Subject: ECB view - Euro banks topside play
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Date: Wed, 23 Jan 2019 17:23:24 -0500
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Paul – research piece with some nice charts on the banks topic we talked about.

https://research.db.com/Research/Article?rid=2f75ac9d-8fd7-40f4-a215-d9b93915e21b-604&kid=RP0001&documentType=R

Page 16 ->

How/when could the ECB adjust rates policy for the banking system?

Our baseline view is that the start of the ECB policy tightening cycle will be

delayed to March 2020 due to the current loss of cyclical economic momentum.

However, delaying the tightening cycle for cyclical reasons opens the door wider

to arguments for a non-cyclical rate adjustment in 2019. We think the ECB should

take some type of policy action this year to support the structural profitability of

the banking system – one could even make the inverted argument that a rate

hike could ease bank-based financial conditions were it to be particularly positive

for banking – the only question is how and when?

If the ECB is becoming concerned about current economic conditions, March

could be a 'live' Council meeting for an adjustment in the policy stance. March is

the obvious time to announce details of the replacement for TLTRO2. This presents

an opportunity to consider the width of the standing facilities corridor.

The ECB could adjust the deposit facilities rate upward, arguing for the structural benefit for banking, but use the TLTRO2 replacement to lean against a tightening of financial conditions 20.

One challenge with this scenario is that it implies the ECB breaches its current forward guidance that all policy rates will remain on hold at least through summer 2019. For this scenario to materialise, either the ECB would have to signal before March the possibility of taking the deposit rate out of the rates guidance framework or argue after the event in March that it made sense for structural reasons to breach the guidance.

Another scenario would have the ECB wait until the time-commitment element of the current rates forward guidance expires in September before hiking the deposit rate for structural reasons. Although this would not breach today's forward guidance, the reality is there seems little prospect of getting to September without the forward guidance being extended further. This means that if the ECB is to hike the deposit rate for structural rather than cyclical reasons it will at some point have to flag the possibility of breaching forward guidance.

Introducing a tiering system as a way to reduce the costs of negative rates rather than raising the deposit rate has the benefit of not being constrained by the existing forward guidance on rates. The downside is its sheer complexity in terms of determining levels of exemptions, etc.

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