Daily Insight

Group Economics
Financial Markets Research

3 October 2017

Financial Markets Research Team
Nick.kounis@nl.abnamro.com
Tel: +31 20 343 5616
nick.kounis@nl.abnamro.com

UK bank capital shortfalls tiny

European Banks: BoE signals UK bank capital shortfalls modest - The BoE released their updated approach to resolution yesterday, with a further document that discussed capital shortfalls. The calculations on capital shortfalls were very encouraging for the UK banks. The BoE estimates the UK banks require around another EUR 120bn of MREL eligible debt by 2022. However, and crucially, of this EUR 120bn, there exists EUR 116bn of long term debt that exists that could be structurally replaced with MREL eligible debt. For example, group operating companies may have long-term senior unsecured debt. If this debt was refinanced from a holding company, it would be structurally subordinated and MREL-eligible. Indeed, there is a higher cost to issue out of the holding company, but this shows that there is a vast amount of debt that can be rolled over to create MREL eligible capital. As a result this leaves the UK banks with a net MREL requirement of roughly EUR 4bn. In the scheme of things, EUR 4bn is a tiny amount, equivalent to 0.1% of the banking assets in the UK. A net increase in funding of EUR 4bn could be completed by next week if desired, let alone by 2022. For more, please see our note here for professional clients, see disclaimers in the document. (Tom Kinmonth)

Global Markets: Rise in US real yields supports dollar and hits gold - Since the 8 September, US 10y real yields (nominal yields corrected for inflation expectations) have doubled from 0.24% to 0.51%. Better-than-expected US data and more hawkish-than-expected Fed commentary have been the main drivers behind this move. As a result, the US dollar has recovered, rising by close to 3% in trade-weighted terms. As government bond yields in Germany have also risen, the recovery in the US dollar versus main currencies has been modest. Meanwhile, gold prices have dropped by more than 6% versus the US dollar. Investors seem confident that the situation on the Korean peninsula will not escalate and this has resulted in lower safe haven demand. This has also weighed on gold prices. We expect the US dollar recovery to continue in the coming days and weeks and EUR/USD could drop to 1.15 and gold prices could test USD 1,250 per ounce (200-day moving average). Afterwards we expect the US dollar to weaken again in line with our forecast for lower US real yields. As a result, EUR/USD will probably rise again towards 1.20 at the end of 2017 and gold prices will likely rally to USD 1,300 per ounce again (our year-end target). Next year we expect more US dollar weakness. Our year-end 2018 target for EUR/USD is 1.30 and for gold prices USD 1,450 per ounce.

If investors were to adjust their Fed rate hike expectations in line with what Fed officials currently signal, US real yields could continue to rise and so can the US dollar. In this scenario, investors will probably close their US dollar short positions and a large part of their net-long euro and net-long gold positions. This could result in EUR/USD testing the 200-day moving average around 1.1150 and gold prices revisiting the USD 1,200 per ounce level. This is not our base case scenario. Indeed, we think that the Fed will hike interest rates only very slowly in the coming months given a slower than expected development of inflationary pressures. At the same time, we expect the ECB slow the pace of its asset purchases next year, which provide support for the euro, with the announcement expected later this month. (Georgette Boele)

ABN AMRO Bank
Gustav Mahlerlaan 10 (visiting address)
P.O. Box 283
1000 EA Amsterdam
The Netherlands