EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS 19 August 2013

Money Market Contact Group meeting

Helsinki, Monday, 17 June 2013, 14:30-18:30 CET+1

S U M M A R Y   O F   T H E   D I S C U S S I O N

1. Review of the latest market developments.

Mark Dearlove presented the regular review of market developments since the last MMCG meeting.

MMCG members noted an increase in the volatility of money market rates due to general market factors (e.g. LSAP tapering discussion in the US), changes in market expectations on ECB policy rates, and perceived passive liquidity tightening due to VLTRO repayments. Developments in autonomous factors over the past maintenance period were volatile and also contributed to a temporary liquidity tightening. As a result, the 1y-1y EONIA forward rates rose to 57 bps, for the first time quoting above the MRO rate since July 2011.

The upcoming quarter-end was a concern for some MMCG members and the EONIA rate over that date was expected to rise by at least 10 bps (vs. +4 bps over the previous month-end). Also the marginal rate of the ECB 1-week SMP absorption operation was expected to increase towards 50 bps.

With regard to market expectations on ECB policy measures, MMCG members brought forward a number of ideas which could help to address the volatility of the EONIA rate and to limit the pace of passive tightening. These measures included a narrowing of the monetary policy rate corridor (a cut in the rate of the main refinancing operations, while keeping the rate of the deposit facility unchanged) and/or a parallel downward shift in all ECB rates. The recent narrowing of the corridor on 2 May reportedly reduced banks' incentives to repay the 3-year VLTRO funds and another cut in the MRO rate could be used as a tool to further reduce the pace of passive tightening. However, some MMCG members remarked that this measure could come at the cost of lower market trading activity and a larger intermediation role of the ECB. Meanwhile, according to MMCG members, structural problems in the flow of cash/collateral across the euro area should be addressed by other measures addressing the root causes of the remaining market impairment.

MMCG members also raised a number of other issues which were considered to have a strong impact on the money market developments: (i) An exceptional level of regulatory uncertainty, complemented by the uncertainty on the implementation of a financial transaction tax in some euro area countries, was judged to have a detrimental impact on the normalisation and re-integration of the euro area money market. For instance, prevailing uncertainty about the financial transaction tax reportedly forced counterparties to avoid trading repos maturing after 1 January 2014, the date when the tax was scheduled to come into force. Similarly, regulatory plans with regard to a maximum leverage ratio and minimum haircuts in repo transactions also contributed to create significant uncertainty of the future of key money market segments. (ii) A non-harmonised application of market regulation across countries and 'gold-plating' was seen as a major issue and the establishment of the Single Supervisory Mechanism was very much awaited to resolve this. (iii) Finally, a lack of transparency and predictability in the risk management policies of the central clearing counterparties (CCPs) were seen negative for cash lenders investing in the Spanish and Italian repo markets (see below). It was noted that CCPs have (intentionally) developed into systemically predominant players in repo markets, while their risk management policies were not necessarily taking into account this new situation.

2. Developments in the secured money market

Jose Rull and Alberto Covin provided an overview of recent developments in Spanish and Italian repo markets.

Spanish repo market remained largely domestically-oriented with limited volumes traded among domestic and international banks and with a notable degree of divergence between the two segments in terms of rates, traded maturities and haircut levels. Overall, Spanish repo market daily trading volumes in 2013 increased somewhat compared to the 2012 levels but remained lower than in 2011. Meanwhile, repo volumes cleared by the international CCPs did not recover and remained at very low levels, mainly due to high haircut levels and limits, thus limiting Spanish banks' access to the international repo market. However, some tentatively positive developments on the CCP limits side were also reported.

Also in Italian repo market, centrally-cleared repo transactions represented an important channel for domestic banks to refinance their large holdings of the government debt. Hence, changes in the CCP risk management practices had a large impact on the cross-border flow of liquidity in the repo market, both in terms of volumes and pricing. Uncertainty and a perceived lack of transparency about potential changes in the CCP risk management framework reportedly prevented international banks from lending at longer maturities.

Andreas Biewald updated the group on the most recent developments in COGESI work which would help to improve the cross-border use of collateral and improve settlement efficiency. A comprehensive update on the COGESI work will be provided at September meeting by the ECB staff.

3. Update on money market benchmarks, the on-going reform process and transaction-based data collection exercise.

A status update on the MMCG participation in the transaction-based data collection exercise

Roberto Schiavi informed the MMCG that the level of participation in the transaction-based data collection exercise was high and 56 banks took part. He expressed his appreciation of the participating banks for their efforts. He also reported that the EBF Task Force was analysing the data and would soon organise a workshop among contributing banks to discuss its findings and possible solutions.

As key finding of the transactions-based data collection exercise, it appeared that interest rates of actual transactions were generally consistent over the test period with reported Euribor rates. The data however also suggested that transactions volumes were limited beyond the 3-month tenor.

EONIA-Euribor panel split

The Chairman (Ulrich Bindseil) recalled the ECB press release on this topic, highlighting the importance of this decision by the EBF and the related expectations on its implications on panel membership.

Eurepo and new alternative secured market benchmarks.

Harald Endres provided an overview of the currently available secured market benchmarks. It was noted that the usage of the Eurepo rate in the market as a secured market benchmark had been limited, which could partly be attributed to the fragmented nature of the euro repo market. Two other recently established secured market benchmarks (Stoxx GC Pooling Funding Rate and Repo Funds rate) addressed some of the above concerns (both are transaction based) but were not considered to be suitable replacements for the Eurepo (due to their methodology, lack of maturity structure, and governance).

In general, secured benchmarks were not seen as a potential alternative to the unsecured benchmark rates, such as Euribor, as contrary to the unsecured rates, these were not seen suitable in pricing unsecured loans.

4. LCR and its impact on bank funding.

Laurent Cote presented an overview of the most recent changes to the LCR requirements which were announced in January this year. Although no official estimates were available, the introduced changes generally helped to improve the LCR compliance by the European banks.

National discretion with regard to interpretation of the LCR rules by the national regulators was seen as a major concern from a level playing field and efficiency perspective, and several MMCG members urged for the uniform application of liquidity regulations across jurisdictions.

5. Other business

Next MMCG meeting will take place in Frankfurt on 3 September to be followed by an annual MMCG dinner.