

European Rates Watch

Operational framework review to guide ECB gov deposit remuneration

Key takeaways

- The ECB's case for reducing remuneration on gov deposits may be framed in 2 ways
- But this risks volatility in front-end swap spreads and repo
- We do not expect any changes before the operation framework review is concluded

Returning to pre-negative rate remuneration structure...

Government and non-EA resident deposits at the Eurosystem are currently remunerated at or close to €str minus 20bp. Prior to the introduction of a negative depo rate in June 2014, most government deposits were remunerated at 0% (Exhibit 1). The case for a return to 0% remuneration rate on these deposits may be framed as 1) part of a normalisation process that also incentivises these deposits to fall back towards pre-June 2014 levels, i.e. prior to negative depo rate environment (Exhibit 2), or 2) a desire to reduce remuneration costs.

... risks swap spread widening and repo richening...

There are just under €600bn of government, non-EA resident, and other EA resident deposits at the Eurosystem (Exhibit 3). A 0% remuneration rate on these deposits may 1) prompt governments to finance expenditure with deposits instead of bond issuance, and 2) lead to a search for yield by these depositors in short dated assets. These flows may put widening pressures on swap spreads and richening pressures on repo rates.

A comparable experience was in August-September 2022, when the market was concerned over the risk of a 0% remuneration rate on c. €1.2tn of these deposits while the depo rate was widely expected to become strictly positive: Schatz spreads widened by c. 25bp and the Germany one-day GC-€str spread richened to c. -97bp (Exhibit 4 and Exhibit 5). If a similar risk returns, we believe the magnitude of swap spread widening and repo richening may be less than before given the net increase in bond supply since and less deposits potentially affected.

... but any change unlikely to be implemented this year

The ECB aims to conclude its operational framework review by the end of 2023 ([Liquid Insight](#)). This review will determine its medium-term balance sheet size and potential instruments that could be introduced to manage it ([European Rates Viewpoint](#)). We believe any changes to the remuneration structure may also be part of the review and guided by its results. As such, we do not expect any remuneration structure changes to be announced before the end of this year, and any change is unlikely to be implemented this year.

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ECB = European Central Bank

EA = Euro area

€str = euro short-term rate

GC = general collateral

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Exhibit 1: Remuneration rate on government deposits

Remuneration rate on government deposits was 0% before the negative rates were introduced

Remuneration rate on government deposits

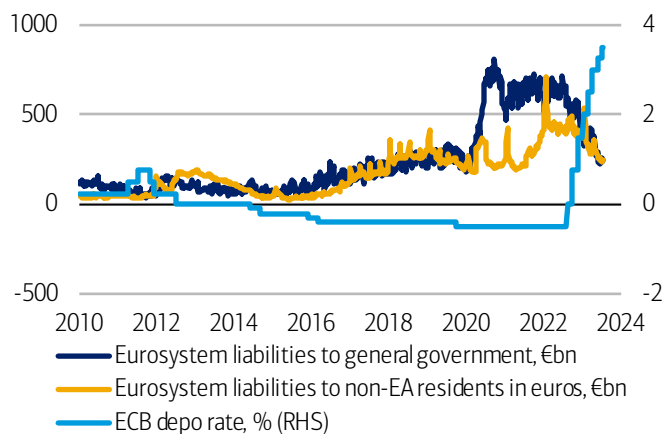
Prior to Jun 2014	Most government deposits remunerated at 0%
June 2014 to September 2022	If depo is negative, ceiling is the lower of the depo rate or the relevant market rate; if depo is 0% or higher, 0%
September 2022 and April 2023	Ceiling is the lower of the depo rate or €str
May 2023 - Present	€str minus 20bp

Source: BofA Global Research, ECB

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Exhibit 2: Gov. and non-EA deposits at central bank vs depo rate

Government deposits arguably still high relative to pre-negative rate era

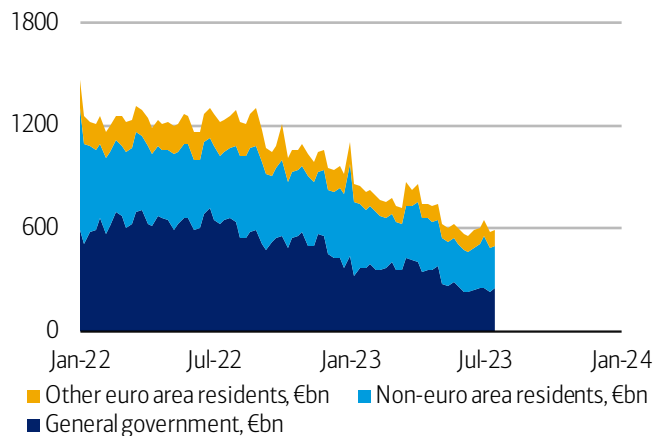


Source: BofA Global Research, Bloomberg

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Exhibit 3: Gov, non-EA & other EA resident deposits at Eurosystem

These three depositors now have just under €600bn of deposits



Source: ECB

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Exhibit 4: Schatz-€str spreads

Spreads widened c. 25bp when remuneration concerns grew in 2022

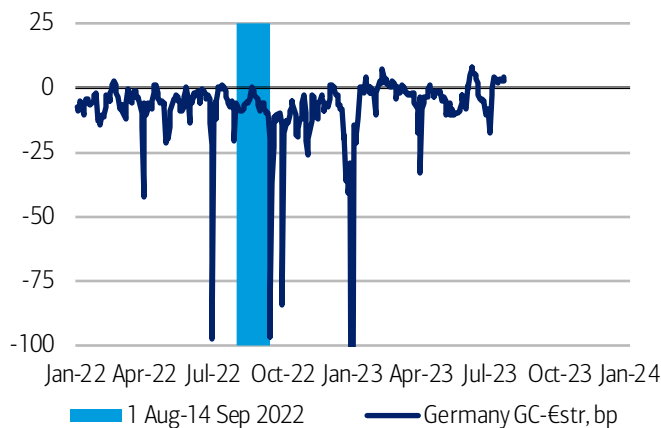


Source: BofA Global Research, Bloomberg

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Exhibit 5: Germany one-day GC vs €str spread

Repo richened significantly in mid-Sep 2022 on remuneration concerns



Source: BofA Global Research, Bloomberg, CME Group

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