

European Rates Alpha

Long Schatz vs Bobl Euribor spreads

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We open a new recommendation: long Schatz vs Bobl Euribor spreads (entry: -2bp, target: +10bp, stop: -8bp). We expect all NCBs to reduce remuneration rates on government and non-EA resident deposits to 0%, supporting short-dated bonds. Fair value framework suggests Bobl spreads are rich relative to Schatz spreads. Risks are: no remuneration changes by other NCBs and non-EA resident deposits remunerated meaningfully above 0%; and lower-than-expected reduction in government and non-EA resident deposits at Eurosystem even with a 0% remuneration rate.

We expect 0% remuneration on all on gov deposits

The Buba will remunerate domestic government deposits at 0% from 1 October 2023 (see [European Rates Watch](#)). We expect all NCBs to announce a 0% remuneration rate by end-2023 (to be applied in 2024) and for general government deposits to fall eventually to c. €100bn from €228bn currently. This deposit reduction may raise demand for short-dated euro assets and put widening pressure on Schatz spreads. Year-to-date, EA general governments reduced their deposits at the Eurosystem by €209bn (Exhibit 1). But the distribution of this reduction is uneven, with Germany accounting for €94bn of that decline. Beyond Germany, governments that have meaningfully reduced deposits at their NCBs may provide scope for their NCBs to change the remuneration rate sooner. In 1H 2023, the central government in France reduced their deposits at the BdF and increased deposits at French banks significantly (Exhibit 2).

Non-EA resident deposit flows can be significant

Non-EA residents have €239bn of deposits at the Eurosystem. We believe non-EA resident deposits at NCBs will be paid close to 0% when the remuneration on domestic government deposits is set at 0%. This may prompt non-EA residents to search for yield in other short-dated euro and non-euro assets. Such flows may widen Schatz spreads. We expect these flows to reduce non-EA resident deposits at the Eurosystem to c. €50bn. The reduction in non-EA resident deposits year-to-date has primarily been from the Buba (Exhibit 3). We believe non-EA resident outflows from other NCBs will be strongest when all NCBs set the remuneration rate close to 0%.

Fair value model shows Bobl spreads are rich

Bobl spreads are 5bp rich vs fair value while Schatz spreads are less than 1bp rich (Exhibit 4). Our fair value model accounts for rates volatility, peripheral spreads, and collateral scarcity. September is expected to be the fourth-highest net supply month for EGBs this year at c. €70bn, and it is also traditionally a large financial issuance month (Exhibit 5). We expect this to impact the 5Y-10Y part of the curve most, challenging the current richness of Bobl spreads (see [European Rates Supply Preview, 11 August 2023](#)). We expect remuneration changes by the Eurosystem on government and non-EA resident deposits to put more widening pressure on short-dated spreads. We forecast Schatz spreads vs Euribor to widen to 70bp (i.e., +4bp) and for Bobl spreads to tighten to 60bp by year-end.

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Abbreviations:

Euribor = euro interbank offered rate

NCBs = national central banks

EA = euro area

Buba = Bundesbank

BdF = Banque de France

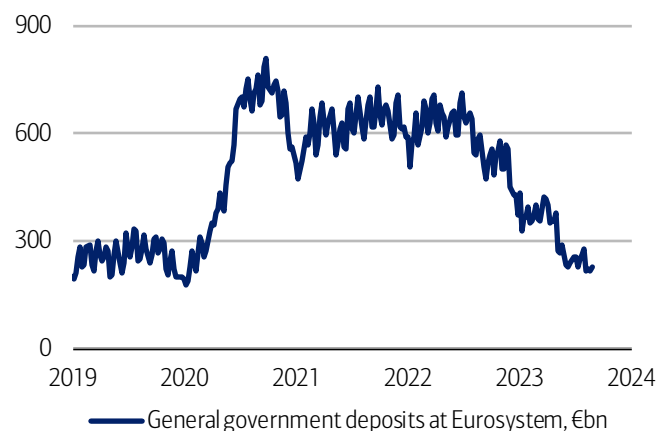
EGB = European government bond

MFI = monetary financial institutions

ECB = European Central Bank

Exhibit 1: General government deposits at Eurosystem

Government deposits fell over €200bn YTD

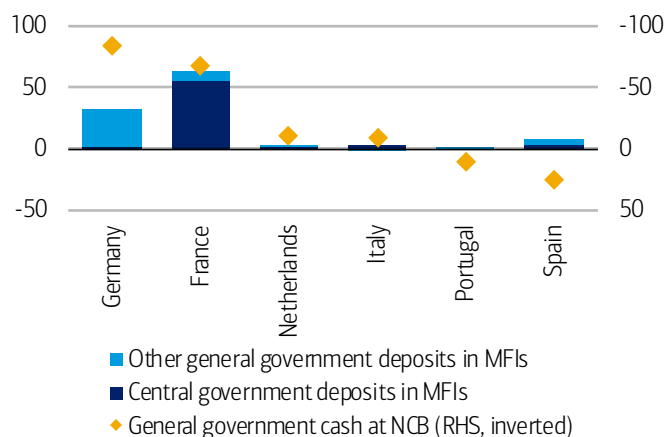


Source: ECB

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Exhibit 2: Change in 1H 2023, €bn

Central government France increased deposits in MFIs significantly

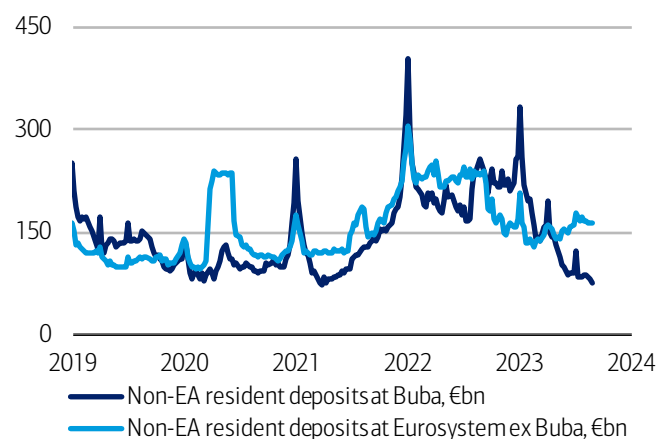


Source: ECB

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Exhibit 3: Non-EA resident deposits at the Eurosystem

Decline so far this year has come from the Buba

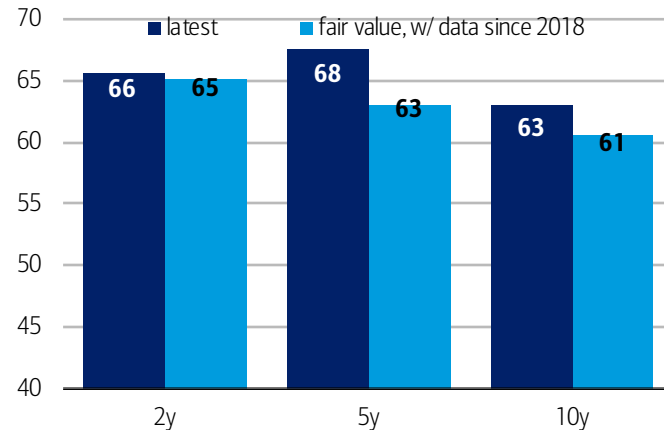


Source: Bundesbank, ECB

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Exhibit 4: Euribor based swap spreads vs fair value (*)

Bobl spreads trade richest versus fair value

Source: BofA Global Research. (*) Based on regression vs implied vol, 1st Principal Component of Periphery spreads, and German 1-day Specific Collateral repo spread to €str.

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Exhibit 5: Seasonality of gross supply split by financial/non-financial corporates

Corporate bond issuance tends to concentrate in Q1, but September is still third largest issuance month of the year, historically

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Fin	12%	8%	12%	9%	10%	9%	7%	3%	11%	8%	8%	5%
Non-Fin	7%	8%	12%	9%	10%	9%	6%	2%	11%	8%	11%	6%

Source: ECB

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