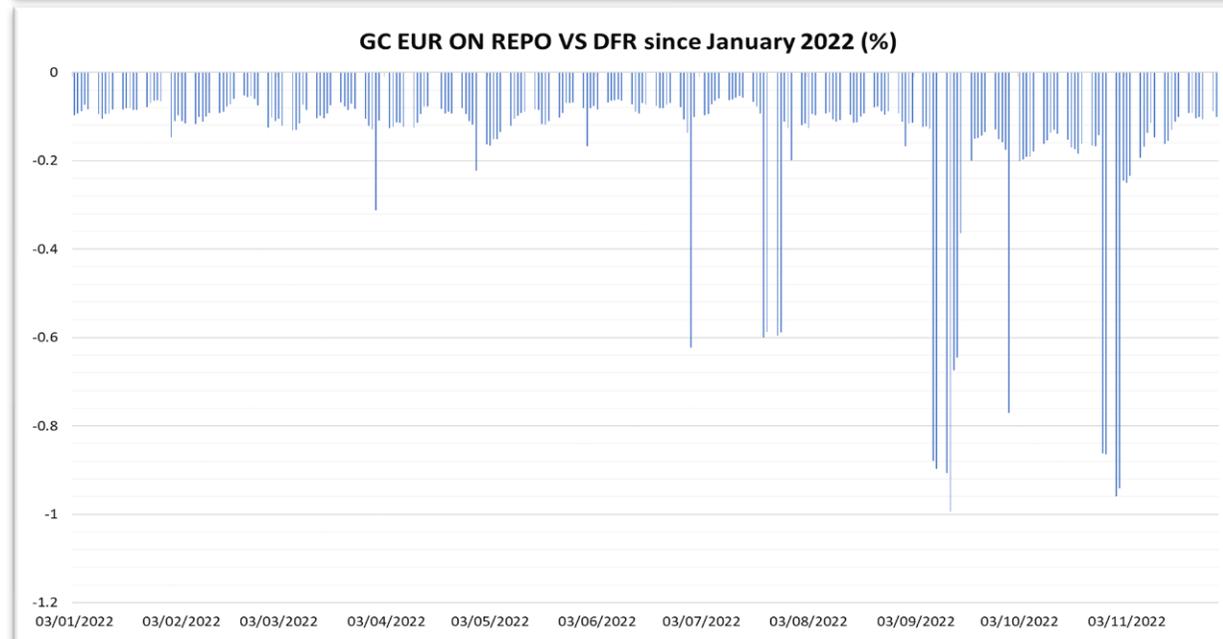
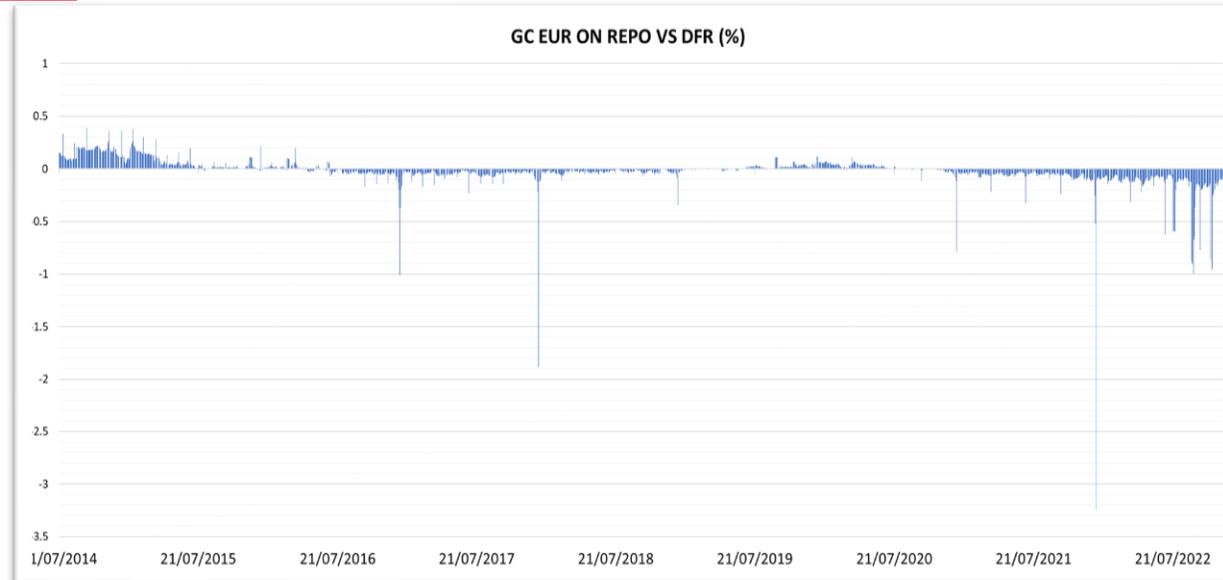
➤ **RECENTLY, THE SPREAD HAS CONTINUOUSLY DECREASED, HIGHLIGHTING EASIER CONDITIONS FOR BANKS' MEDIUM -TERM FUNDING IN NOVEMBER (-30 BPS), WHICH BANKS WILL CONTINUE TO CAPITALIZE ON IN ORDER TO REPLACE TLTRO FUNDING**



Source: iBoxx by HIS Markit LTD

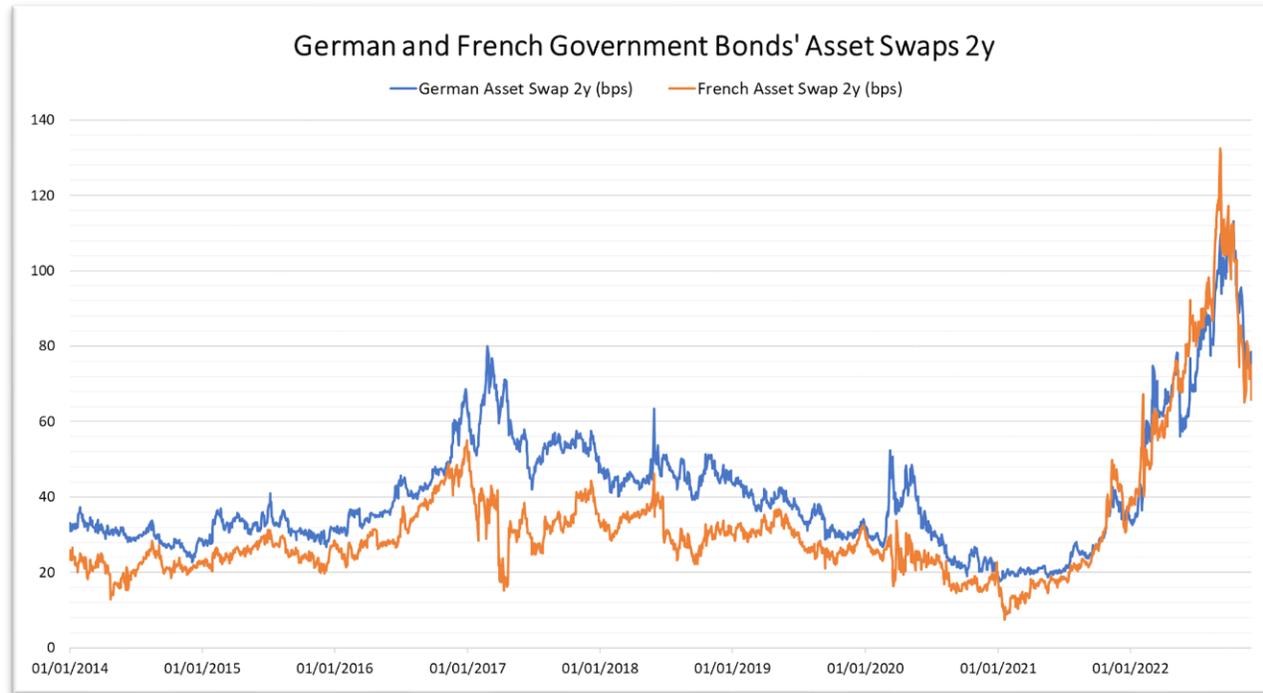
❑ **ONE QUESTION MARK IS HOW THE ECB RESTRICTIVE MONETARY POLICY WILL AFFECT THE EUROZONE ECONOMIES AND THE DEMAND FOR CREDIT IN THE COMING YEAR. THIS WILL DETERMINE BANKS' APPETITE AND COST OF FUNDING INDEPENDENTLY FROM TLTRO MATURITIES**

THE SECURED SEGMENT OF MONEY-MARKETS SEEMS STILL FAR FROM NORMALIZATION EVEN IF SOME RELIEF IS NOTICEABLE SINCE ECB ANNOUNCEMENTS IN OCTOBER



GOVERNMENT BONDS' ASSET SWAPS HAVE BEEN INCREASING THROUGHOUT THE BEGINNING OF THE RATE-HIKE CYCLE AND THE TLTRO DEVELOPMENTS, YET THE LAST TLTRO ANNOUNCEMENTS PROBABLY HAD A NARROWING EFFECT

- GERMAN AND FRENCH GOVERNMENT BONDS' ASSET SWAPS INCREASED BY 100 BPS SINCE MID-2021
- BANKS MAY HAVE INCREASED PURCHASES OF CORE EUROPEAN GOVERNMENT DEBT IN PREPARATION FOR FINALLY MAINTAINING THE TLTRO AS ECB RATES WERE EXPECTED TO RISE
- THERE WAS A CLEAR DOWNTURN (-40 TO 50 BPS) SINCE EARLY SEPTEMBER 2022 AS THE MARKETS WERE PRICING A HIGHER PROBABILITY OF NEW ANNOUNCEMENTS TO COME REGARDING TLTRO REPAYMENT CONDITIONS
- THIS TREND WAS CONFIRMED AFTER THE ECB ANNOUNCED THE CHANGE IN TLTRO CONDITIONS IN OCTOBER



Source: Bloomberg

BANKS' LONG-TERM RESPONSE TO TLTRO MATURITIES WAS TO RAISE SUBSTITUTE LIQUIDITY FROM VARIOUS SOURCES, OTHER THAN THE ONES DEVELOPED EARLIER IN THIS PRESENTATION

- **COVERED BONDS**
- **LONG-TERM ISSUANCE**
- **SHORT-TERM ISSUANCE**
- **WHOLESALE AND RETAIL DEPOSITS : PRODUCT OFFER IS ADAPTING TO THE NEW POSITIVE RATES ENVIRONMENT**
- **BANKS' STRATEGY INCLUDE PREPARING FOR ADDITIONAL CAPITAL NEEDS IN 2025 (RWA INCREASE)**
- **IN A CONTEXT OF INCREASED LIQUIDITY COST AND HIGHER ABSOLUTE RATES**

LONG-TERM IMPACTS FOR EUROZONE BANKS

- **HIGHER COST OF FUNDING**
- **LOWER EXCESS LIQUIDITY BUFFERS**
- **LOWER LIQUIDITY RATIOS**
- **POSSIBLE RETURN OF THE FRAGMENTATION STORY**
- **SOME BANKS MAY BE EXCLUDED FROM THE MARKET AND THE RELIANCE ON LTRO MAY INCREASE, WITH THE ASSOCIATED ISSUE OF THE CENTRAL BANK DEPENDENCY STIGMA**
- **THE QUESTION OF NON-CORE EUROPEAN GOVERNMENT DEBT PLACEMENT AFTER THE TLTRO MATURITIES AND ITS POSSIBLE IMPLICATIONS MAY PROVE A CONCERN AGAIN, AS WAS THE CASE IN THE PRE-COVID PERIOD**

ACKNOWLEDGEMENTS

- **MANY SG TEAMS AND PERSONS DIRECTLY OR INDIRECTLY CONTRIBUTED TO THIS PRESENTATION AND I WOULD LIKE TO THANK THEM FOR THEIR INSIGHTS**

- **I WOULD LIKE TO MENTION THE FOLLOWING TEAMS :**
 - **GROUP TREASURY**
 - **SHORT-TERM TREASURY**
 - **LONG-TERM FUNDING**
 - **DCM**
 - **STRATEGY**
 - **REPO**
 - **SHORT-TERM PAPER**

- **MY PARTICULAR THANKS GO TO THE SHORT-TERM TREASURY INTERN, VICTOR MAREMBERT, AN ESCP-EUROPE MASTER IN MANAGEMENT STUDENT, FOR HIS ACTIVE SUPPORT IN PREPARING THIS PRESENTATION**