

European Rates Watch

Banks & EUR money markets

Focus to shift from low Euribor fixings ...

Attention in Euro money market space has recently been on the low Euribor fixings, as the 3M Euribor-OIS spread grinded lower into negative territory (to as low as -16bp at the end of Feb). This came at odds with the idea that the credit component in Euribor should keep fixing above the matching overnight index swap. Yet, three factors can explain the tightening, alongside the hybrid methodology used for Euribor calculation: (1) the large excess liquidity in the system, (2) the surge in bank bond issuance, to front-load redemptions and TLTRO repayments, with an NSFR benefit, (3) the unattractiveness of 3M funding when the large June TLTRO repayment is still more than three months away.

... to risks of funding pressures, thereby widening bases

The failure of Silicon Valley Bank and the spectre of large TLTRO redemptions is likely to shift the focus to the risk of liquidity pressures emerging in parts of the Euro area banking system. The breakdown in banks liabilities will be scrutinised, as will the management of Interest Rate Risk on Banking Book (IRRBB). On that front, we note that updated EBA guidelines on IRRBB will apply from 30-Jun. While Euribor fixings may not react immediately (they could be biased lower as rate hikes are priced out), this situation should drive FRA-OIS and 3s6s bases wider, at least temporarily. Continued large financial bond issuance would contribute to the widening as issuance is swapped.

ECB and banks should turn more cautious...

Euro area banks are in general better placed than US regional banks to face the decline in fixed income prices and/or reduced deposits (see report: [European Banks Strategy](#), 10-Mar). Still, with yet another example of the side effects of the sharp global tightening cycle, the ECB may consider a more cautious approach, including (1) a potential reversal of the tightening in collateral rules/hairecuts that was scheduled for June, (2) the introduction of additional liquidity operations, beyond the MRO & 3M LTRO that carry a stigma, and (3) on the pace of QT beyond June. Banks may consider paying higher rates on deposits, or review their early TLTRO repayment plans, as ECB funding provides an LCR boost.

...Including on early TLTRO repayments in March

On Friday, the ECB will publish the amount of TLTROs that banks will repay early at the end of March, on top of the maturing €32bn operation. In our recent report, [ECB operational framework review](#), we assumed that €130bn would be repaid in Mar – more than in Jan or Feb, on account for the fact that, this time, there will be a €290bn operation falling below 12M maturity and another (€90bn) dropping below 6M, making them less attractive from an NSFR perspective. However, in the current context, and as banks have until Wednesday to notify the ECB of their early repayment intentions, risks are of a lower repayment.

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12529254

Timestamp: 13 March 2023 04:55AM EDT

13 March 2023

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Abbreviations

EBA: European banking authority
FRA-OIS: Forward rate agreement spread to overnight index swap
LTRO: long term repo operation
MRO: marginal repo operation
NSFR: net stable funding ratio
QT: quantitative tightening
TLTRO: targeted long term repo operation

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