EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS 13 December 2019

ECB Money Market Contact Group

Tuesday, 3 December 2019, 13:00-17:00 CET, Frankfurt

SUMMARY OF DISCUSSION

1. Review of the latest money market developments and expectations for 2019 year-end

António Paiva (Caixa Geral de Depósitos), Harald Bänsch (UniCredit), Jaana Sulin (Nordea), Bineet Shah (Barclays) and Neil McLeod (Erste Group) presented the main developments in the euro money market.

The Money Market Contact Group's (MMCG) sentiment regarding the first reserve maintenance period with *the two-tier system* is positive. It triggered sizeable and swift cross-border liquidity flows in the repo segment, especially towards Italy, with no material impact on rates and so far only a 2 to 3-basis point uptick in Italian and Spanish general collateral repo rates. MMCG members expected a larger impact on rates, as for them the two-tier system is a new asset class of €800 billion at 0% return that qualifies as high-quality liquid assets. Other members added that the realised effects were lower due to liquidity frontloading and a shift in liquidity to shorter tenors to fill unused allowances early in the maintenance period. The maintenance period starting on 18 December 2019 will again test the resilience of the Italian repo market, as the two-tier system will confluence with two other liquidity-absorbing factors, namely the year-end and a sizeable tax collection exercise in Italy. The risk of renewed upward pressure was seen as small, as the APP will increase excess liquidity, thus exercising downward pressure on rates.

The MMCG believes that the upcoming *TLTRO allotment and repayments* could lead to liquidity absorption, as TLTRO II repayments may likely be larger than the take-up from TLTRO III.2. For reporting purposes, some banks will wait for TLTRO III operations next year, so as not to expand their balance sheets over the year-end. Although a significant share of the TLTRO II amount will probably be rolled over once the seven TLTRO III operations have concluded, a lower overall take-up is expected.

As regards *year-end price developments*, repo markets are so far calm in all jurisdictions and liquidity conditions are good. Some upward pressure on repo rates for non-core collateral is still expected in late December, as investors providing cash in those markets are likely to withdraw. For collateral in core jurisdictions, effects may be moderate because of early preparations and sufficient collateral availability. As regards the FX swap segment, MMCG members foresaw a year-end similar to 2018, characterised by an early widening of spread levels and some volatility, but less stress than in 2017. An important factor this year is that the demand for USD funding is mainly driven by US domestic market participants acting in the USD repo market and not so much by the demand of foreign market participants in the FX swap market. Considerable focus continues to be on the level of excess reserves in the United States and the segmentation of the US repo market. The high level of concentration, combined with the conservative level of liquidity buffers of US market participants and the high costs of intra-day liquidity, contributes to the reluctance to lend cash.

2. Developments in short-term securities issuance

Harald Endres (Bayerische Landesbank) and Olivier Hubert (BPCE/Natixis) discussed developments in short-term debt security issuance.

Statistics for the last two years show a stable path for Short-Term European Paper (STEP) and a moderate increase for French Negotiable European Commercial Paper (NEU CP). Both markets are currently mostly driven by newcomers rather than prior participants. They include non-banks, which have expanded their funding on capital markets. Monetary financial institutions are still the most significant group of issuers, but on the demand side money market funds (MMFs) have traditionally been the largest holders, although their holdings decreased during the financial crisis. The decline continued in the aftermath of the crisis, but reversed in 2014 when the negative rate on the deposit facility was introduced. This is because in the negative interest rate environment, investors may turn to MMFs investing in commercial paper, as an alternative to bank deposits, since the remuneration of the latter can be below the deposit facility rate. Moreover, banks prefer to issue short-term paper and sell it to non-financial corporations, rather than providing them with bank loans, given the narrow margins imposed by strong lending competition. As yet, no “green” short-term securities have been issued.

3. European mechanism for the issuance and initial distribution of debt instruments (EDDI)

George Kalogeropoulos (ECB) presented the results of the public consultation, which are currently being analysed by the Eurosystem to prepare a proposal for the ECB’s decision making bodies. An announcement by the Governing Council is not envisaged before Q1 2020.

Although market response to the public consultation is mixed, broad agreement on two elements was established. First, further information regarding the implementation model, legal set up, costs and timelines would be required to complete the impact analysis. Second, there is room for harmonisation and standardisation in the full transaction chain, i.e. from the pre-issuance to the post trade.

Some MMCG members see merits on EDDI, especially considering the current situation, where bonds flow from an issuer to a bank and from there to the ultimate investor with a settlement risk of up to T+5 days. Very often this liquidity is split between the central bank money environment of T2S and the commercial bank money environment of international central securities depositories. The advantage of EDDI’s use of a single liquidity pool in central bank money is that it would facilitate settlement of the operation within a day or even a few hours, thus facilitating intra-day liquidity management and reducing settlement risk. Other MMCG members voiced criticism of the initiative, arguing that EDDI would reduce the need for banking intermediation and might eliminate the income from syndication fees, which represent a source of revenue for banks, particularly appreciated in the current negative interest rate environment. The ECB clarified that EDDI is foreseen as an optional and modular service, i.e. enabling issuers, their agents and investors to decide how they want to engage with one other and what issuance models to pursue, independently of which banks or alternative issuance platforms they wish to use.

4. First experiences with the new €STR benchmark

Miguel Angel Monzón (BBVA) presented an overview of the developments since 2 October 2019. Most of the challenges that market participants faced were of a technical nature and were non-critical. Some banks followed provisional solutions due to the change in publication time. Market participants had started to trade €STR-based instruments, however, volumes remained low. MMCG members attributed this to the old habits of market participants, who do not have an incentive to switch. MMCG members believe that the use of €STR will become more wide-spread once CCPs start discounting it by default, which is expected in June 2020.

MMCG members noted that the €STR had been sensitive to the concentration of the top five banks' transactions on some days. It was clarified that, by construction, a transaction-based benchmark can be volatile, also shown in the historical pre-€STR data, representing actual market conditions. The ECB referred to the upcoming quarterly reports on €STR developments for the review of the recent spikes observed in the €STR.

List of participants
Money Market Contact Group Meeting

Participant's organisation	Name of participant	
European Central Bank	Ms Cornelia Holthausen	Chair
European Central Bank	Ms Maria Encio	Secretary
European Central Bank	Ms Julija Jakovicka	
Bank of Ireland	Mr David Tilson	
Barclays Bank	Mr Bineet Shah	
Bayerische Landesbank	Mr Harald Endres	
BBVA	Mr Miguel Monzón	
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 Bank	Mr Neil McLeod	
HSBC	Mr Harry Gauvin	
ING	Mr Jaap Kes	
Intesa Sanpaolo	Ms Maria Cristina Lege	
LBBW	Mr Jan Misch	
Nordea Bank Finland	Ms Jaana Sulin	
Société Générale	Ms Ileana Pietraru	
UniCredit Bank	Mr Harald Bänsch	

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

Via teleconference	Name of participant
Banco de España	Mr Enrique Esteban
Banco de Portugal	Mr Luis Sousa
Bank of Greece	Mr Michail Sfakianakis
Banka Slovenije	Ms Tina Ritonja
Banque centrale du Luxembourg	Mr Achim Hillen
Central Bank of Cyprus	Mr Marios Karsoumas
Central Bank of Ireland	Mr Patrick Haran
Central Bank of Malta	Ms Josette Grech
Eesti Pank	Ms Karoline Jostov
Oesterreichische Nationalbank	Ms Bettina Moser
Oesterreichische Nationalbank	Ms Maria Thury
Suomen Pankki	Ms Päivi Heinäaro-Ehgartner