Expanding Unremunerated MRR: Potential Impact On Eurozone Banks

Presentation to SUERF BAFFI Bocconi webinar

Nicolas Charnay
December 12th, 2023
Our Prognosis For Rated European Banks In 2024

Weakening but not dire operating environment

Predominance of stable outlooks on bank ratings

Interest rates stay higher for longer due to slow disinflation

Slow economic growth but a still resilient job market

Comfortable profitability though structural issues persist for some

Median return on equity forecast at 8.2%

Better margins compensate for lower business volumes, at least for a while

Median cost of risk forecast at 22 bps

Credit costs to normalize from low levels

Resilient balance sheets despite reversal of growth trends

Median risk-adjusted capital ratio forecast at 12.3%
Positive outlooks are mainly among lower ratings

Rating bias relative to other regions

Covers Top 100 European banks only. Data as of Nov. 02, 2023. Data reflect outlooks at the level of the lead operating company. Source: S&P Global Ratings.

Eurozone Banks | Higher MRR Would Dent Profits And Liquidity

Under current ECB/NCB policy, required reserves are not HQLA eligible and remunerated at 0%. Assuming a moderate increase in MRR (for instance a return to 2%), we find a manageable impact in most systems.

Impact of increase in MRR on eurozone banks’ LCRs
Sensitivity analysis

<table>
<thead>
<tr>
<th>LCR (%)</th>
<th>Minimum reserve requirements (currently 1%)</th>
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<tbody>
<tr>
<td></td>
<td>1%</td>
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<tr>
<td>Austria</td>
<td>171</td>
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<tr>
<td>Belgium</td>
<td>166</td>
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<tr>
<td>Germany</td>
<td>154</td>
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<tr>
<td>Spain</td>
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<td>Finland</td>
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<td>France</td>
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<td>Greece</td>
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<td>Ireland</td>
<td>180</td>
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<td>Italy</td>
<td>194</td>
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<tr>
<td>Netherlands</td>
<td>156</td>
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<tr>
<td>Portugal</td>
<td>248</td>
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<tr>
<td>Slovakia</td>
<td>289</td>
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<tr>
<td>Eurozone*</td>
<td>165</td>
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</tbody>
</table>

Due to missing datapoints, we exclude Croatia, Cyprus, Estonia, Lithuania, Latvia, and Slovakia. Additionally, we exclude Luxembourg from the analysis because of discrepancies in the reporting of minimum reserves.

LCR—Liquidity coverage ratio, MRR—Minimum reserve requirements.
Sources: ECB Data Warehouse, S&P Global Ratings.
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Eurozone Banks | Monetary policy uncertainties

Together with upcoming TLTRO repayments (and potentially a switch to active QT), an increase in MRR would deplete excess reserves, which are not equally distributed across systems.

Potential Depletion of Excess Reserves Due to TLTRO Repayments* and increase in MRR

Excess reserves are not equally distributed across systems and banks.

- Effect would therefore be asymmetric and lead to further differentiation in banks’ funding costs.

In case the MRR is raised meaningfully, some banks would need to source reserves on the interbank market, or let go of some deposits.

Banks would also likely react in many other ways:

- shift deposits where they are not subject to MRR (for the banks that can); and/or

- Seek to offset the loss of interest income by taking on more risk (e.g. interest rate risk)

Source: S&P Global Ratings, ECB Data Warehouse. * Assuming a 64% pass-through between TLTRO repayments and decline in excess reserves, in line with trend observed in the eurozone in the past year.
Eurozone Banks | Normalising Monetary Policies Requires Careful Communication
And the ECB has tools to manage potential risks, should they materialise.

- Financing needs from governments, i.e. fiscal trajectories.
- Financing needs from the broader economy.
- ECB’s risk management tools: full allotment procedure, TPI
- Review of the operational framework (MRR, refinancing operations, role of forward guidance)
- Uncertainties in the financial system:
  - Quality of interest rate risk management by bank and non-bank FIs
  - Amount of liquidity with which banks wish or are required to operate
  - Impact on money markets (esp. repo markets)
- Uncertainties in the real economy:
  - Financing needs from governments, i.e. fiscal trajectories.
  - Financing needs from the broader economy
- Speed and extent of balance sheet reduction
Annex
Further Details In Our Published Research

Eurozone Banks: Higher Reserve Requirements Would Dent Profits And Liquidity

October 24, 2013

Key Takeaways
- As part of the implementation of the capital regulations, the eurozone banks would need to increase their minimum leverage ratio to 5% higher. This would mean an increase in capital requirements.
- The implementation of the higher leverage ratio would impact all banks in the region, but would be less significant for those with higher capital ratios.
- The increase in capital requirements would lead to a decrease in profits, but would improve the banks' overall financial stability.
- The stricter capital requirements would also lead to a reduction in the banks' ability to lend.

European Banks: Protecting Liquidity Will Come At An Increasing Cost

June 25, 2013

Key Takeaways
- The increased capital requirements for European banks have led to a decrease in credit availability.
- The higher capital requirements have led to an increase in the cost of funding.
- The increase in funding costs has led to a decrease in profits for the banks.
- The banks have been forced to reduce their lending in order to meet the new capital requirements.
- The increased cost of funding has led to a decrease in the banks' ability to lend.

Further Details In Our Published Research

Further Details In Our Published Research

Credit FAQ:

What An Acceleration Of Quantitative Tightening Could Mean For Eurozone Banks

September 13, 2013

A bout a decade after what was later called 'the great recession,' the world's economies are once again facing a significant slowdown. The eurozone is no exception, with many countries experiencing a strong slowdown in the face of a large economic slowdown. This has led to a significant increase in the risk of a deep recession, which could have a significant negative impact on the eurozone economy.

The eurozone has been particularly vulnerable to the effects of a deep recession, as it is heavily dependent on exports and the world economy. The eurozone's economic slowdown has led to a significant decline in exports, which has had a negative impact on the country's economy.

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