EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

ECB-PUBLIC

9 July 2019

ECB Money Market Contact Group (MMCG)

Tuesday, 25 June 2019, 10:00-15:00 CET, Amsterdam

SUMMARY OF DISCUSSION

1. Money market outlook

Patrick Chauvet (BNP Paribas) reviewed the latest developments in the repo and foreign exchange swap segments of the euro money market that had taken place during the second quarter of 2019 and provided an outlook for the remaining part of the year. Conditions were smooth in the repo segment, leading to a contraction of spreads across sovereigns' collateral, less activity for specials and smaller spikes in prices at month and quarter-ends. Activity had also remained calm in the foreign exchange swap segment, even if the narrowing of the foreign exchange swap rate observed in the second half of 2018 and in the first quarter of 2019 had re-widened in the second quarter of 2019 owing to an increased issuance in euro.

During the discussion, MMCG members confirmed that the situation in the repo segment had largely stabilised. First, the switch from net purchases to reinvestments under the asset purchase programme had helped in not putting further pressure on the scarcity of certain securities. Second, activity geared towards preserving compliance with regulatory ratios was also more subdued than the activity that had been required to implement them initially.

2. Market expectations for the ECB monetary policy measures

Harald Baensch (UniCredit) and Werner Driscart (Belfius) assessed the implications of the decisions taken by the ECB's Governing Council on 6 June 2019 – including on the price of the third series of longer-term refinancing operations and six-month extension of forward guidance – and the messages conveyed at the ECB Forum on Central Banking in Sintra on 18 June 2019.

MMCG members shared the impression that the tone between 6 and 18 June had moved from less to more "dovish", with the latter signalling the ECB's willingness and readiness to act, if needed. MMCG members deemed the third series of targeted longer-term refinancing operations (TLTRO III) to be an important backstop for the system. Several MMCG members doubted that market participants would borrow large amounts in the first TLTRO III operations given that alternative market funding can be obtained under better conditions, the excess cash resulting from TLTRO usage would turn economically costly, and the indexation and conditionality attached to the price of the operation do not permit the funds to be hedged.

3. Developments in the euro money market curve and bank intermediation

Olivier Hubert (BPCE/Natixis), David Tilson (Bank of Ireland) and Jan Misch (LBBW) reviewed the latest developments affecting the euro money market curve and the impact of negative interest rates and abundant liquidity on banks' profitability. They noted that other central banks with negative rate policies had introduced tiering schemes to mitigate the effect on their banks' profitability. Since Mr Draghi's speech at Sintra on 18 June 2019, market participants had believed that a tiering scheme could be implemented along with rate cuts as early as September 2019. An overview of how tiering schemes worked in Denmark, Sweden, Switzerland and Japan was presented for illustration purposes.

Some MMCG members expected rate cuts to jeopardise banks' profitability, despite tiering being a mitigating measure. The lowering of the rate curve would squeeze banks' net interest margins further because retail deposit rates were effectively floored at zero while yields of assets (loans and securities) were not. The protracted period of low (negative) rates was already eroding banks' profitability and could eventually limit their function of financing the real economy activity. Given the uneven distribution of excess reserves across euro area banks, some members showed concerns that a tiering scheme would affect banks in different jurisdictions unevenly. Finally, MMCG members argued that the implementation of a tiering scheme should not take place before the euro short-term rate (€STR) replaced the euro overnight index average (EONIA) because of the potential impact that the scheme could have on the EONIA.

4. The impact of the net stable funding ratio, the liquidity coverage ratio and the leverage ratio on the euro repo segment

Harry Gauvin (HSBC) and Jürgen Sklarczyk (Deutsche Bank) reviewed how the evolution of EU prudential regulation had increased the demand for safe assets in the repo segment. They noted that the repo market had become a platform for collateral exchange rather than cash exchange. The main reasons for this were the excess liquidity injected by the ECB and that the availability of assets considered "safe" was limited by rating downgrades and the ECB's asset purchase programme.

During the discussion, MMCG members mentioned that the liquidity coverage ratio requires banks to hold sufficient high-quality liquid assets (HQLAs) to cover projected net cash outflows, making short-term funding less attractive than holding these assets. The net stable funding ratio penalises repo funding of less than six months because it incentivises reliance on more stable sources of funding than on short-term wholesale funding. The net stable funding ratio also penalises matched book transactions, since the negative impact of the reverse repo leg more than offsets the positive impact of the repo leg. Overall, the impact from the net stable funding ratio is reckoned to be lower repo supply, reducing volumes and increasing prices. The net stable funding ratio may also cause participation in Eurosystem refinancing operations to increase, as the latter allows non-HQLA eligible collateral to be transformed into HQLA deposit facility holdings. The leverage ratio contributes to volatility around reporting dates. The effect of the leverage ratio on the repo segment can be mixed. On the one hand, it has the potential to increase price and reduce volume because it provides for a higher penalty on sovereign bonds holdings than the capital ratio does. The leverage ratio is calculated over total assets, while the capital ratio is calculated over risk-weighted assets. On the other hand, the leverage ratio contains provisions for the netting of offsetting cash positions when they are with the same counterparty and settled through the same system. This has resulted in central counterparties being used much more. MMCG members reported a broad difference in the pricing of trades cleared bilaterally and those cleared through central counterparties, and in the contribution of central counterparties towards increasing the repo trading volume. The increased volume of derivative trades centrally cleared at central counterparties due to new regulations such as the European Market Infrastructure Regulation means that those institutions tend to hold significant quantities of cash. Given that placing that cash in unsecured transactions would represent an undue risk for financial stability, central counterparties that opt for secured transactions are increasingly large participants in the repo markets. Lastly, it was mentioned that year-end effects in repo volumes and rates were not only driven by the importance of the assessment of prudential standards as reflected in banks' annual reports and accounts but also by the fact that taxation and resolution fund contributions were based on year-end numbers.

5. Update on the transition of risk-free rates

MMCG members were updated on the developments that had taken place and the announcements that had been made with regard to the transition from the EONIA to the €STR in the second quarter of 2019. As of 2 October 2019 the European Money Market Institute (EMMI) would start publishing the EONIA as the €STR plus 8.5 basis points at or shortly after 09:15 CET (Frankfurt time) on each TARGET holiday for the preceding business day and until the end of 2021 (i.e. the last publication being on 3 January 2022). No EONIA value would be published on 1 October 2019.

Bineet Shah (Barclays) called on market participants to proceed with their preparations to adapt their systems to a T+1 publication in October 2019 and to design an action plan for legal contracts referencing the EONIA. For illustration purposes, he noted that the United Kingdom's experience with the transition to the sterling overnight index average (SONIA) suggested that several months of preparatory work – including testing, documentation and client communication – would be needed to adapt business and cope with required pre-trade (market data, trade capture, risk and finance) and post-trade (collateral and settlement) arrangements. In line with the EONIA legal action plan of the working group on euro risk-free rates, new contracts referencing the EONIA should include robust fallback provisions and an acknowledgement that references to the EONIA would be understood as being references to the €STR plus 8.5 basis points from 2 October 2019 onwards.

6. Other business: planning of the next meeting

The next meeting will take place in Frankfurt on Tuesday, 24 September 2019.

Andreas Biewald (Commerzbank) drew the MMCG's members' attention to an event on the European distribution of debt instruments (EDDI) initiative which had taken place on 21 June 2019. It was likely that this topic would be addressed at the MMCG meeting in December 2019.

List of participants

Money Market Contact Group meeting

Participant's organisation	Name of participant	
European Central Bank	Ms Cornelia Holthausen	Chair
European Central Bank	Mr Holger Neuhaus	
European Central Bank	Ms Maria Encio	Secretary
Bank of Ireland	Mr David Tilson	
Barclays Bank	Mr Bineet Shah	
Bayerische Landesbank	Mr Harald Endres	
BBVA	Mr Miguel Monzon	
Belfius Bank	Mr Werner Driscart	
BNP Paribas	Mr Patrick Chauvet	
BPCE/Natixis	Mr Olivier Hubert	
Caixabank	Mr Xavier Combis	
Caixa Geral de Depósitos	Mr António Paiva	
Commerzbank	Mr Andreas Biewald	
Deutsche Bank	Mr Jürgen Sklarczyk	
DZ Bank	Mr Michael Schneider	
Erste Group	Mr Neil Mcleod	
HSBC	Mr Harry Gauvin	
ING	Mr Jaap Kes	
Intesa Sanpaolo	Ms Maria Cristina Lege	
LBBW	Mr Jan Misch	
Nordea	Mr Markku Keränen*	
Société Générale	Ms Ileana Pietraru	
UniCredit	Mr Harald Baensch	

*Alternate agreed via the MMCG secretariat

National central banks	Name of participant
Nationale Bank van België/ Banque Nationale de Belgique	Mr Kristof Vandermeersch
Banca d'Italia	Ms Maria Lucia Marras
Banco de España	Mr Enrique Esteban
Banque de France	Ms Nassira Abbas
Deutsche Bundesbank	Mr Karsten Stroborn
De Nederlandsche Bank	Mr Dion Reijnders
Národná banka Slovenska	Mr Peter Andresič

Via teleconference	Name of participant
Central Bank of Cyprus	Mr Andreas Mylonas
Bank of Greece	Ms Chrysoula Giannakou
Banca d'Italia	Mr Salvatore Nasti
Banque centrale du Luxembourg	Mr Achim Hillen
Central Bank of Malta	Ms Josette Grech
Oesterreichische Nationalbank	Ms Bettina Moser
Banco de Portugal	Mr Luís Sousa
Banka Slovenije	Ms Sandra Jurišević
Suomen Pankki – Finlands Bank	Mr Jukka Lähdemäki