EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

24 September 2020

ECB Money Market Contact Group (MMCG)

Tuesday, 22 September 2020, 13:00-17:00 CET

Webex conference

Summary of the discussion

Address by Fabio Panetta, Member of the Executive Board

Full transcript of the speech is available here.

1) Banks' usage of TLTRO III funds

Oliver Deutscher (DZ Bank) and Maria Cristina Lege (Intesa Sanpaolo) introduced the topic.

Many members confirmed the positive effect of TLTRO III funding on loan provision. According to the MMCG, TLTRO III.4 had represented a unique opportunity to increase profitability in an environment where larger loan loss provisioning had become necessary due to the COVID-19 shock. While the usage of TLTRO funding for lending provides the highest return, the demand for loans did not increase with the same speed and magnitude. Instead, the increase in borrowing by non-financial corporations (NFC) in the second quarter of the year was accompanied by a similar increase in deposits placed by borrowers with banks, as many NFCs used standing credit lines in order to have the reassurance that they would maintain access to liquidity. Another group of members pointed to government guarantees as the current driver of loan growth, which were, however, temporary in nature. Under these circumstances, banks opted for allocating TLTRO III funds also to activities with lower returns, such as: (i) the fulfilment of the two-tier system exemption allowance; (ii) liability substitution – except for liabilities that are required to comply with MREL – and (iii) purchases of government securities with short maturities.

TLTRO III had a strong impact on money markets, resulting in lower interest rates, spreads and trading volumes. Most MMCG members mentioned that the ample excess liquidity had triggered an adjustment in banks' funding plans, leading to a decreased activity in both capital and money markets. The TLTRO III funding helped to narrow the spreads between long-term and short-term EURIBORs, this trend was accompanied by a reduction in underlying trading volumes.

MMCG members expected TLTRO bid limits to be fully exploited should the Eurosystem expand the additional credit claims (ACC) frameworks in all countries. According to some members, should this occur, the overall TLTRO III take-up could surpass €2 trillion by March 2021. Several MMCG members noted that the ACC framework was instrumental for a large take-up, as it provided relief for banks' balance sheets. Finally, some MMCG members expressed concerns about potential cliff effects in cases where the maturing TLTRO operations were not backed by future Eurosystem bridging operations.

2) Review of money market developments

Werner Driscart (Belfius) presented recent developments in the unsecured and secured segments of the money market, while Jürgen Sklarczyk (Deutsche Bank) and Bineet Shah (Barclays) covered the FX swap segment.

The €STR had shown less downward pressure and greater stability throughout the crisis than the EURIBOR. The latter had sustained strong upward pressures at the onset of the COVID-19 crisis but declined substantially once central banks measures were put in place. By contrast, even the technical glitch of the €STR calculation in August had not had a significant impact on the published rate. Some MMCG members pointed out that the volume in the €STR OIS derivative markets had not yet picked up, as traders were relying on established habits in the more liquid EONIA OIS markets during the crisis months.

In repo markets, trading of special collateral remained predominant. MMCG members attributed it to the ECB's asset purchase programmes and heavy sovereign issuances. To avoid squeezes, the MMCG was of the view that the securities lending programme should remain in place. General collateral was traded at lower volumes, as there was less need for bank funding given the high levels of liquidity injected via the TLTROs. Other members confirmed the negative correlation between general collateral volumes and excess liquidity.

FX swap market spreads returned to pre-crisis levels. This was mostly attributed to the excess liquidity provision in the United States and the available swap line between the ECB and the Federal Reserve System as a valid backstop. It was noted that backstop swap lines with little stigma had been instrumental for the normalisation of USD funding conditions and should become permanent, also for other currencies. For the year-end 2020, low volatility was expected. Markets saw the Federal Reserve reintervening should the stress on US dollar funding markets return. Members praised the recently established euro liquidity lines with central banks in Europe as well as the EUREP announcement.

3) Update and exchange of views on the ACC framework

Isabel Kerner (ECB) presented some information on the recent changes to and extensions of ACC frameworks across the euro area and Andreas Biewald (Commerzbank) reported on the pros and cons of ACCs and the issues arising from the different national set-ups in place.

There was a call for greater transparency regarding the types of collateral being used by banks within the Eurosystem across the different countries and for a more level playing field regarding the use of ACCs as collateral for Eurosystem operations. The ACC framework allowed Eurosystem NCBs to address specific collateral needs in their jurisdiction by taking into account the country-specific legal, operational and market situation around credit claims. While ACCs have existed in some jurisdictions since December 2011, the framework was extended in the context of the ECB decision of 7 April 2020, which facilitated the acceptance of ACCs backed by COVID-19-related public sector guarantees, lowered the ACC requirements relating to internal ratings and eased ACC loan-level reporting obligations. 14 NCBs had so far implemented or amended their existing ACC frameworks. The MMCG expressed a desire to see ACC frameworks more uniformly established across countries in order to foster a level playing field among institutions and to improve transparency. Some MMCG members felt that the eligibility of ACCs in all jurisdictions was needed to more evenly allow those assets to be used as collateral in the TLTROs and to free up space on banks' balance sheets.

4) Money market perspective on future ECB decisions, including its policy strategy review

Miguel Ángel Monzón (BBVA) presented market expectations for further monetary policy measures[1], while Harald Bänsch (Unicredit) and Ileana Pietraru (Société Générale) provided an overview of market considerations surrounding the ECB's strategy review. The views of the members differed.

Some MMCG members expected a continuation of the same policy with minor adjustments. This group of MMCG members expected the economic outlook to remain weak and fragile and inflation to continue to be below target. Under such a scenario, they were of the opinion that that the ECB should persevere with easing measures in order to support economic growth, avoid fragmentation and stimulate inflation. These members anticipated further negative rates and larger liquidity over a longer time. The former could arise in the form of rate cuts, through a new series of TLTROs that provide funds on very favourable terms, or by strengthening the forward guidance, for

[1] This was Item 3b on the agenda but related to the discussion surrounding the ECB's strategy review.

instance by yield curve targeting[2]. The latter could materialise through additional lending operations and asset purchases. At the same time, some of these members also expected small adjustments to the ECB's policy that may include: (i) some tolerance of inflation temporarily above 2%, similar to the Federal Reserve; (ii) the revision of the inflation basket to better reflect housing costs; (iii) a substantial increase in the two-tier multiplier as soon as excess reserves reach €3 trillion to provide relief for banks that cannot pass through negative remuneration to retail deposits; (iv) swap lines among central banks as a backstop to becoming permanent. Some of these members felt that the negative interest rate policy applied by the ECB had had some negative effects but that overall it had been positive for banks, because it constituted an indispensable support for credit risk.

Other MMCG members believed that a bold change to the monetary policy was needed. This group considered that the mechanism of excess liquidity stimulating credit provision by banks and leading to higher inflation was no longer working. Some of them claimed that it was time for fiscal authorities to step in to foster European integration and free up large central bank resources for its inflation task. According to these members, further negative rates and larger excess liquidity over a longer period would be counterproductive for banks. Others mentioned that the asset purchase programme created a scarcity of high-quality liquid assets, thereby also having an adverse impact on other market participants such as pension funds. The regulatory costs imposed on banks were already shifting intermediation to the non-banking sector. These members wondered whether this shift may be responsible for the insufficient transmission of the ECB's bold monetary policy impulse to the economy. They believed it may be the right time for a change and hoped that this could come from the comprehensive reflection embedded in the ECB's strategy review. At the same time, (cross-border) consolidation in the banking sector and further harmonisation was slow due to the lack of structural pressure on legislators and authorities as a result of relying rather too heavily on the success of monetary policy actions.

5) Other items

This was the last meeting with Cornelia Holthausen acting as Chair of the MMCG. The MMCG members expressed their gratitude for her role as Chair and wished her every success in her future roles and responsibilities.

[2] This might be a complement to state-based forward guidance, however, it should consider the undesired effects and fragmentation risks arising from the lack of a common euro area yield curve.

List of participants

Money Market Contact Group meeting

Participant's organisation	Name of participant
Bank of Ireland	Mr David Tilson
Barclays Bank	Mr Bineet Shah
Bayerische Landesbank	Mr Harald Endres
BBVA	Mr Miguel Angel Monzón
Belfius Bank & Insurance	Mr Werner Driscart
BNP Paribas	Mr Patrick Chauvet
BPCE/Natixis	Mr Olivier Hubert
Caixabank	Mr Xavier Combis Comas
Caixa Geral de Depósitos	Mr António Paiva
Commerzbank	Mr Andreas Biewald
Coöperative Rabobank U.A.	Mr Frank Beset
Deutsche Bank	Mr Jürgen Sklarczyk
DZ Bank	Mr Oliver Deutscher
Erste Group Bank	Mr René Brunner
HSBC	Mr Harry Gauvin
ING	Mr Jaap Kes
Intesa Sanpaolo	Ms Maria Cristina Lege
LBBW	Mr Jan Misch
Nordea	Ms Jaana Sulin
Société Générale	Ms Ileana Pietraru
UniCredit Bank	Mr Harald Bänsch
European Central Bank	Ms Cornelia Holthausen (Chair)
European Central Bank	Mr Fabio Panetta (Member of the Executive Board)
European Central Bank	Mr Julija Jakovicka
European Central Bank	Ms Maria Encio (Secretary)