

European Rates Watch

Euro repo: cheapest since 2020

Euro repo is cheapest since 2020...

Euro repo rates are at their cheapest since 2020: the Germany and Italy one-day GC rates are trading c. 5bp and c. 10bp above €str, respectively (Exhibit 1). This primarily reflects the unwinding of the cash-rich collateral-scarce environment created by the ECB's unconventional monetary easing policies.

... as cash-collateral imbalance unwinds

Cheapness in euro repo rates is likely to persist: we estimate Germany one-day GC to be between +5 and +10bp vs €str by the end of the year. Regulatory requirements mean banks' reserve demand could exceed supply this year, with most pressure in Italy and Spain (Exhibit 2). Net EGB supply will likely stay high at c. €500bn this year (see European Rates Supply Preview): large supply allowed participants to post more securities than cash as collateral when borrowing bonds from the central bank (Exhibit 3).

Participants from governments...

Repo has become a more attractive place for governments to park cash. The Buba remunerates its government deposits at 0% and Gfin parked as much as €9bn in the repo market in January 2024 (Exhibit 4). The Spanish Treasury recently lent cash in the repo market to increase its profitability and stood to make at least c. 30bp when compared to placing cash at the Bank of Spain (see [European Rates Watch](#)).

... to MMFs turned to repo for higher returns

In the past year, Euro denominated MMFs increased the share of assets allocated to repos, which is now back to 2020 levels at c. 12%. This increase came as the share of time deposits decreased (Exhibit 5). Over the same period, MMFs increased their WAM from record lows. This suggests to us that the increase in WAM may have been achieved via an increase in the maturity of other assets, such as CP.

Cross currency repo opportunities now limited...

Euro repo rates are currently not attractive on a cross currency basis despite being cheap relative to their own history. Other developed repo markets offer higher FX hedged pickup over euro repos (Exhibit 6). Even so, we do not think current pickups are sufficiently high to attract meaningful cross market flows.

... but may increase as central bank balance sheets change

Our US colleagues expect the Fed to taper QT in May and debt limit dynamics to prompt a TGA drain towards the end of year (see [US Rates Watch](#)). These dynamics would contrast with accelerated QT by the ECB in 2H24 as previously announced, which is likely to put further cheapening pressure on euro repo rates (Exhibit 7). This could make the Euro repo more attractive vs the US repo, and could ultimately be a source of tightening pressure on the EUR FX-Sofr basis.

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€str: euro short-term rate

Buba: Bundesbank

CP: commercial paper

ECB: European central bank

EGB: European government bond

Fed: Federal Reserve

GC: general collateral

Gfin: German finance agency

MMF: money market fund

QT: quantitative tightening

Sofr: secured overnight financing rate

TGA: Treasury general account

WAM: weighted average maturity

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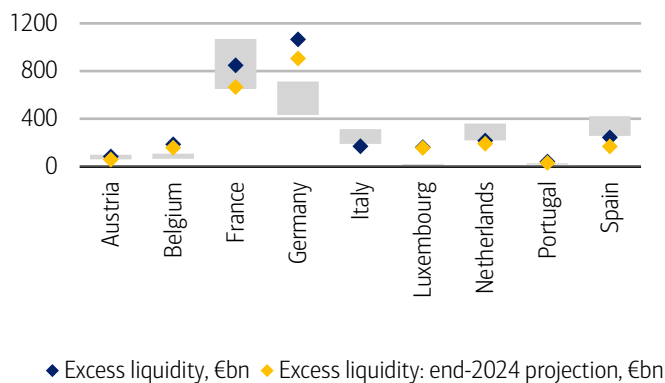
Refer to important disclosures on page 3 to 4.

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Exhibit 2: Excess liquidity estimated demand and supply by country

Largest shortfall projected by end-2024 in Italy and Spain

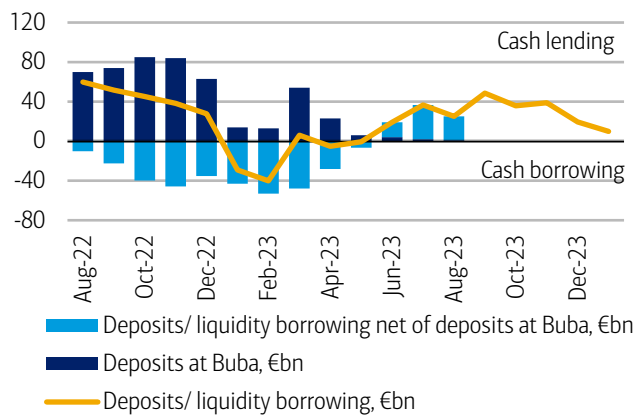


Source: BofA Global Research, ECB

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Exhibit 4: Gfin deposits/liquidity borrowing

Gfin shifted cash from the Buba and likely into repo

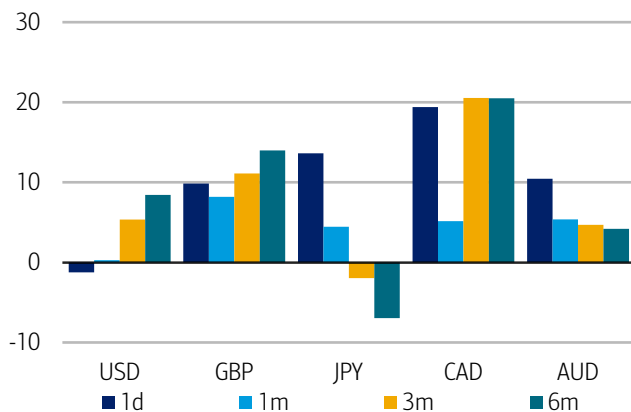


Source: BofA Global Research, Finanzagentur

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Exhibit 6: FX hedged repo pickup over euro equivalent, bp

Euro repo not particularly attractive cross marketEuro

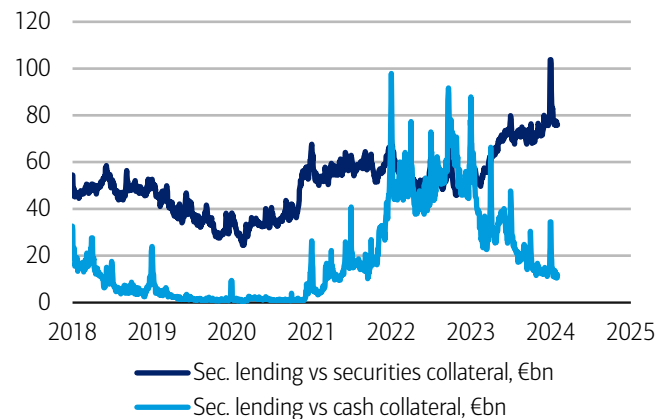


Source: BofA Global Research. Data as of 28 February 2024.

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Exhibit 3: Securities lending from Eurosystem

Participants posted more securities as collateral

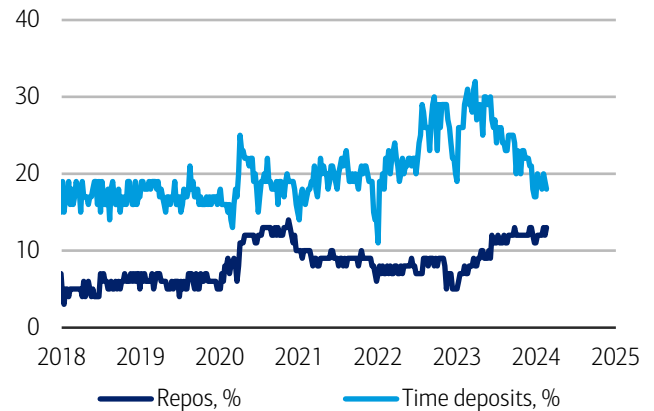


Source: ECB

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Exhibit 5: Repo and time deposits as a % of MMF assets

MMFs increased asset allocation into repo

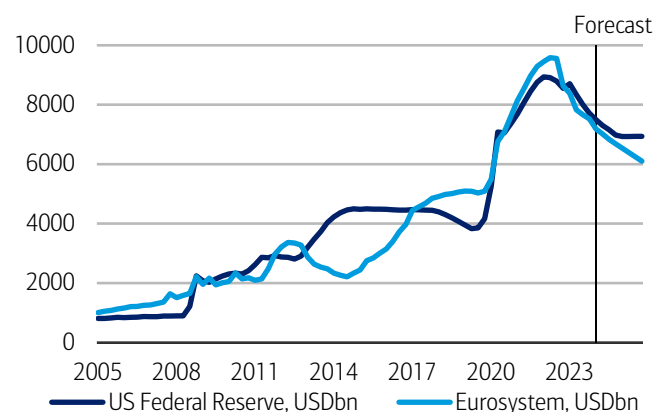


Source: iMoneyNet

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Exhibit 7: Fed and Eurosystem balance sheet

Fed and Eurosystem balance sheet to diverge



Source: BofA Global Research, Bloomberg

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