DECEMBER 4, 2024

MONEY-MARKET CONTACT GROUP

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SOCIETE GÉNÉRALE

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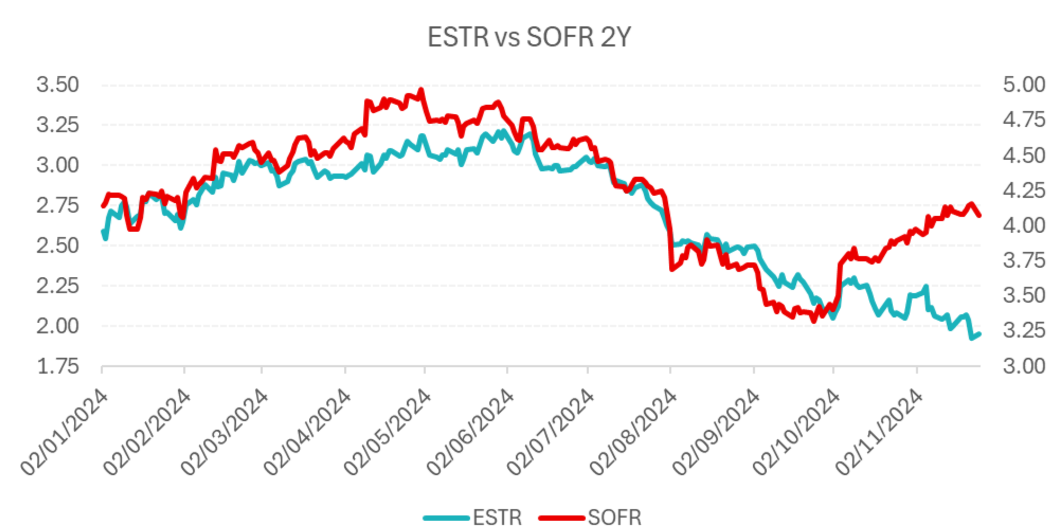
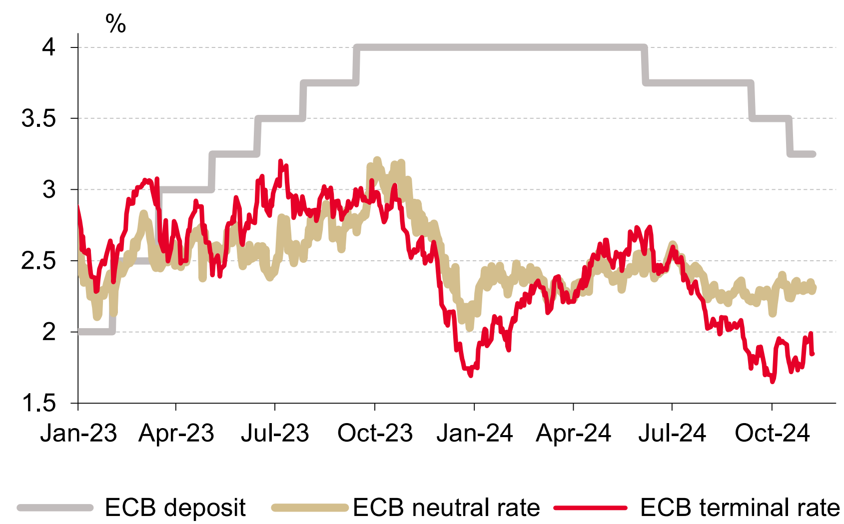
ECB GOVERNING COUNCIL : MARKET EXPECTATIONS AND REACTIONS

- ECB Governing Council monetary policy decision on 17th October had muted impact on market pricing as ECB delivered 25 bp and announced steady steps as anticipated by most participants.
- On a broader picture, EUR and USD rates strong correlation fading as markets expect ECB to focus on medium term growth concerns rather than short term inflation developments.
- Market expects ECB Governing Council to cut rates at every meeting by 25 bp and possibly faster, steadily to below neutral rate.
- But there is little room for terminal rates to fall further.



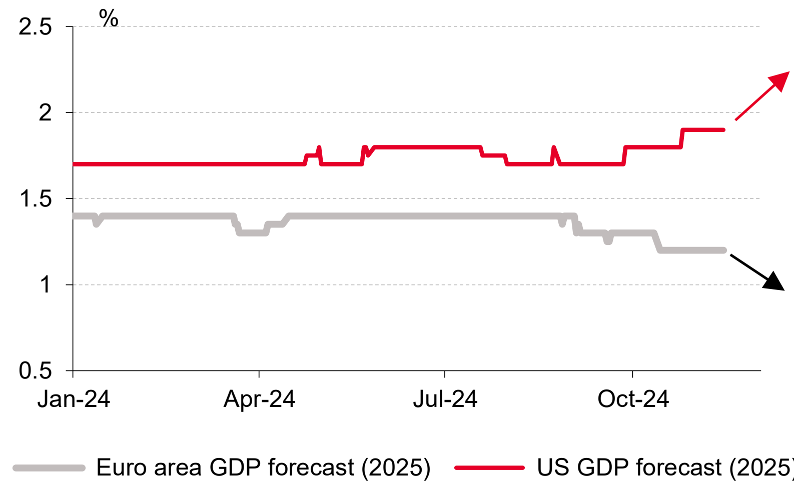


Source: SG Cross Asset Research/Rates, Bloomberg, IMF (scenario analysis considers a global 10% tariff on trade flows) , Santander

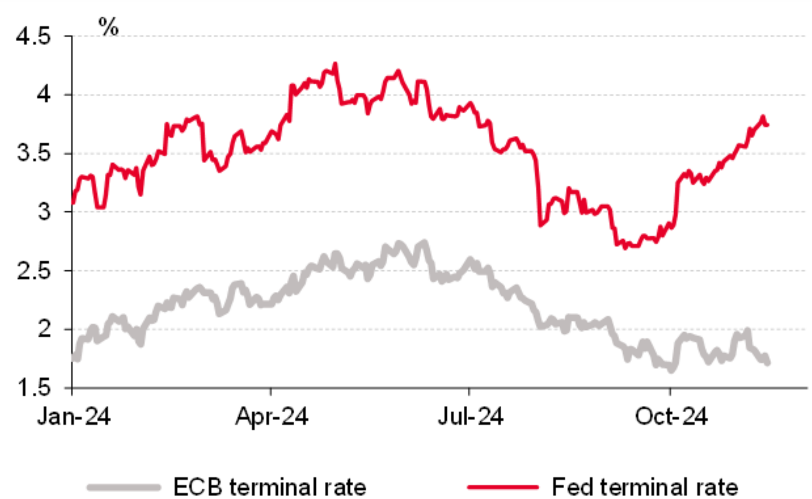
US ELECTIONS IMPACT ON MONEY-MARKETS

- **Inflation : Trump policy is expected to have an inflationary impact in the US with possible spill-over in Europe**
- **Trade : impact of higher tariffs on euro area GDP likely to be muted, but trade uncertainty may act faster and stronger**
- **Geopolitics : disengagement of US from Ukraine conflict means higher defense budgets, increased government deficit and issuance**
- **Financial markets spill-over : exuberance in cryptos and equities**

Consensus 2025 growth forecasts likely to be revised up for the US and down for the euro area

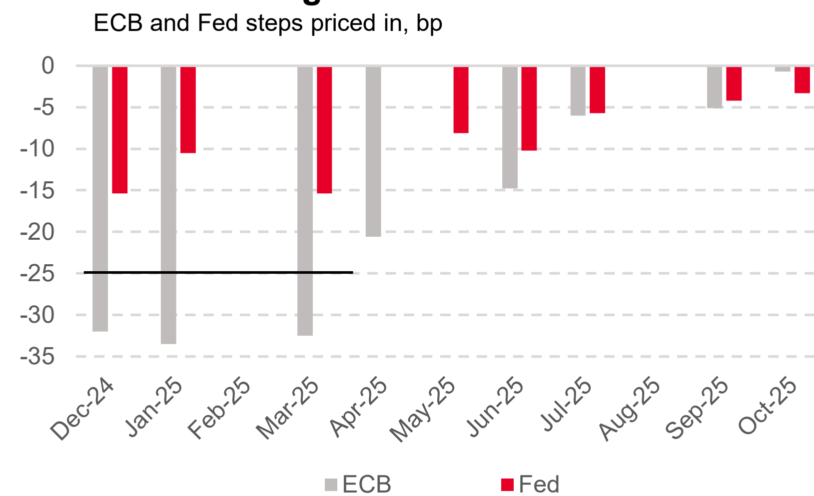


EUR terminal rates are priced at 1.85%, while USD rates are revised higher by 100 bp (below chart)



Source: SG Cross Asset Research/Rates, Bloomberg

Market is pricing cuts larger than 25bp for the ECB over the next three meetings but is not sure about Fed's action



GERMANY, WHY THE SHARP CHEAPENING OF ASW SPREADS?

- **Known knowns:** The cheapening of ASW spreads is a global phenomenon and came at different speeds. Within the triple-A world, names more exposed to supply like Bunds and EU bonds cheapened much more than low-beta names like ESM, EFSF or EIB. Triple-A covered bonds have cheapened much less since issuance needs have decreased and some issuers even pre-funded ahead of 2025. Our models suggest that every 110bn of net supply net of QT in Bunds should be cheapening ASW spreads by 4-6bp. Whereas this may help to explain the cheapening of repo markets, this does not fully explain the cheapening we have seen in cash markets.

- **Known unknowns**. ASW spreads have cheapened much more than what supply and QT would imply. There are many more factors that we could highlight.

  - Short Bund ASW positions were the best carry trade and hedged investors for any fiscal uncertainty (US, UK, France and Italy were all in focus). Short ASW positions were cleaned during the yen carry trade episode of August, so investors started September with a clean sheet. Macro data coming from the US was more positive than in July and term premium trades with the UK budget + US elections around the corner made short ASW positions attractive from a risk-reward perspective. If hedge funds started to sell to dealers, it also makes sense that dealers were reluctant to take the paper for the same rationales (fiscal debates in major economies, better data…) but also due to the usual budget constraints into the end of the year.

Supply expectations (€bn)

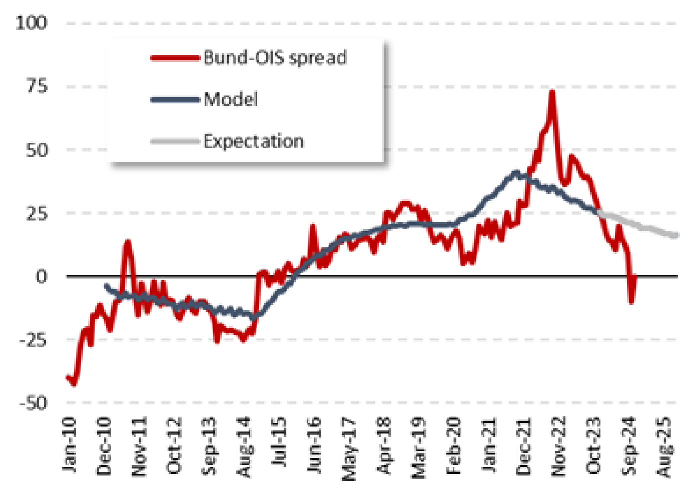
	EGB Issuance 2025 - Based on the Govts 2025 Budget plans sent to the EC								
	Gross			Net			Net, net of ECB's QE/QT		
	2023	2024	2025	2023	2024	2025	2023	2024	2025
Germany	295	248	235	113	52	44	138	109	104
France *	270	285	300	119	130	125	157	156	177
Italy	333	350	328	78	82	81	110	124	151
Spain **	168	173	156	70	55	42	90	78	76
Netherlands	46	40	49	16	7	29	23	17	35
Austria ***	45	45	38	17	21	15	20	26	22
Belgium ***	45	41	53	24	12	29	27	15	35
Finland	20	26	22	9	17	11	11	19	15
Portugal	7	15	15	-4	6	0	0	2	5
Greece	12	10	5	5	5	2	8	5	3
Ireland	7	8	12	-2	0	0	1	2	4
TOTAL	1248	1240	1213	445	386	380	585	553	626
						Amount not rolled over by ECB	*140*	*168*	*246*

* The AFT has already anticipated some preliminary issaunce targets for 2025, included here

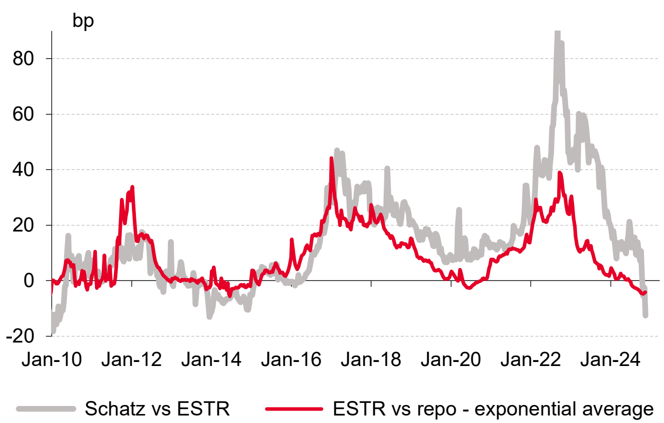
** No Budget draft sent to the EC yet. Medium-term fiscal plans sent to the EC used instead

*** No Budget draft / Medium-term fiscal plans sent to the EC yet. Latest EC forecasts used instead

Bund 10y spread vs OIS (bp)



Schatz - ESTR (bp) vs Repo spread to ESTR(bp)



Source: SG Cro

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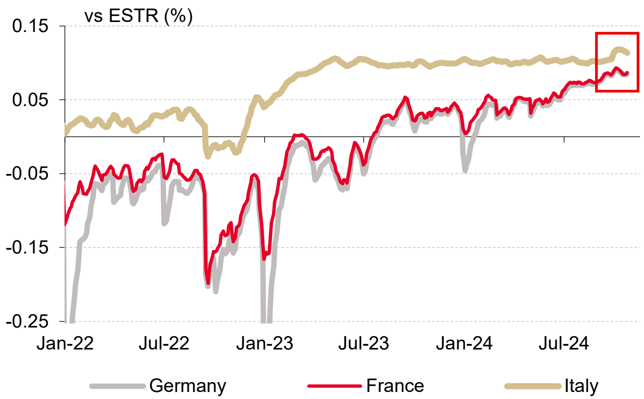
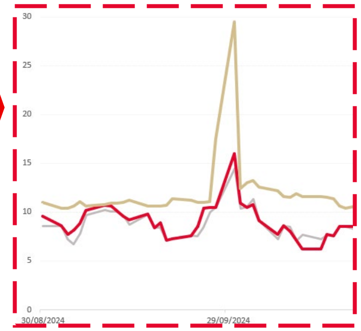
Sources: SG, Santander, Bloomberg

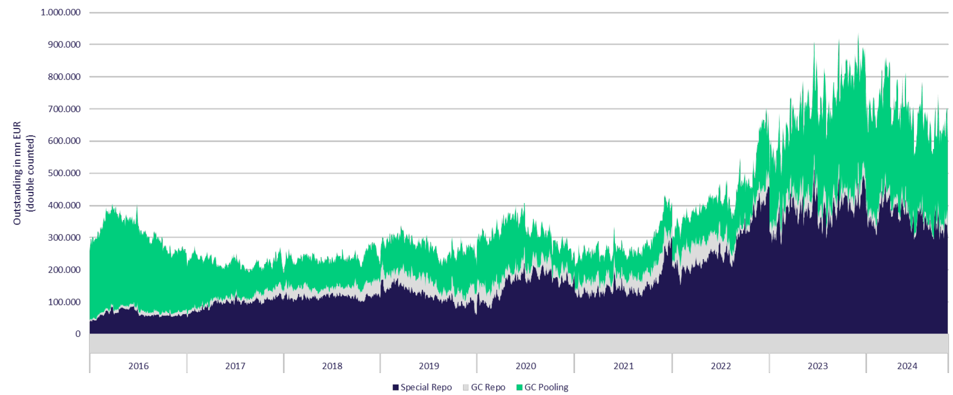
REPO MARKET DEVELOPMENTS

GC repo rates vs ESTR



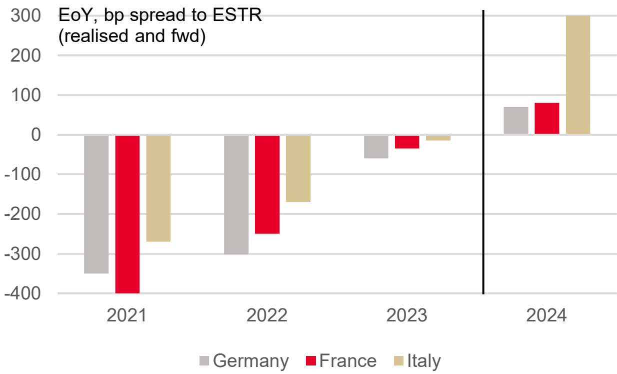


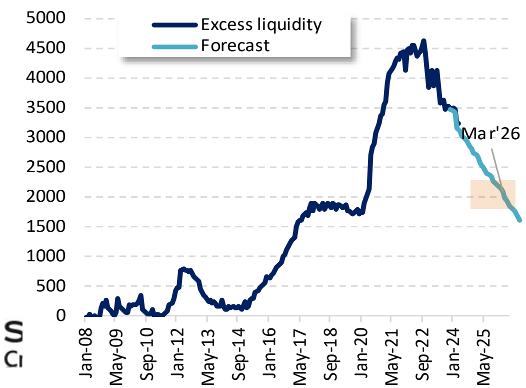
Eurex Repo Outstanding Volumes



Remark: Calculation of outstanding volumes including forward repo transactions according to ICMA methodology (cleared volume)

Repo – Year End





Repo Market

Repo evolution

- QT, Net issuance generating abundant collateral supply
- Excess liquidity, Little signs of fragmentation weighting on repo rates
- GC pooling volumes up c.10% YTD in 2024, while Specials volume falling, mainly in Germany and Spain

September End

- Balance sheet issue or reserves scarcity?
- What has changed vs June?

Year-End expectations

- Govt repo market showing clear signs of stress
- Equity funding markets also revealing significant volatility ahead of year-end
- No netting applicable to SRO's implying banks constrained due to leverage implications

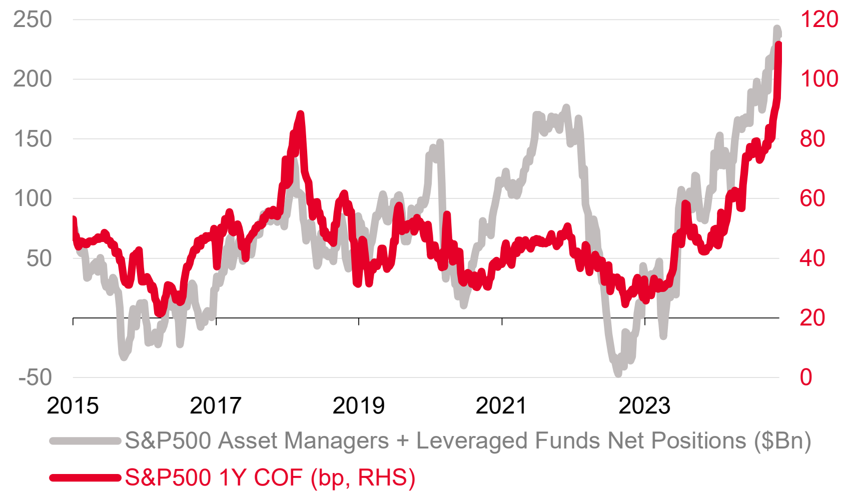
Others

- ISDA Standard IM Model Change
- NSFR June 2025

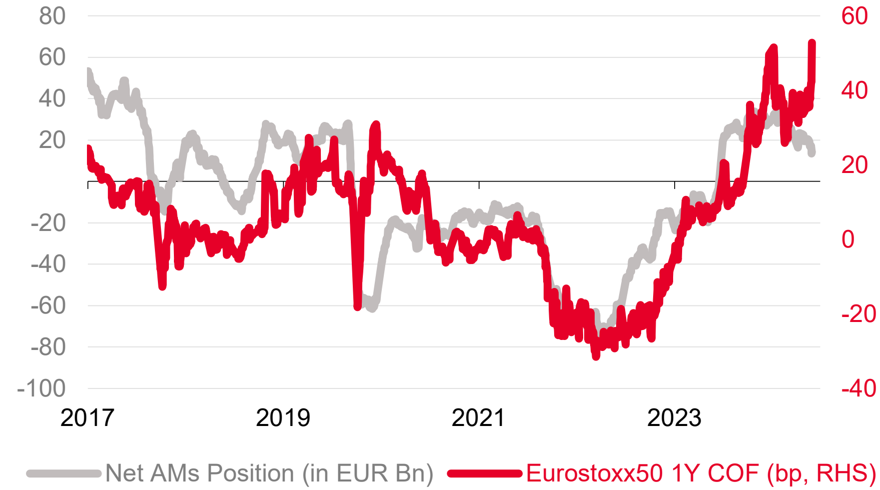
Sources: SG, Santander, Eurex, CME

GROWING FUNDING COSTS IN EQUITIES

SPX AM and leveraged fund net position vs cost of funding (COF)



SX5E Net asset managers (AM) position vs cost of funding (COF)



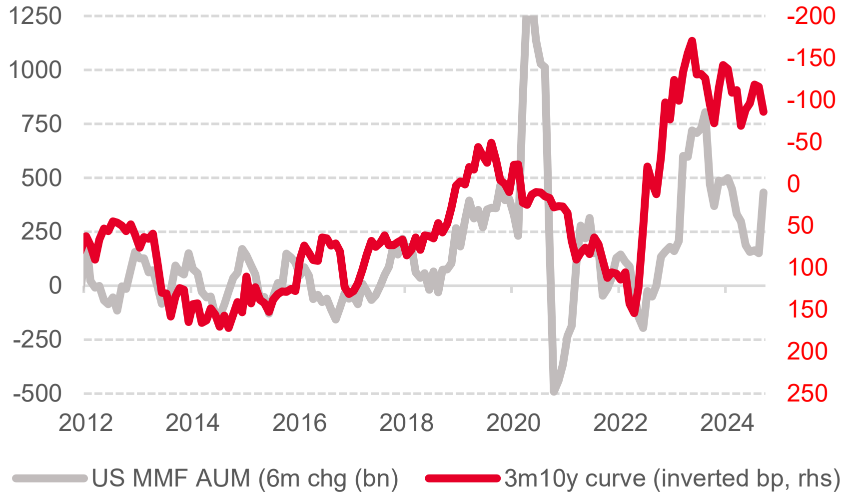
Record demand for leverage amid scarce balance sheet availability continues to exercise significant upward pressure on the cost of funding.

In the context of banks' balance sheet constraints and approaching year-end, growing funding costs in equities may exert an upward pressure on bonds funding costs.

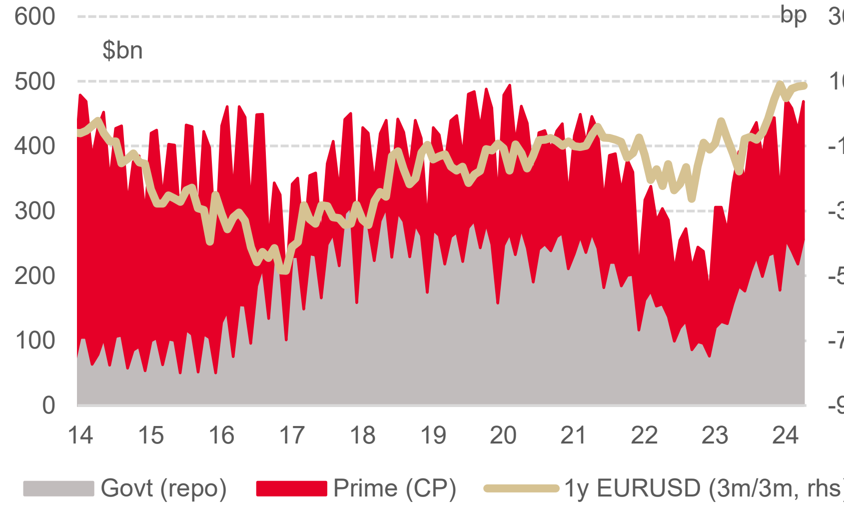
Source: SG Cross Asset Research, Bloomberg, Cofbox - https://analytics.sgmarkets.com/cofbox/

NO STRESS EXPECTED OVER YEAR-END FOR UNSECURED FUNDING AND FX SWAP SEGMENTS

The MMF AUM typically grows when the curve is inverted or flat, as the front end becomes more attractive to investors



As MMF investment into the euro area increases, EURUSD cross-currency basis tightens



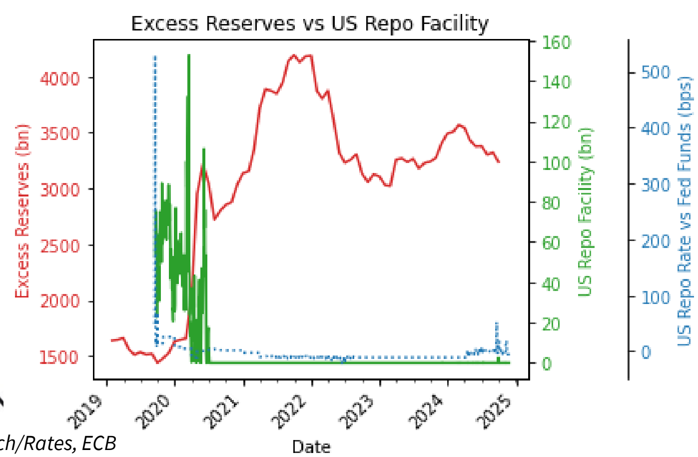
End of year 2024 does not show any signs of stress :

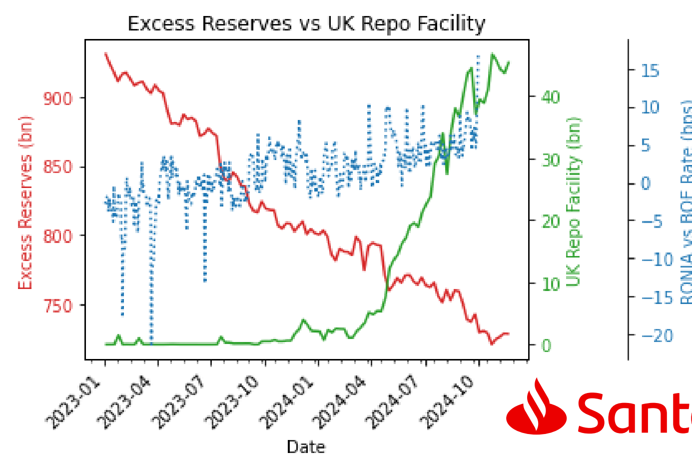
- **Cheap and available USD funding over year-end and into 2025.**
- **Tight FX basis.**
- **Inflows in MMF support favorable liquidity condition in EUR unsecured markets**
- **Balance Sheet management, EBA stress tests and last day of reserve maintenance period should limit Banks funding demand and should put downward pressure on rates**

Source: SG Cross Asset Research/Rates, Bloomberg, OFR US MMF monitor,

FORECASTING EXCESS LIQUIDITY AND STANDARD REFINANCING OPERATIONS

- Until the present, the usage of ECB refinancing facilites is subdued :
  - Ample liquidity in the system, normalization is implemented only gradually
  - Less needs from banks as loan production is impacted by ECB rate hikes much higher than neutral
  - Liquidity ratios structure that ensure a high LCR excess when NSFR is at or above regulatory levels
  - Market making repo desks may have limits which implies funding repo in the market instead of accessing SRO's or funding internally
  - Little upside in being first mover
- Going forward, factors that may encourage banks to leave less excess cash with ECB / to use standard refinancing operations :
  - Further reduction of ECB balance sheet to the FREL (Floor Required Excess Liquidity)
  - Government bonds repo rates consistently and persistently above DFR. In other jurisdictions, usage has been correlated to falling excess liquidity and raising repo rates.
  - Term premia steepening
  - Reduction of stigma attached to liquidity operations





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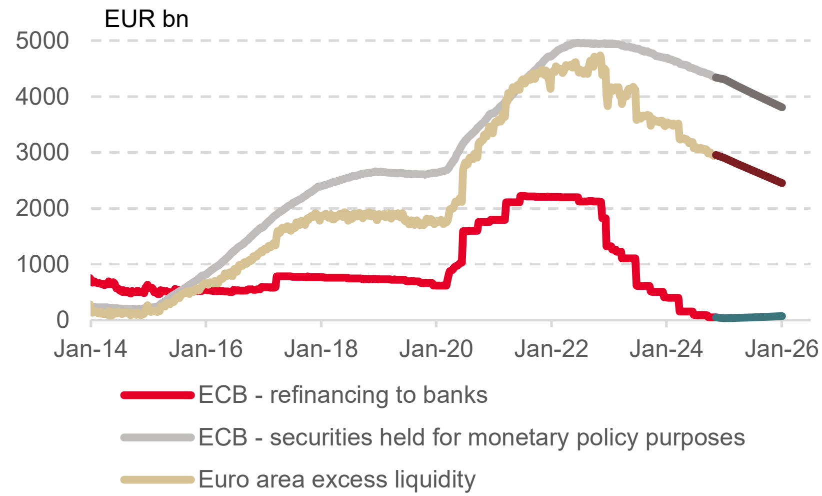
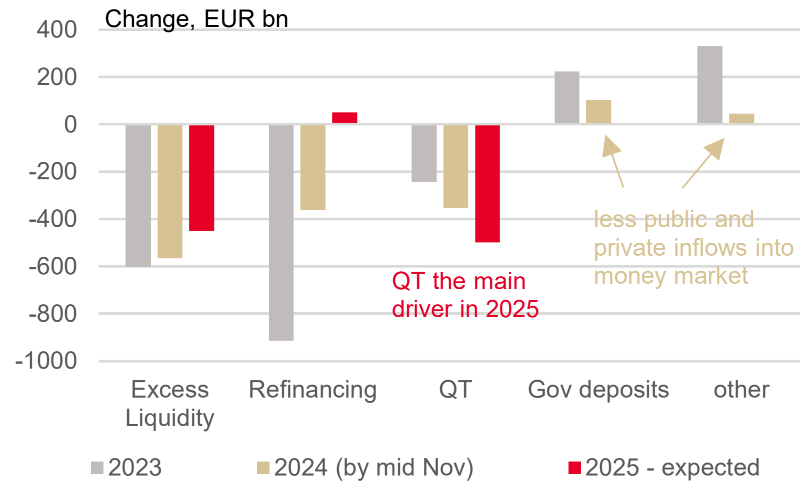
Source: SG Cross Asset Research/Rates, ECB

ANNEX FORECASTING EXCESS LIQUIDITY

ECB balance sheet (€bn) – a slow normalisation



Excess liquidity and its drivers – outflows (TLTROs, QT) vs inflows (public & private cash)



- Excess liquidity still close to €3000bn (**target** 2024: 2,900bn, **€2,400/2500bn at end-2025**)
  - **TLTROs-III** maturing – only c. **€29.2bn** remining until Dec;
  - Slowly increasing **MRO/LTROs:** SMA for end 2025 is €28bn for MRO and €35bn for 3M LTTRO (range 15-40 & 13-75)
  - **QT roughly €500bn/year from 2025**; in 2024: **APP €320bn** (c. €27bn/m), €255bn PSPP; **PEPP €45bn** (€7.5bn/m in 2H24).
  - Autonomous factors: government deposits now quite stable, no more inflows to money markets.

Source: SG Cross Asset Research/Rates,, ECB

ANNEX MONETARY POLICY METER

To neutral – and beyond?

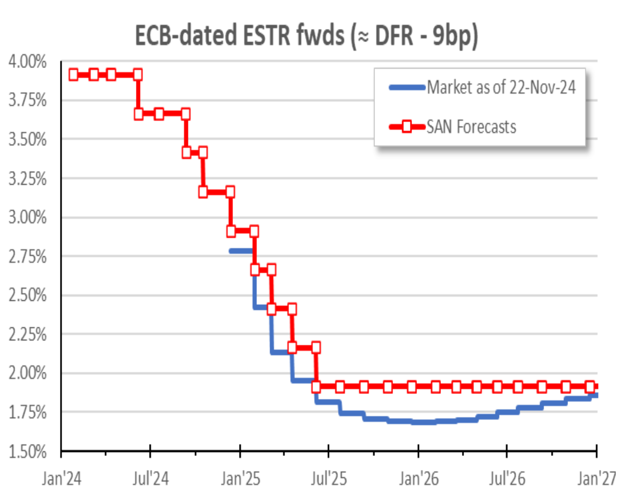
EURO

- **Monetary Policy:** We have added and extra, "insurance" 25bp cut to our ECB call, which now implies 25bp cuts every meeting until June, taking the DFRF to 2.00%. This is below our estimates for neutral.
- **Current market expectations** are slightly below our ECB call. This makes sense, since from a probabilistic point of view, the market is pricing a weaker economic outlook based on 1) the victory of Donald Trump in the US elections and the expectation of tariffs; 2) weak economic data coming out of Germany and France; 3) the latest round of PMIs released last Friday. With all these risks in mind, it makes sense that market prices terminal rate in the 1.5-2.0% range from a probabilistic point of view.

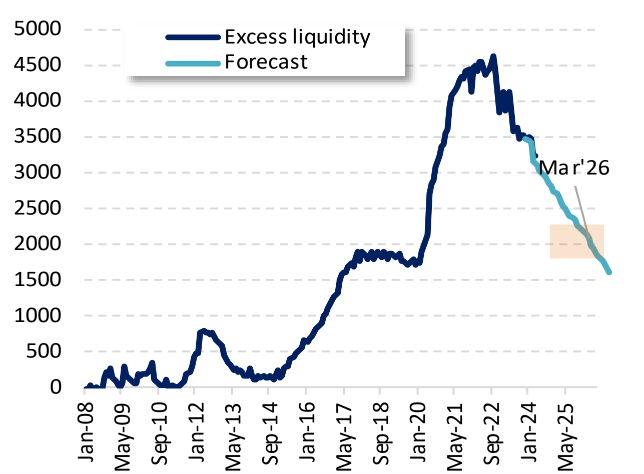
- **We expect the ECB to keep QT as expected in 2024 and 2025.** The pace of QT will accelerate from an average of €28bn/month in 2H24 to an average of €37bn/month in 2025 as PEPP's QT gets full speed. This will help the decrease of excess liquidity towards levels between €1.75-2.25trn in 1Q26.
- **Once this level of excess liquidity is achieved, we expect the ECB stabilize the drop by injecting liquidity through a mixed approach**: (a) via new LTROs and (b) via a structural portfolio of bonds. The ECB will specify the sequencing and pace of these tools in coming months but we expect the general idea to remain unchanged: to keep excess liquidity around €2trn.

- **Macro:** Growth picture is worsening in the Eurozone, with core countries (Germany, France) suffering the most against a periphery supported by the services sector. Trump's victory further complicates this view, as tariffs and deglobalisation represent an additional headwind for European exporters such as Germany.
- **On the inflation front,** prices are expected to rise during 4Q24 given inflationary base effects. By 2025, we believe that EURUSD depreciation and higher import prices due to US tariffs (and subsequent EU retaliation) could push European prices higher next year. However, if the growth outlook fades, we could see prices decelerate after a first inflationary wave.

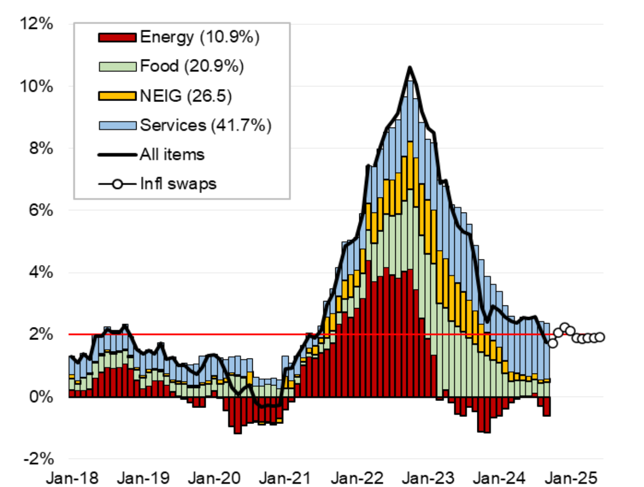
Market implied €STR rates & SAN expectations



Euro area excess liquidity (€bn)



Euro area inflation (%)



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