



Fixed Income Special

NORD/LB Floor Research

19 January 2024

Marketing communication (see disclaimer on the last pages)

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ECB preview: New year, new luck?!

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

The slightly longer roadmap for 2024

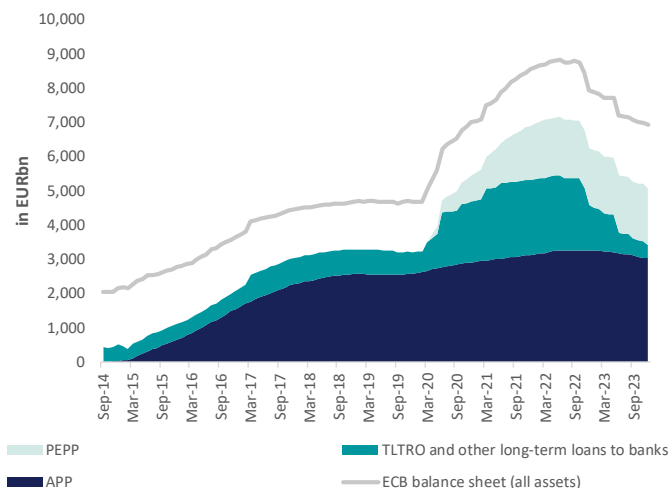
The year of interest rate cuts continues to cast its shadow ahead. The ECB meets on the following dates:

- 25 January
- 07 March – incl. new *staff projections*
- 11 April
- 06 June – incl. new *staff projections*
- 18 July
- 12 September – incl. new *staff projections*
- 17 October
- 12 December – incl. new *staff projections*, then for the first time for 2027

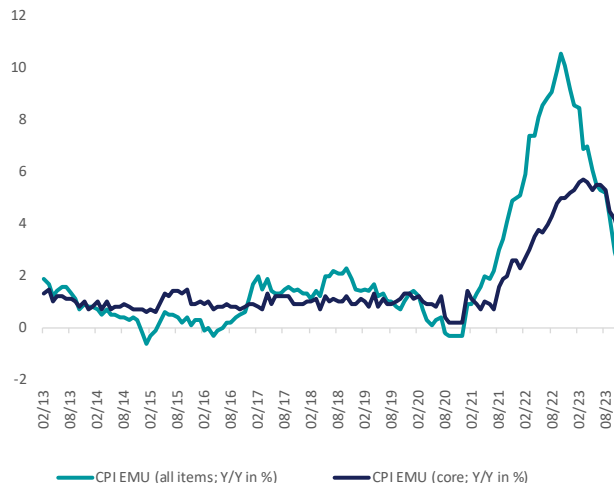
Key interest rate decision on 25 January: New year, new luck

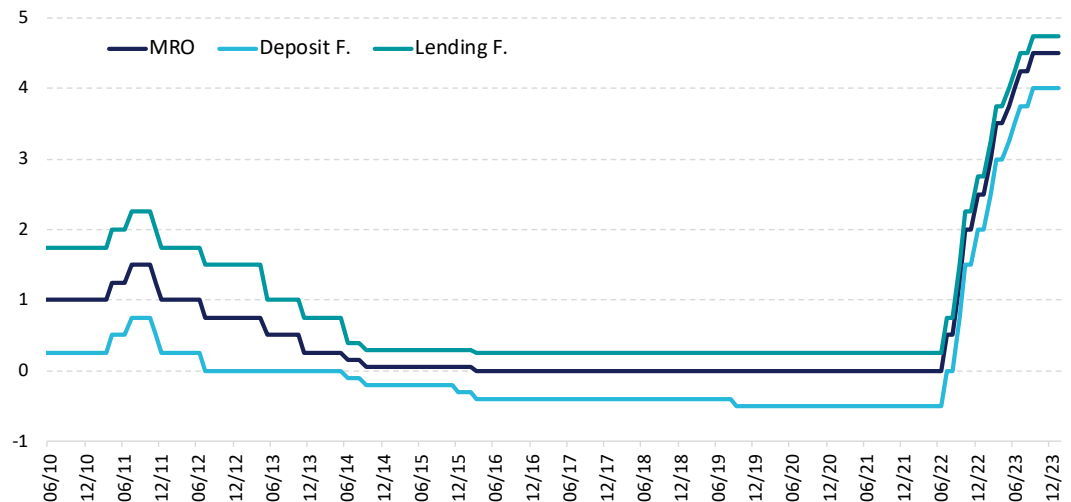
The environment in which the ECB Governing Council will have to hold its upcoming key interest rate meeting continues to be characterised by a heightened level of geopolitical uncertainty. These geopolitical concerns in Ukraine and the Middle East are overshadowing the usual monetary policy parameters and, as expected, we have inherited them from the previous year. Many transport routes no longer run through the Suez Canal, but around the Cape of Good Hope. Then, for example, the Tesla factory in Brandenburg will be closed for a fortnight this winter due to a lack of components. This is an example to illustrate that there is either a lack of affordable parts due to increased freight costs or that they are not available at all. 10y Bunds fell below 1.9% right after Christmas and are now back at 2.3%. For the upcoming ECB Governing Council meeting, all parameters underpin the fact that key interest rates will remain unchanged – for the time being. The roadmap for the PEPP is on the table and will be stoically implemented in 2024. Market participants are now wondering when the ECB Governing Council will dare to tackle the minimum reserve topic. And how quickly will the interest rate cuts really happen?

ECB balance sheet



Inflation development (in %)



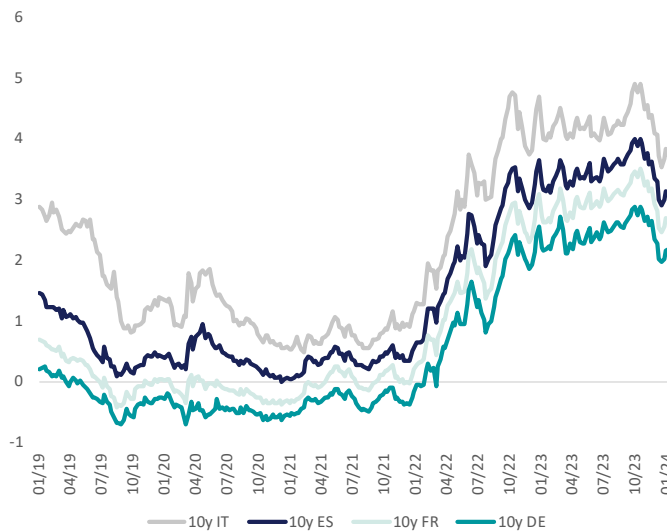
ECB key interest rates (in %; incl. interest rate pause expected by us)

Source: ECB, Bloomberg, NORD/LB Floor Research

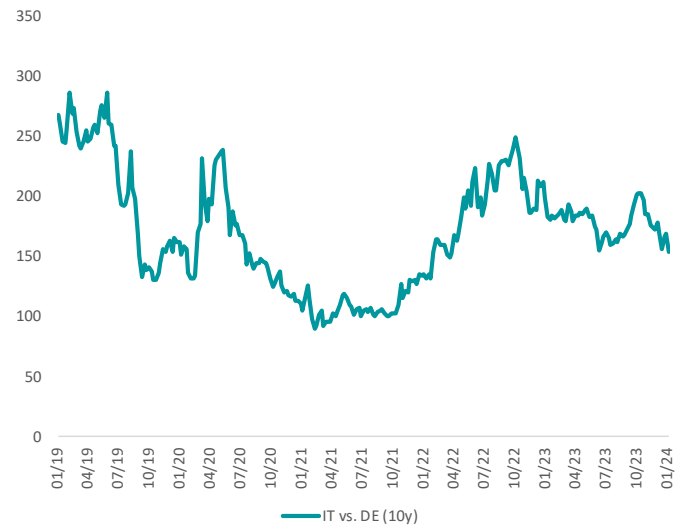
Opinions from the inner ECB circle: "Council vs. market"?

As we also point out in the following paragraph on the ECB minutes, the ECB Governing Council made it clear at the end of the year that the interest rate peak had been reached. This view inevitably raises the question of when and at what speed the descent will begin. Immediately after the December meeting, the opinion prevailed in the "market" – supported in part by fresh economic data – that key interest rates would be cut sooner rather than later. A larger proportion of ECB watchers also felt compelled to forecast earlier interest rate cuts by the Council. Following an initial outwardly closed attitude towards cuts in key interest rates, we can now speak of a change in strategy by ECB central bankers in the "Council vs. market" situation. One member of the Council, Joachim Nagel, a proven monetary policy hawk, was even open to discussions on interest rate cuts. In his opinion, however, the "summer break" would be a good time to think about it. This is a clear change of heart on the part of the central banker, who had previously signalled no willingness to engage in such discussions. This shifts the focus to the middle of the year and therefore the June meeting at the earliest with a view to the first interest rate moves. However, we would like to take this opportunity to point out that Nagel has also kept a back door open and included a severability clause. For example, the situation could change significantly if wage increases fuel demand-side inflation. However, the market remains more aggressive, even though there are hardly any supporters of this view in the ECB Governing Council. Yannis Stournaras and Martins Kazaks, for example, were open to a move in the middle of the year. The outlier opinion of Robert Holzmann came as no surprise. For the Austrian, described by Bloomberg as an "arch hawk", interest rate hikes in 2024 are by no means guaranteed. For example, he cited the unpredictable influences from geopolitical crises. ECB chief economist Lane also recently saw certain dangers here. In the [interview on 13 January](#), however, he did not miss to emphasise his institution's successes in the fight against inflation. With regard to interest rate cuts, he made it clear that there would be not "one step only", but that he was already preparing observers for a sequence of steps. When asked about the corresponding stimulus expected by the market in March or April, Lane remained true to the ECB line and referred to the Council's dependence on data.

Yield development in the euro area (in %)



Spread development: Italy vs. Germany (in bp)



Source: Bloomberg, NORD/LB Floor Research

Minutes of the December meeting: The "last mile" narrative

Yesterday, THU 18 January, the [ECB published the minutes](#) of the last key interest rate meeting in 2023. The simple number of mentions of the root word "disinflation" alone shows what moved the central bankers in December. The general trend of falling consumer price inflation was certainly also emphasised favourably by the Governing Council during the discussions. After all, this development also reflects the success of the ECB's own monetary policy to a significant extent. While it was undisputed that key interest rates had reached their peak, the view that the "last mile" on the disinflation path was the most difficult to overcome came into focus. This would also require, for example, moderate wage growth and an increase in productivity so that price pressure would not continue via rising unit labour costs. In the discussion, the Council also explicitly mentioned possible backward-looking aspects of wage negotiations. However, not all Council members were entirely in favour of this thesis. Finally, it was emphasised that the narrative of the "difficult last mile" could undermine confidence in the timely achievement of the ECB's inflation target. Furthermore, not all Council members saw any empirical evidence for the hypothesis of a difficult last mile. To summarise, the Council believes that the environment remains characterised by increased uncertainty, which could also have an impact on financial market stability. The real economic outlook is also characterised by downside risks, which could overshadow any positive surprises. Unsurprisingly, interest rate cuts were not discussed in this mixed situation. This would have introduced a new element of uncertainty into the debate. The December decision on the PEPP certainly had a heightened relevance for the asset classes we are focussing on. In the opinion of the majority of Council members, the "normalisation" of the Eurosystem's balance sheet should be driven forward in a measured and predictable manner. The path laid out for the PEPP would favour a smooth adjustment here – also because "repayments in the PEPP portfolio are very low compared to other sources of balance sheet reduction in 2024."

Our expectations for 25 January: Questions about interest rate cut fantasies

For the upcoming interest rate decision, we assume that the ECB Governing Council will extend the summit pause. Interest rate hikes are a thing of the past and the cards are on the table for the further course of the PEPP, so all market observers are focussing on two relevant questions: not whether interest rates will be cut in 2024, but when and how often? And when will the content of the minimum reserve be discussed by the Council and doubled from 1% to 2%? As we expected and as communicated by the ECB, the meetings will remain data-based so as not to be "data-driven" again. After all, some past interest rate moves are still having an effect. We are already looking forward to the months of March and June with anticipation, as this is when the new *staff projections* will be published. It is too early to categorically rule out a rate cut for H1. We have decided in favour of very few interest rate cuts in 2024 and have also pointed out that the first cuts called for in Q1 appear premature in our view. All the more reason to focus on other topics: everything seems to have been said about the PEPP for 2024, which means that QT is progressing. Initially only for the APP, but then also for the PEPP from H2 when full reinvestment ceases. This leaves the issue of minimum reserves and the minimum reserve ratio for the time being and, at some point, the resulting interest rate. We expect that there will be a stronger focus on interest rate cuts both in the internal discussion and at the press conference. President Lagarde will have to be just as skillful in dodging the cunning questions. We are also curious to see whether the market will see the PEPP as the "first line of defence" crumbling in H1/2024. The ECB Governing Council cannot want the TPI to be activated at some point. All in all, everything continues to speak in favour of a meeting-by-meeting approach instead of forward guidance on the interest rate side. This also applies to the minimum reserve.

Conclusion and outlook

New year, new luck!? Some people thought they would find happiness in premature interest rate cuts. We still believe that nothing will happen until the summer, although a small move in June wouldn't hurt either. Everyone agrees that another interest rate pause is clearly on the cards for January. The central bankers' wait-and-see attitude actually has some advantages. Certainly, a wait-and-see attitude should not be confused with the ability to sit back and relax. There are enough topics for discussion. More hawkish central bankers would certainly like the topic of minimum reserve requirements to be a little more prominent on the agenda. Discussions on the economic situation are likely to be just as vigorous. After all, against the backdrop of current developments, there are many conceivable outcomes. Against the backdrop of a meeting-by-meeting approach, discourse is once again and in any case the most effective means. We expect the meetings in March and June to be more explosive when the new *staff projections* are announced. These have become even more important as everyone is looking ahead to the data-based first interest rate meeting in the middle of the year.

Appendix

Publication overview

Covered Bonds:

[Issuer Guide Covered Bonds 2023](#)

[Covered Bond Laws](#)

[Covered Bond Directive: Impact on risk weights and LCR levels](#)

[Risk weights and LCR levels of covered bonds](#) (updated semi-annually)

[Transparency requirements §28 PfandBG Q3/2023](#) (quarterly update)

[Covered bonds as eligible collateral for central banks](#)

SSA/Public Issuers:

[Issuer Guide – German Laender 2023](#)

[Issuer Guide – German Agencies 2023](#)

[Issuer Guide – European Supranationals 2023](#)

[Issuer Guide – French Agencies 2023](#)

[Issuer Guide – Dutch Agencies 2023](#)

[Beyond Bundeslaender: Belgium](#)

[Beyond Bundeslaender: Greater Paris \(IDF/VDP\)](#)

[Beyond Bundeslaender: Spanish regions](#)

Fixed Income Specials:

[ESG-Update 2023](#)

[ECB: Scarf, dry cough and with less liquidity unwell into 2024](#)

[ECB preview: A silent, but holy summit meeting?](#)

[ECB: Now is not the time for forward guidance!](#)

Appendix

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