



Year-end expectations

FX swap and secured segments

Jaap Kes, ING Group Treasury
Amsterdam • 27 November 2020

thinkforward

ING 

Non-core Repo rates over year end are expected to decline

Eurozone excess liquidity, Nov 2019 – Nov 2020



Non-core & Italy repo

- European repo rates over year-end, core + non-core, have declined, driven by seasonal but **mainly contemporary factors**:
 - banks limitation to intermediate due to balance sheet restrictions;
 - extreme excess liquidity driven by TLTRO3;
 - increasing collateral demand driven by PEPP.
- **Italy is the second largest borrower in TLTRO** (almost equal to nr1 France), supporting the decline of Italian repo rates, also over year-end.

What ECB action in Dec could change to market momentum?

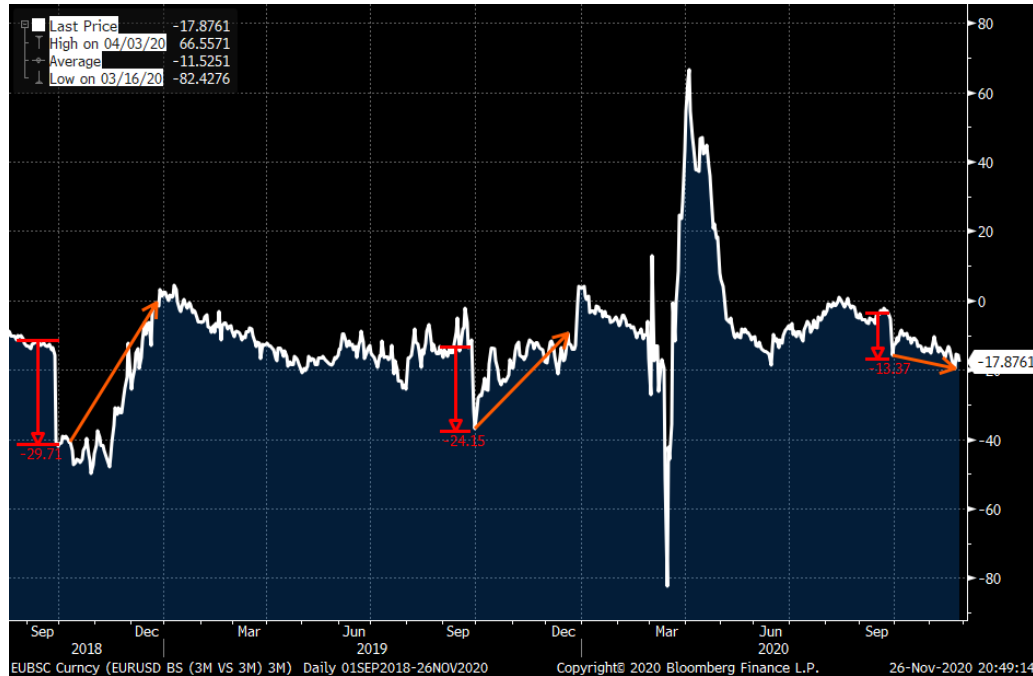
- Increased tiering multiplier could reverse momentum, reducing real excess
- Extending TLTRO3 favorable conditions can add to lower rates sentiment

Pricing over year-end:

- Italy 1m – trades at -/-6 bps vs EONIA, compared to -/- 3 in O/N
- Core 1m – trades around -/- 12 bps vs EONIA, compared to -/- 8 in O/N

FX Swap: EUR/USD basis low, but no complacency on funding

3m eur/usd basis, Sep 2018 – Nov 2020



Historical perspective:

- 3m FX swap rates price year-end premia every year from end September;
- Towards year-end, basis contracts as participants are done pre-hedging;
- This year, the basis actually widens somewhat towards year-end.

Does the low, slight widening of eur/usd basis towards year-end in 2020 imply complacency on year-end USD funding?

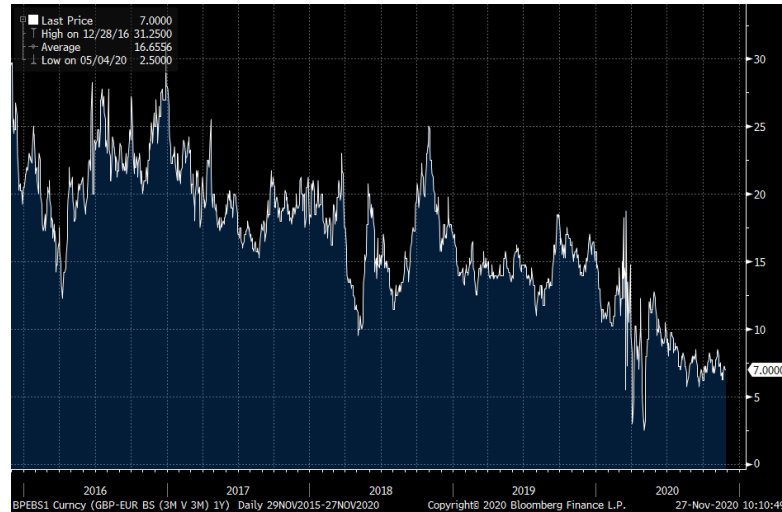
Research indicates a few other factors at work:

- **International Portfolio flows:** With US yield curves flattening post-COVID, international investors have less demand for USD;
- **Mild Regulatory Frictions:** This year, due to less severe G-SIB scores, aggressive dollar supply and CB swap backstops, quarter-end and year-end balance sheet pressure is less than previous.

Therefore, in our experience, banks are as vigilant on their year-end USD funding as always, but there seems less market pressure in USD supply than in 2014-2017.

Brexit: markets pricing 31 dec Brexit date

1y eur/gbp xccy basis, nov 2015 – Nov 2020



eur/gbp FX Spot, nov 2015 – Nov 2020



Negotiation update and timing

- EU-UK negotiations will restart this weekend as talks were halted earlier this week after some officials had to self-isolate. Barnier will be briefing EU diplomats today before travelling to London;
- Exact timing remains unclear although it does seem that the make-or-break moment for markets is around the corner. Markets are also looking at the Dec 10-11 EU Council Summit as a key target date.

Market pricing

- Markets have been optimistic around Brexit negotiations in recent weeks which is shown by a lack of GBP risk premia (1y xccy eur/gbp basis, top graph) and a well performing GBP (eur/usd FX spot, lower graph);
- Nevertheless, there has been some change in positioning recently with CFTC data showing an increase in investors' GBP shorts. However, these shorts are not as deep as when a no-deal scenario was a tangible option in the past, and could be seen as positioning for a 'thin' deal outcome where further GBP rallying would be limited. This indicates a still low speculative short against GBP.

BREXIT: Derivative Trading Obligation

ESMA SETS OUT ITS FINAL VIEW ON THE DERIVATIVES TRADING OBLIGATION (DTO)

- The European Securities and Markets Authority (ESMA), the EU's securities markets regulator, has released a [public statement](#) that clarifies the application of the European Union's (EU) trading obligation for derivatives (DTO) following the end of the UK's transition from the EU on 31 December 2020.
- The statement clarifies that the DTO will continue applying without changes after the end of the transition period. ESMA considers that the continued application of the DTO would not create risks to the stability of the financial system. The statement confirms the approach outlined in ESMA's previous [statement](#) in March 2019.
- ESMA acknowledges that this approach creates challenges for some EU counterparties particularly UK branches of EU investment firms. However, ESMA considers that EU counterparties can meet their obligations under the DTO by trading on EU trading venues or eligible trading venues in third countries, and this situation is primarily a consequence of the way the UK has chosen to implement the DTO.
- Based on the current legal framework, and in the absence of an equivalence decision by the European Commission, ESMA does not see room for providing different guidance. ESMA will continue to closely monitor the situation to assess whether markets would be sufficiently liquid for the purpose of the DTO after the end of the transition period.