Fixed Income Special

NORD/LB Markets Strategy & Floor Research

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Marketing communication (see disclaimer on the last pages)

Agenda

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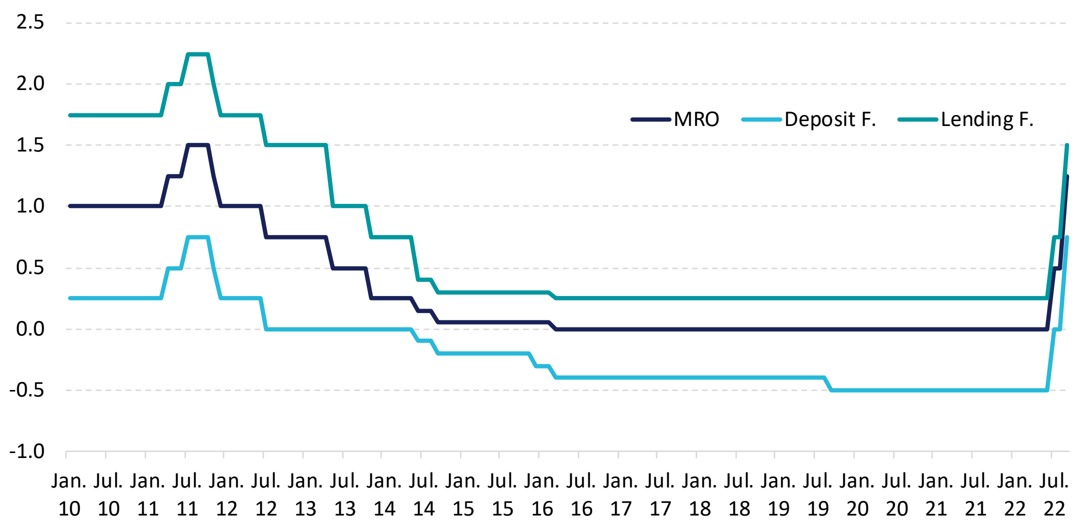
ECB acts as the 'House of Hikes' – or: Winter is coming!

Authors: Dr Frederik Kunze // Dr Norman Rudschuck, CIIA

ECB interest rate decision: Frontloading before the Winter is coming

Recently, it not only seemed that the hawks in the Governing Council had the upper hand. In this respect, today's announcement by the monetary authorities from the Main is by no means surprising. The historic rate hike of +75 basis points was definitely expected by the capital market participants, even if the forward guidance is no longer a strategic part of the ECB Council's communication, as we were able to learn already at the key rate meeting in July. The Council has again increased all three key ECB interest rates and in this context speaks of an earlier transition to an interest rate level that "will ensure the timely return of inflation to the ECB's 2% medium-term target". In fact, however, numerous statements made by those close to the Council indicated that there was a high probability of a "very big step" as part of today's ECB interest rate decision. The 75bp were far from being a foregone conclusion. Reservations were expressed – especially by the ECB's chief economist Philip R. Lane – with regard to the ability of the financial markets to absorb such large interest rate hikes and the additional increased uncertainty that may accompany them. With today's decision, the hawks seem to be ahead again. This is particularly true against the background of the wording of today's statement, according to which the Council expects to continue raising interest rates in order to (further) dampen demand. Viewed from a different angle, the "bigger sip from the bottle" could also have arisen – at least in part – from a desire to do some frontloading for the winter. 'House of Hikes', so to say. Finally, the monetary watchdogs are also expecting growth to stagnate, which once again – but this time for different reasons – draws the focus to the central bank's projections.

ECB's once symmetrical interest rate corridor has been unbalanced since 2015



Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

ECB projections: Inflation revised upwards again for all years and...

With a detailed view to the *ECB Staff Projections*, our focus is once again on the assumptions regarding the further development of inflation. Ultimately, these expectations serve as a guide for the monetary policy course in Frankfurt. As expected, these were revised significantly upwards for 2022. Clear message: Winter is coming! For the current year, the central bank is now expecting an inflation rate of 8.1% (previously: 6.8%), while the ECB projections for 2023 are at 5.5% (previously: 3. 5%) and will amount to 2.3% for 2024 (previously: 2.1%). As is known, the forecast for the year 2025 will be communicated for the first time in December. The ECB is thus drawing a clear picture with regard to its own assumptions about further price developments and is assuming that inflation rates will subside towards the inflation target at the end of the forecast period. We expect the projections to be revised upwards again in December, since the duration of the war in Ukraine remains questionable and nobody is seriously returning to the negotiating table, plus the minimum wage in Germany will be raised again this year (from EUR 10.45 on October 1st EUR 12.00) as well as food and energy prices remain at high levels or even still rise at a rapid pace.

... GDP growth does not (yet?) signal a recession

The ECB now sees growth in the Eurozone of a (surprisingly) revised upwards 3.1% for 2022 (previously: 2.8%). For the years 2023 and 2024, we expect a terrific and almost threatening – at least positive – 0.9% (previously: 2.1%) and 1.9% (previously: 2.1%) respectively. Not only investors, but also private households and companies seem to need a thick winter coat here (German: *Winterfell* is more precise). What is clearly positive here is that the recovery – albeit revised downwards overall – should be boosted everywhere by the current opening strategy due to the easing of the pandemic. As with the inflation projections, there is still no assessment or comprehensive consideration of the Ukraine war and the forthcoming economic setbacks for the expectations for an increase in real economic activity. In this respect, the upward revisions in the inflation rate are also accompanied by downside risks for the GDP projections. With regard to the economic expectations of the central bankers, it is worth mentioning in our opinion that no recession is (yet?) in sight. That may have a somewhat reassuring effect for the moment, but for some market observers it may have been a "necessary condition" for today's monetary policy decision. Angry tongues could claim: "Whereas inflation rates used to have to match monetary policy, growth has to match interest rate hikes, now."

Previous 2022 ECB projections for euro area growth and inflation (in %)*

	March 2022 projections				Adverse scenario				Severe scenario			
	2021	2022	2023	2024	2021	2022	2023	2024	2021	2022	2023	2024
Real GDP	5.4	3.7	2.8	1.6	5.4	2.5	2.7	2.1	5.4	2.3	2.3	1.9
HICP inflation	2.6	5.1	2.1	1.9	2.6	5.9	2.0	1.6	2.6	7.1	2.7	1.9

Latest ECB projections for euro area growth and inflation (in %)*

	September 2022 projections				Adverse scenario				Severe scenario			
	2021	2022	2023	2024	2021	2022	2023	2024	2021	2022	2023	2024
Real GDP	5.4	3.1	0.9	1.9	-	-	-	-	-	-	-	-
HICP inflation	2.6	8.1	5.5	2.3	-	-	-	-	-	-	-	-

* Change versus previous year in %

Source: ECB, NORD/LB Markets Strategy & Floor Research

Implications of today's ECB decision for public sector issuers (SSAs)
We are firmly convinced that today's interest rate decision will not have a particularly negative impact on the refinancing conditions of supranationals, federal states or e.g. KfW. Supras do not act in the vacuum of the above-mentioned political tensions, but if order books are several times oversubscribed, then clearly in this sub-segment, which is growing significantly thanks to the EU. The German federal states are currently exercising restraint anyway, as they used the summer break to collapse their cash registers and will be less likely to be found on the primary market in the second half of the year than was thought just a few months ago. The credit allowances for this year therefore seem generous. Whether the veritable energy (price) crisis and/or the war is suitable for a renewed suspension of the debt brake in 2023 will become apparent in Q4. If we are heading for a recession, the suspension of the debt brake for the fourth year in a row will be inevitable anyway. KfW, in turn, knew in its recently adjusted planning which interest rate steps were roughly pending and nevertheless decided to increase its funding target from EUR 80-85bn to EUR 90bn. The Frankfurt-based company would not have announced this for H2/2022 if they believed that they could not cover this need on the international markets with their funding mix. Today's second big interest rate step may have a different effect on other European regions, keyword “Beyond Bundeslaender”. For some issuers, the tax revenues may not be as plentiful and others have a tighter budget than German sub-sovereigns. Yesterday we saw a strong deal from Wallonia (EUR 1bn for 15 years) to which we contributed a research piece.

Impact on the covered bond market
Yesterday we adjusted our 2022 supply forecast for the EUR benchmark segment significantly upwards and now expect EUR 184.3bn in fresh bonds (previously: EUR 156bn). Our expectation that today's ECB meeting will not have any direct impact on that issuance behavior in the covered bond segment has been confirmed. This does not mean that the icy wind of interest rate hikes or the economically “frosty winter” will pass the asset class unnoticed. As a result, as part of the realignment of monetary policy, further repricing should also be observed in the covered bond segment. Covered bonds are likely to continue to be in demand as a means of refinancing – also to get through this phase of uncertainty. For technical reasons alone, this speaks in favor of tightening spreads and could also be at the expense of senior unsecured bonds via asset encumbrance. In connection with the economic challenges, it is also not surprising that the central bankers did not give any new indications with regard to TLTRO III in their statement, but left the reference to the assessment of possible targeted lending transactions in the statements. Looking ahead, geopolitics will also remain a major uncertainty factor for the commercial banks in the common currency area. In the event of sharpening of conflicts, it should not be particularly difficult for the Governing Council of the ECB to find a line of argument that adequately justifies the central bank's renewed refinancing operations for the benefit of the monetary policy transmission mechanism. In our opinion, the influence on the covered bond segment would then be noticeably dampened by the fact that the terms and conditions should be much less attractive. We see the lowering of the multiplier for the graduated interest rate as a further monetary policy hygiene factor. We do not see this having a massive impact on the covered bond segment. Having said that, some banks are now likely to benefit further from the interest rates on deposits ranging significantly above the TLTRO III rates.

Conclusion and comment

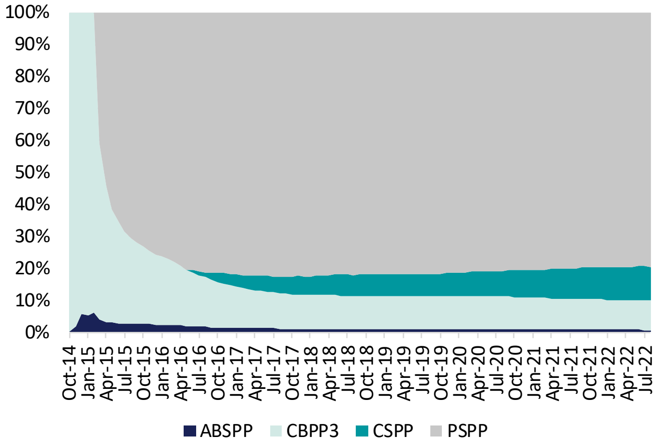
As obviously expected by the majority of market participants in advance, the Governing Council of the ECB raised all three key interest rates by 75 basis points today. The central bank of the common currency area is thus taking a large and powerful sip from the bottle in the 'House of Hikes'. For some observers, one can definitely speak of a certain front-loading. Against the background of the adjusted projections of the experts at the ECB, this view is entirely understandable. These predict "initially" only stagnation (GDP growth in 2023: +0.9%). However, in winter – i.e. in Q4/2022 and/or Q1/2023 – it will also be economically frosty. In our opinion, a textbook like technical recession cannot be ruled out. Nevertheless, our base scenario remains that the Governing Council of the ECB remains on course to hike interest rates several times. Even with this step, the monetary watchdogs have not yet created much air or space. And they still have a lot of work ahead of them when it comes to normalizing their own monetary policy. The reinvestments of maturities from APP and PEPP are still ongoing and quantitative tightening (QT) is again not part of the statement on the key interest rate decision. We do not see any direct influence from today's ECB meeting for the asset classes of public issuers/SSA or covered bonds that we are looking at. Certainly, monetary policy and the economy also have an effect on these comparatively low-risk bonds. Distorting effects caused by course changes or new instruments are not to be "deplored" here today. But Winter is coming!

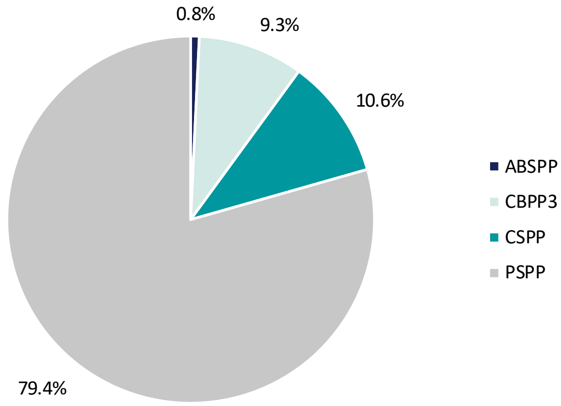
ECB tracker

Asset Purchase Programme (APP)

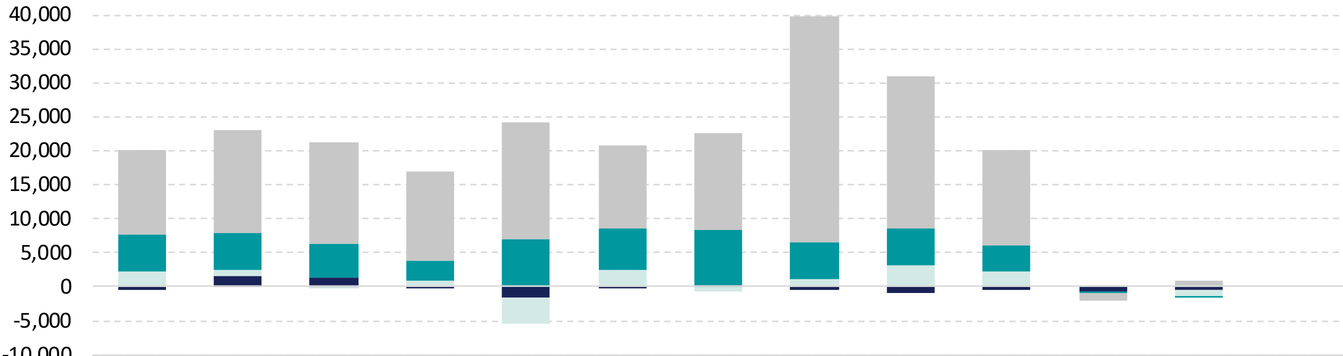
	ABSPP	CBPP3	CSPP	PSPP	APP
Jun-22	25,337	302,210	344,952	2,592,645	3,265,144
Jul-22	24,638	302,427	344,811	2,591,531	3,263,407
Δ	-699	+217	-141	-1,114	-1,737

Portfolio structure





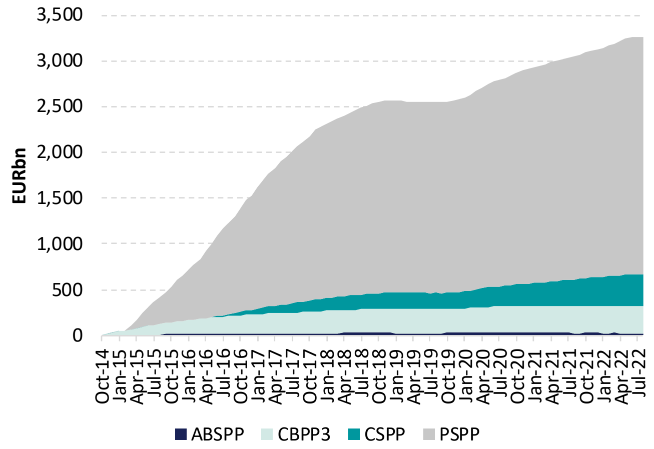
Monthly net purchases (in EURm)



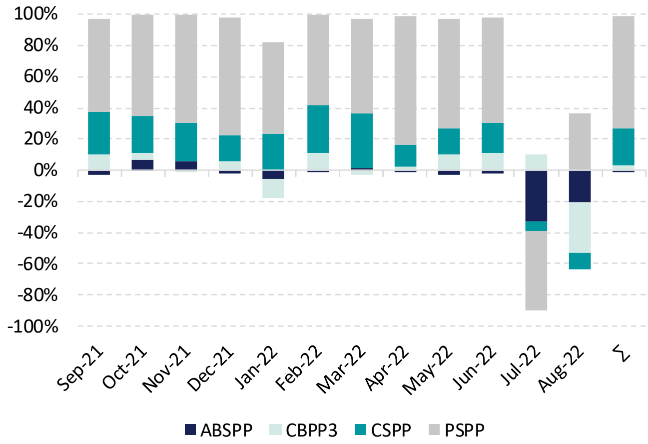
	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	∑
APP	19,659	23,017	21,200	16,596	18,838	20,698	21,929	39,397	30,232	19,722	-1,759	-655	228,874
PSPP	12,423	15,038	14,815	12,989	17,292	12,095	14,172	33,238	22,443	13,924	-1,114	869	168,184
CSPP	5,590	5,481	5,142	3,007	6,970	6,272	8,042	5,461	5,366	3,858	-141	-253	54,795
CBPP3	2,184	1,008	-12	942	-3,761	2,376	-606	1,074	3,247	2,339	217	-787	8,221
ABSPP	-538	1,490	1,255	-342	-1,663	-45	321	-376	-824	-399	-721	-484	-2,326

Source: ECB, NORD/LB Markets Strategy & Floor Research

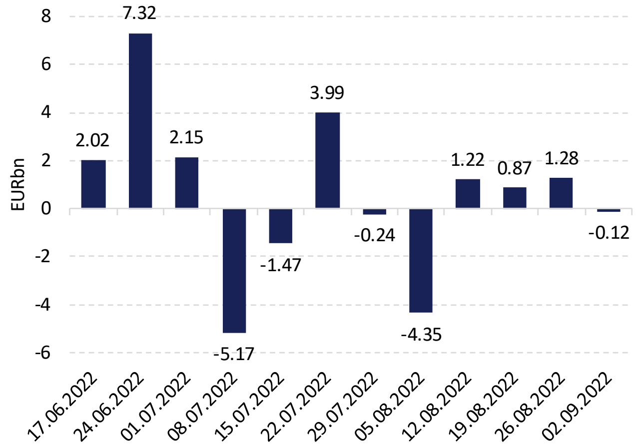
Portfolio development



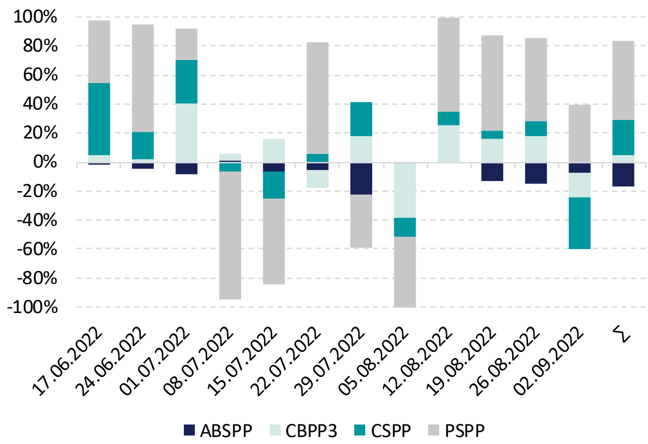
Distribution of monthly purchases



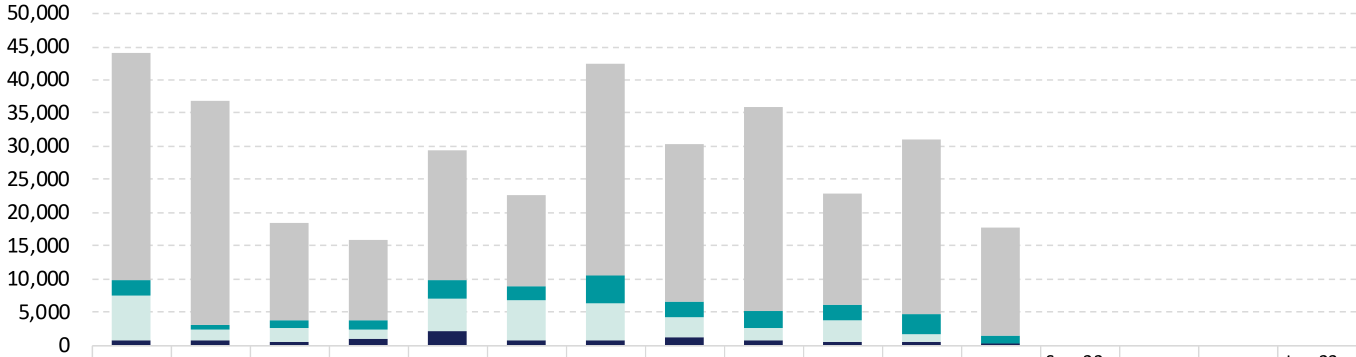
Weekly purchases



Distribution of weekly purchases



Expected monthly redemptions (in EURm)

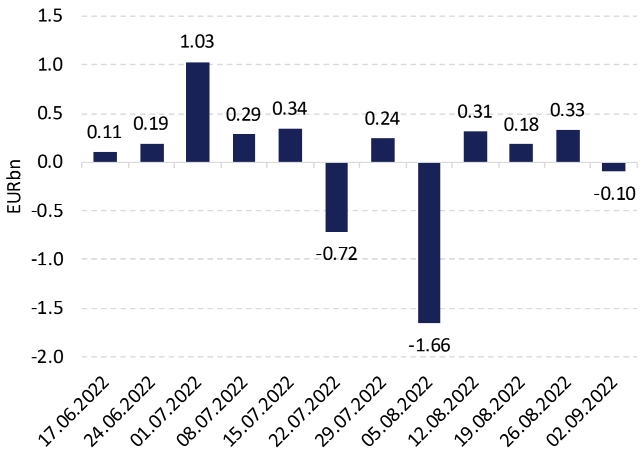


	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-22 - Aug-23	2021	2022	Jan-23 - Aug-23
APP	44,114	36,965	18,361	15,844	29,368	22,586	42,567	30,235	35,827	22,809	31,094	17,816	347,586	247,069	298,879	232,302
PSPP	34,354	33,927	14,669	12,016	19,469	13,657	32,033	23,663	30,552	16,619	26,378	16,445	273,782	188,494	228,585	178,816
CSPP	2,221	674	1,031	1,416	2,947	2,182	4,219	2,388	2,579	2,521	3,023	979	26,180	17,134	17,428	20,838
CBPP3	6,873	1,651	2,167	1,487	4,786	6,013	5,631	2,937	1,874	3,108	1,170	0	37,697	30,143	41,244	25,519
ABSPP	666	713	494	925	2,166	734	684	1,247	822	561	523	392	9,927	11,298	11,622	7,129

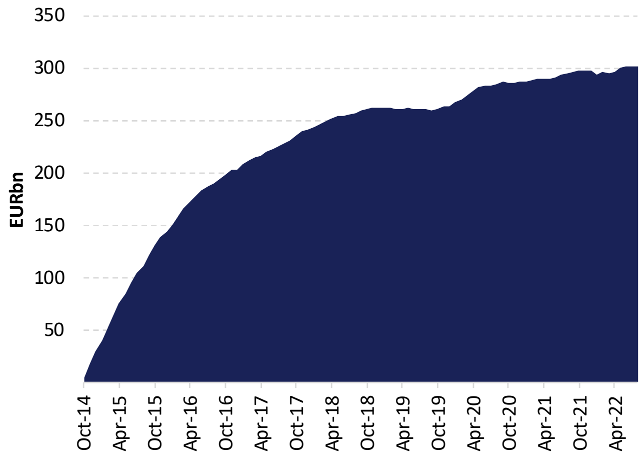
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Covered Bond Purchase Programme 3 (CBPP3)

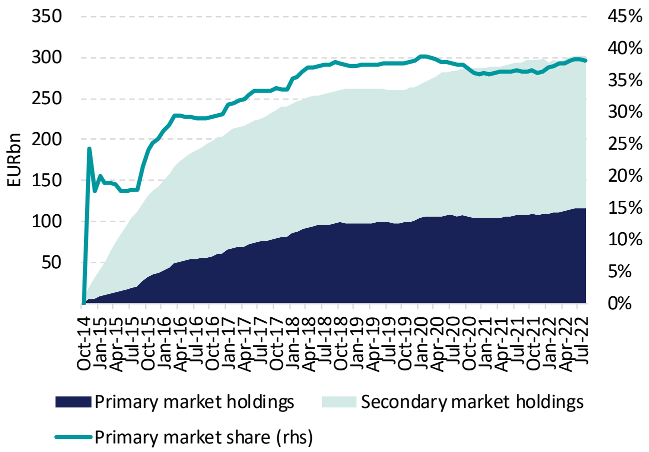
Weekly purchases



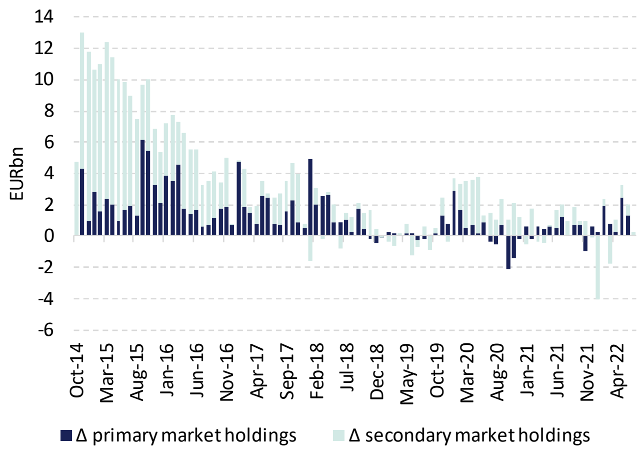
Development of CBPP3 volume



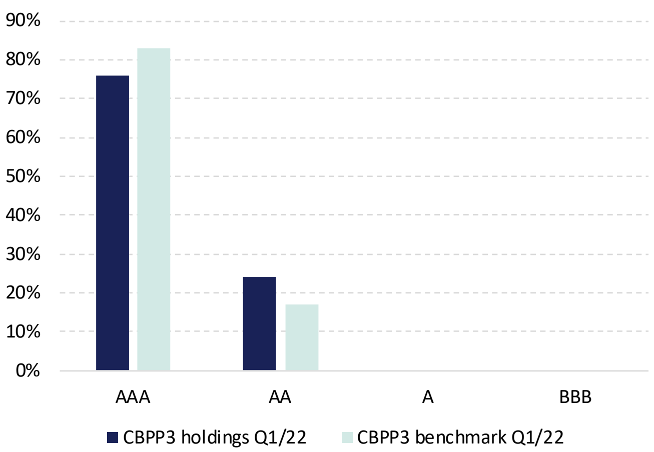
Primary and secondary market holdings



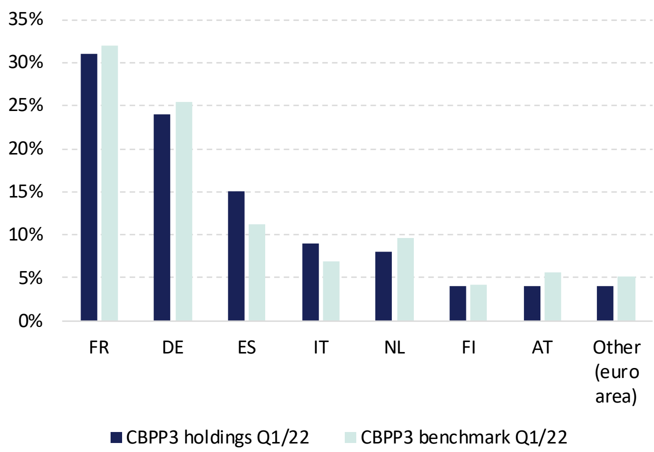
Change of primary and secondary market holdings



Distribution of CBPP3 by credit rating



Distribution of CBPP3 by country of risk

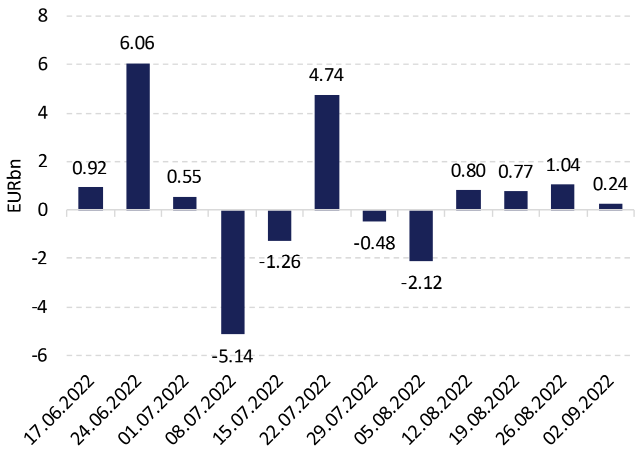


Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

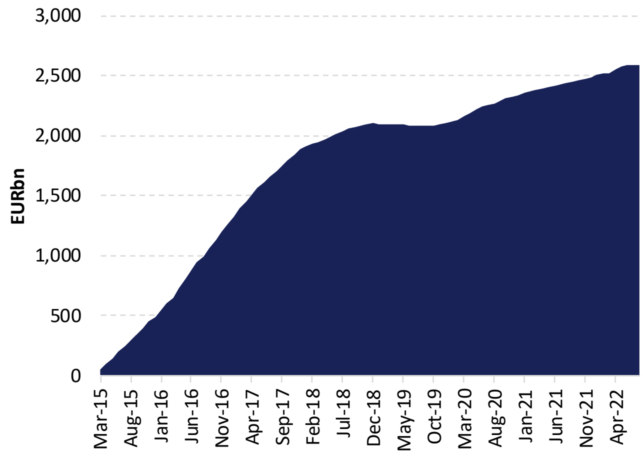
NORD/LB

Public Sector Purchase Programme (PSPP)

Weekly purchases



Development of PSPP volume



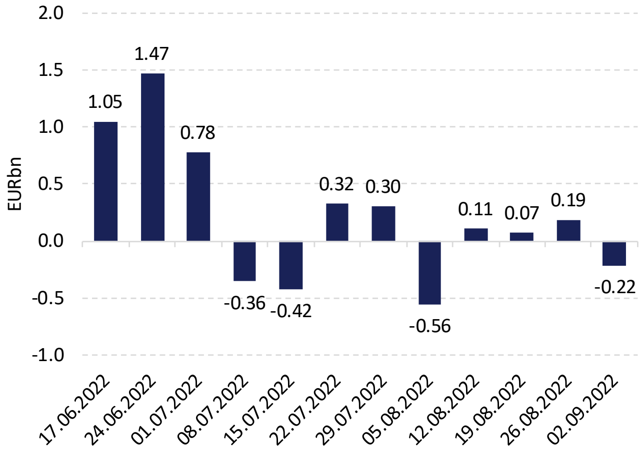
Overall distribution of PSPP buying at month-end

Jurisdiction	Adjusted distribution key[1]	Holdings (EURm)	Expected holdings (EURm)[2]	Difference (EURm)	Current WAM of portfolio[3] (in years)	WAM of eligible universe[4] (in years)	Difference (in years)
AT	2.7%	78,139	74,117	4,022	7.2	8.4	-1.2
BE	3.4%	95,598	92,256	3,342	7.2	10.3	-3.1
CY	0.2%	4,328	5,449	-1,121	8.8	9.2	-0.4
DE	24.3%	664,195	667,541	-3,346	6.6	8.0	-1.4
EE	0.3%	444	7,133	-6,689	7.8	7.8	0.0
ES	11.0%	316,826	301,962	14,864	7.8	8.2	-0.5
FI	1.7%	44,340	46,514	-2,174	8.0	9.4	-1.5
FR	18.8%	531,745	517,196	14,549	6.8	8.8	-2.0
GR	0.0%	0	0	0	0.0	0.0	0.0
IE	1.6%	42,964	42,881	83	8.2	8.6	-0.4
IT	15.7%	447,491	430,193	17,298	7.1	10.5	-3.4
LT	0.5%	5,967	14,656	-8,689	10.3	7.9	2.4
LU	0.3%	3,864	8,341	-4,477	5.7	10.3	-4.6
LV	0.4%	3,812	9,867	-6,055	9.1	7.8	1.2
MT	0.1%	1,411	2,656	-1,245	11.3	9.1	2.2
NL	5.4%	129,560	148,401	-18,841	7.8	9.7	-1.9
PT	2.2%	55,468	59,268	-3,800	7.3	9.7	-2.4
SI	0.4%	10,944	12,193	-1,249	9.5	7.6	1.9
SK	1.1%	18,332	29,000	-10,668	7.9	9.6	-1.7
SNAT	10.0%	288,595	274,403	14,192	7.9	8.5	-0.6
Total / Avg.	**100.0%**	**2,744,026**	**2,744,026**	**0**	**7.2**	**8.5**	**-1.3**

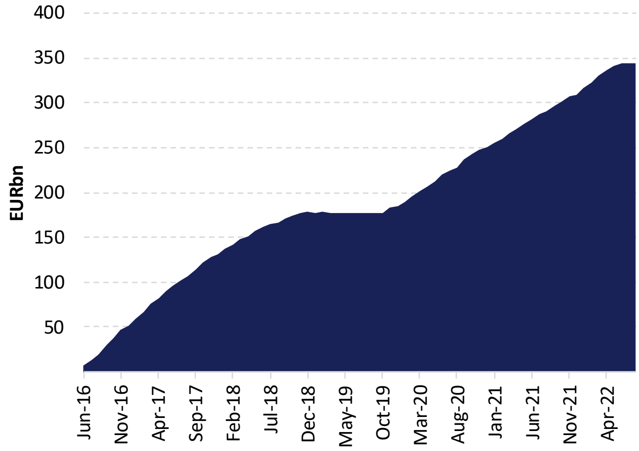
[1] Based on the ECB capital key, adjusted to include supras and the disqualification of Greece
[2] Based on the adjusted distribution key
[3] Weighted average time to maturity of PSPP portfolio holdings
[4] Weighted average time to maturity of the bonds eligible for purchasing under the PSPP
Source: ECB, NORD/LB Markets Strategy & Floor Research

Corporate Sector Purchase Programme (CSPP)

Weekly purchases

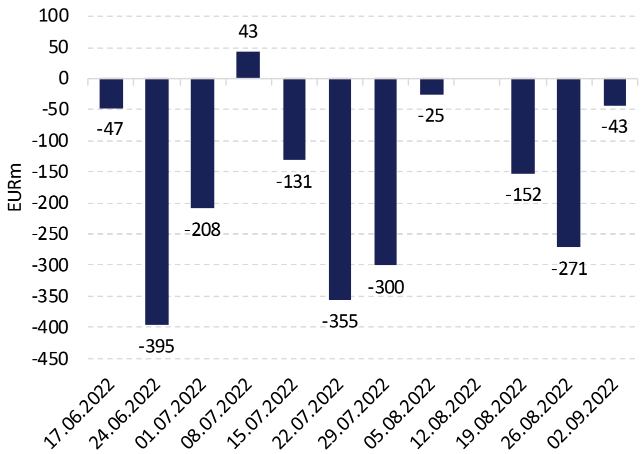


Development of CSPP volume

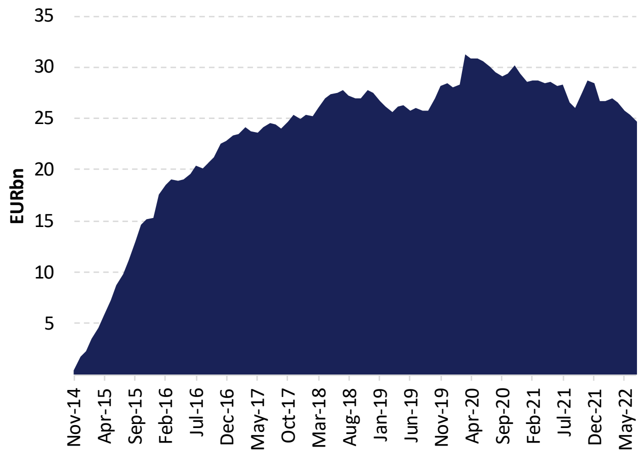


Asset-Backed Securities Purchase Programme (ABSPP)

Weekly purchases



Development of ABSPP volume



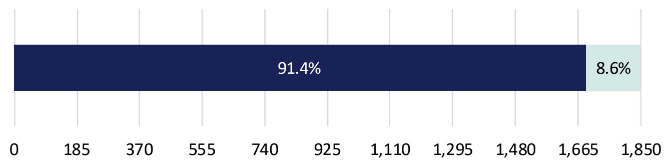
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Pandemic Emergency Purchase Programme (PEPP)

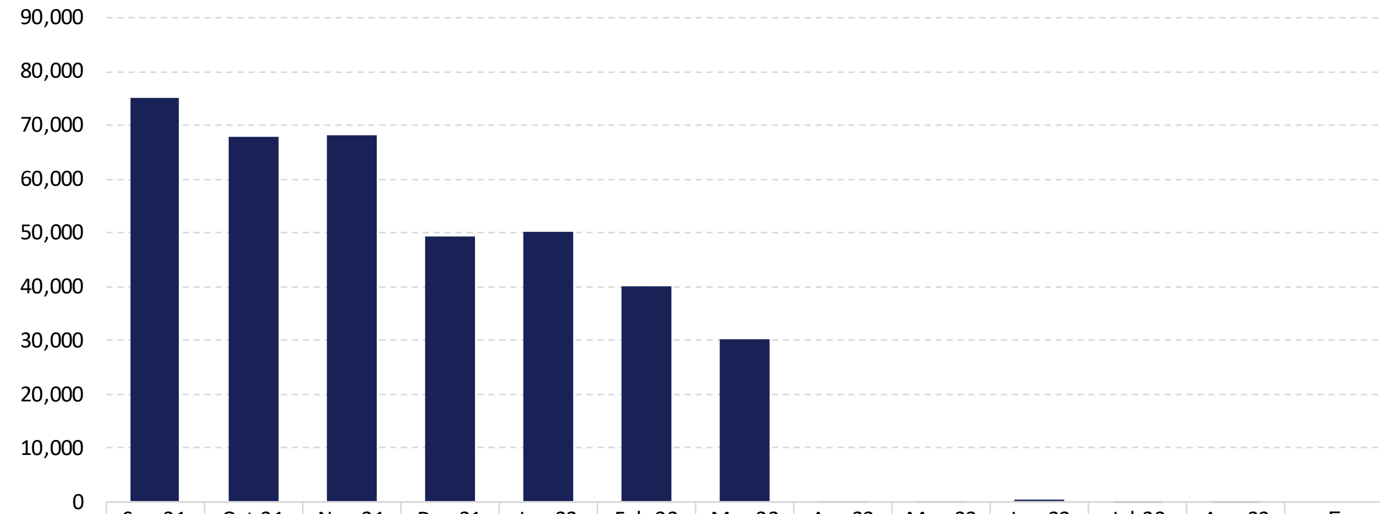
Holdings (in EURm)

	PEPP
Jul-22	1,717,352
Aug-22	1,714,539
Δ (net purchases)	-2,813

Invested share of PEPP envelope (in EURbn)

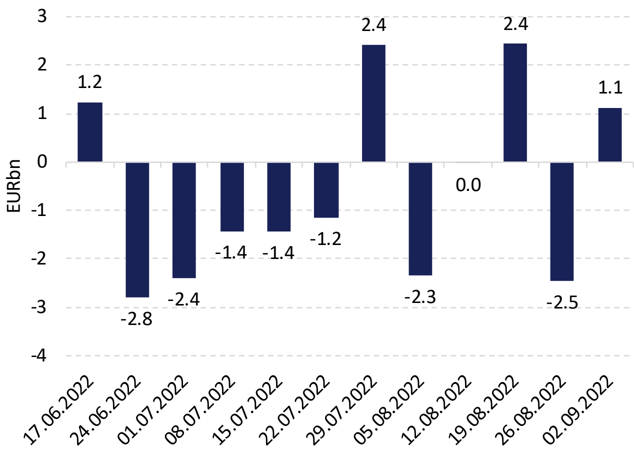


Monthly net purchases (in EURm)

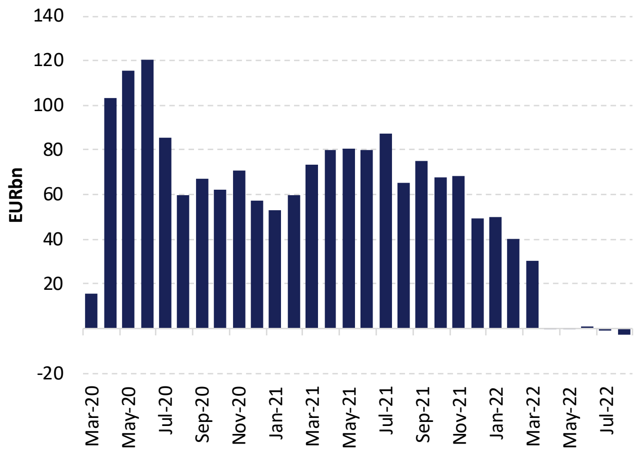


	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	∑
PEPP	75,051	67,855	68,045	49,375	50,113	40,184	30,214	-4	-10	12	-722	-2,813	377,300

Weekly purchases



Development of PEPP volume

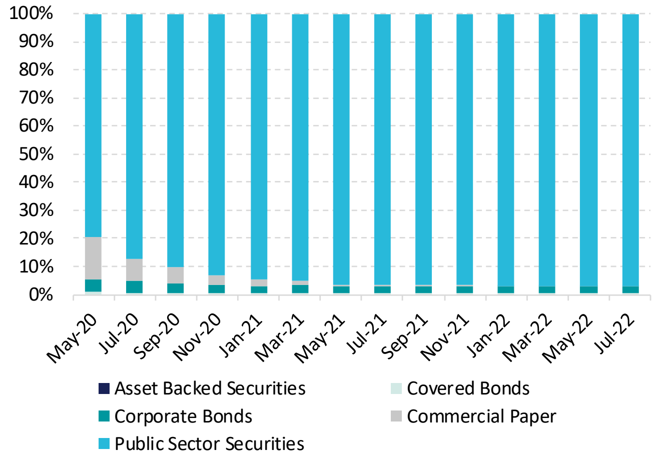


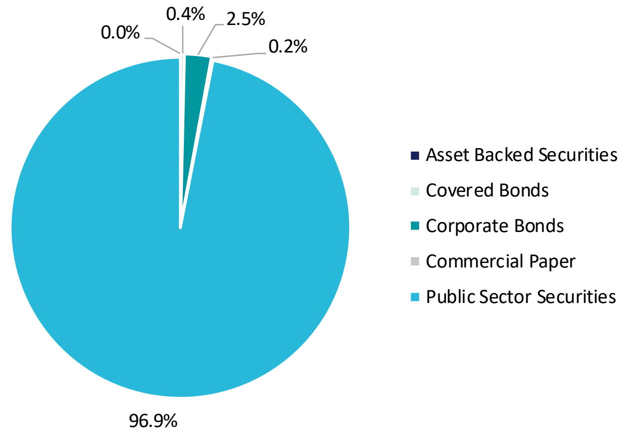
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Holdings under the PEPP (in EURm)

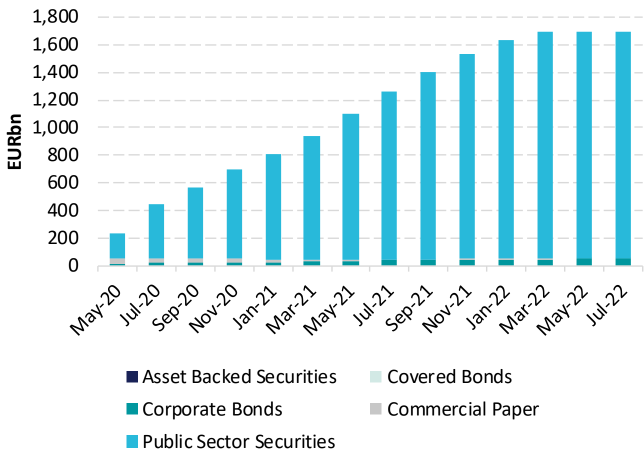
	Asset-backed Securities	Covered Bonds	Corporate Bonds	Commercial Paper	Public Sector Securities	PEPP
May-22	0	6,067	41,825	4,352	1,644,230	1,696,474
Jul-22	0	6,062	42,814	3,322	1,639,774	1,691,971
Δ (net purchases)	0	0	+1,025	-1,029	-705	-709

Portfolio structure

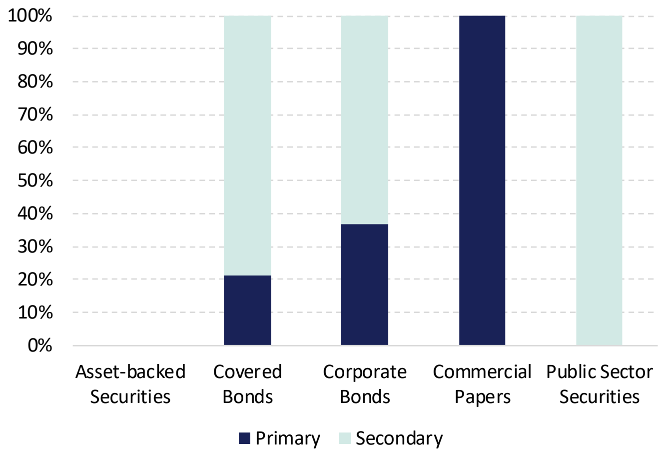




Portfolio development



Share of primary and secondary market holdings



Breakdown of private sector securities under the PEPP

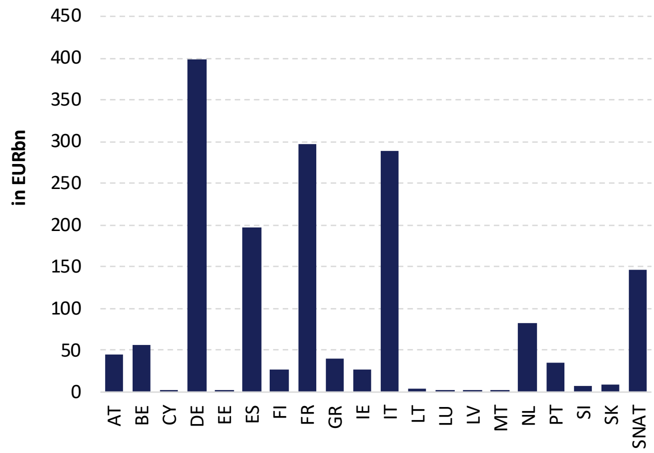
Jul-22	Asset-backed securities		Covered bonds		Corporate bonds		Commercial paper	
	Primary	Secondary	Primary	Secondary	Primary	Secondary	Primary	Secondary
Holdings in EURm	0	0	1,298	4,764	15,262	27,552	3,322	0
Share	0.0%	0.0%	21.4%	78.6%	35.7%	64.4%	100.0%	0.0%

Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

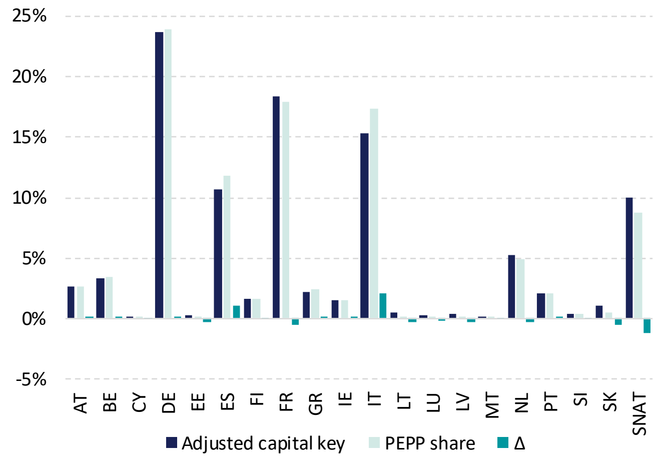
Breakdown of public sector securities under the PEPP

Jurisdiction	Holdings (in EURm)	Adj. distribution key[1]	PEPP share	Deviations from the adj. distribution key[2]	Current WAM[3] (in years)	WAM of eligible universe[4] (in years)	Difference (in years)
AT	44,424	2.6%	2.7%	0.0%	7.7	7.3	0.3
BE	57,057	3.3%	3.4%	0.1%	6.4	9.6	-3.2
CY	2,464	0.2%	0.1%	0.0%	8.9	8.2	0.7
DE	398,212	23.7%	23.9%	0.2%	6.6	7.0	-0.3
EE	256	0.3%	0.0%	-0.2%	7.9	6.5	1.4
ES	196,377	10.7%	11.8%	1.1%	7.5	7.4	0.1
FI	27,454	1.7%	1.6%	0.0%	7.1	8.2	-1.2
FR	297,766	18.4%	17.9%	-0.5%	8.0	7.8	0.2
GR	39,765	2.2%	2.4%	0.2%	8.4	9.4	-1.0
IE	26,004	1.5%	1.6%	0.0%	8.8	9.7	-0.8
IT	289,065	15.3%	17.4%	2.1%	7.1	7.0	0.1
LT	3,235	0.5%	0.2%	-0.3%	9.9	9.6	0.4
LU	1,865	0.3%	0.1%	-0.2%	6.2	7.0	-0.8
LV	1,890	0.4%	0.1%	-0.2%	8.4	8.3	0.1
MT	603	0.1%	0.0%	-0.1%	10.9	9.0	2.0
NL	82,741	5.3%	5.0%	-0.3%	7.9	8.7	-0.7
PT	35,315	2.1%	2.1%	0.0%	6.6	7.0	-0.4
SI	6,542	0.4%	0.4%	0.0%	9.0	9.2	-0.2
SK	7,966	1.0%	0.5%	-0.6%	8.6	8.1	0.5
SNAT	145,953	10.0%	8.8%	-1.2%	10.5	8.7	1.8
Total / Avg.	**1,664,955**	**100.0%**	**100.0%**	**0.0%**	**7.6**	**7.6**	**0.0**

Distribution of public sector assets by jurisdiction



Deviations from the adjusted distribution key



[1] Based on the ECB capital key, adjusted to include supras [2] Based on the adjusted distribution key
[3] Current WAM of public sector securities holdings under the PEPP [4] WAM of eligible universe of public sector securities holdings under the PEPP
Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

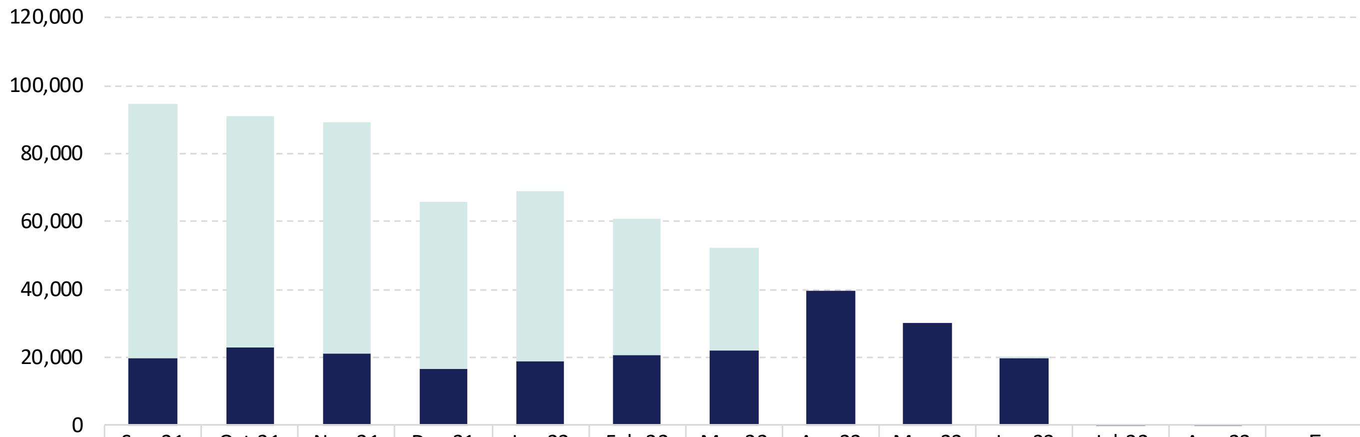
NORD/LB

Aggregated purchase activity under APP and PEPP

Holdings (in EURm)

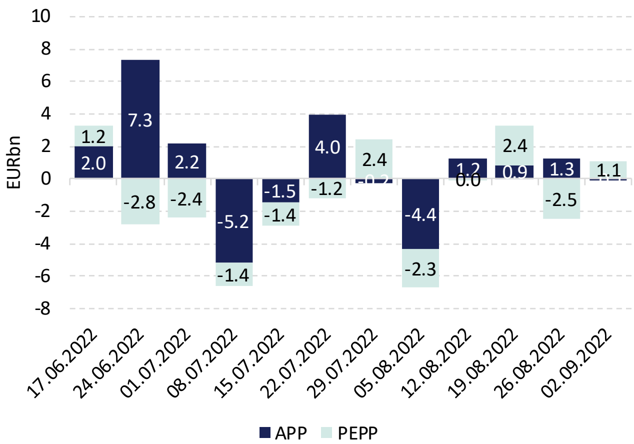
	APP	PEPP	APP & PEPP
Jul-22	3,263,385	1,717,352	4,980,737
Aug-22	3,262,730	1,714,539	4,977,269
Δ	-655	-2,813	-3,468

Monthly net purchases (in EURm)

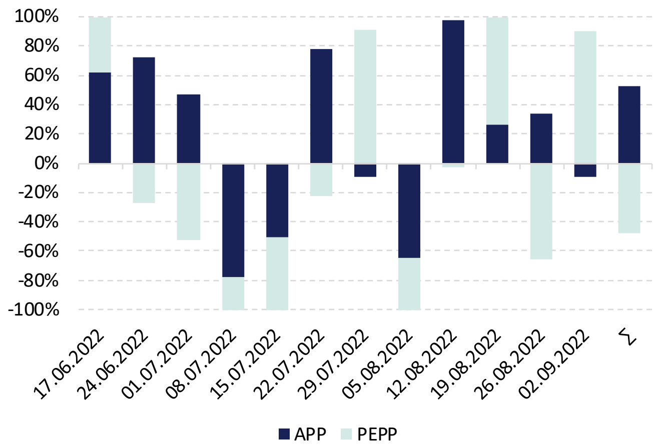


	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	∑
∑	94,710	90,872	89,245	65,971	68,951	60,882	52,143	39,393	30,222	19,734	-2,481	-3,468	606,174
PEPP	75,051	67,855	68,045	49,375	50,113	40,184	30,214	-4	-10	12	-722	-2,813	377,300
APP	19,659	23,017	21,200	16,596	18,838	20,698	21,929	39,397	30,232	19,722	-1,759	-655	228,874

Weekly purchases



Distribution of weekly purchases



Source: ECB, Bloomberg, NORD/LB Markets Strategy & Floor Research

Appendix
Publication overview

Covered Bonds:

Issuer Guide Covered Bonds 2021

Risk weights and LCR levels of covered bonds **(updated semi-annually)**

Transparency requirements §28 PfandBG **(quarterly update)**

Covered bonds as eligible collateral for central banks

SSA/Public Issuers:

Issuer Guide – German Laender 2021

Beyond Bundeslaender: Greater Paris (IDF/VDP)

Spotlight on Belgian regions

Spotlight on Spanish regions

Fixed Income Specials:

ESG-Update 2022

ECB ready for lift-off: Every journey starts with a first step

Face-saving ECB decision: Hawks have won – for now

ECB decision: PEPP benched for now, APP comes in as Point Guard

ECB holds course, but ups the ante – PEPP running until 2022

Appendix
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