



EUROPEAN CENTRAL BANK
EUROSYSTEM

DG MARKET OPERATIONS

23 January 2014

Money Market Contact Group

Frankfurt am Main, Tuesday, 10 December 2013, 1 p.m. – 5 p.m. CET

Summary of the discussion

1. Review of the main findings of the Euro Money Market Survey

Pascal Nicoloso (ECB) presented the main findings of the quarterly Euro Money Market Survey (EMMS), focusing, in particular, on market functioning and fragmentation. The overall interbank money market turnover in the third quarter of 2013, as measured by the activity of the survey participants, remained subdued and broadly stable compared with previous quarters. The level of market fragmentation was illustrated by the geographical distribution of counterparties and collateral used. It was noted that the level of segmentation varied across market segments and countries. For unsecured lending, banks in core countries showed a clear preference for domestic counterparties, whereas the repo lending of these banks was oriented more towards non-domestic counterparties and non-domestic collateral. Members of the Money Market Contact Group (MMCG) remarked that the survey under-represented the importance of the unsecured money market for bank funding. In particular, the commercial paper/certificates of deposit market, which was an active market, was dominated by institutional investors and was therefore not captured by the EMMS.

2. Review of the latest market developments

Frédéric Mouchel presented an overview of market developments since the last meeting. A number of positive developments were noted with regard to market confidence in the European banking sector, as reflected in: (i) the positive performance of banking shares compared with the broad Euro Stoxx index, (ii) convergence in bank credit premia (as measured by credit default swaps) both within the European banking sector and also between the European and US banks, (iii) stable deposit balances and improvements in TARGET2 balances, and (iv) renewed investment activity on the part of US money market funds with the European banks and with French banks in particular. On the money market side, the FRA-OIS spread converged to 10 basis points, which stood close to the pre-crisis levels. Furthermore, since the Fed tapering discussions, there had been a clear decoupling between the USD, GBP and euro interest rates.

The cut in the interest rate on the main refinancing operations (MROs) surprised markets, as reflected in the reaction of the one-year EONIA forward rate one year ahead. The impact of the cut on market activity was limited as banks preferred to pay a premium above the MRO rate to secure market funding and no significant recourse to central bank refinancing was observed.

In line with the decline in excess liquidity, the EONIA rate had exhibited an upward trend over recent months, which was also reflected in a rise in core repo rates. A number of MMCG members were

concerned that the “normalisation” of the EONIA towards 25 basis points was too swift in view of the current state of market functioning and fragmentation. In their view, the tightening was driven by the pace of the ongoing repayments of the three-year longer-term refinancing operations, which exceeded the pace of the market normalisation and was partly attributed to banks’ reluctance to participate in central bank operations.

In the MMCG’s view, the normalisation of the euro money market and of the monetary policy transmission mechanism continued to be hampered by national limits on cross-border flows, as subsidiaries of the same bank were forced to deposit their excess funds with the Eurosystem in one jurisdiction and borrow funds in another jurisdiction.

The forthcoming year-end calendar effect was widely discussed and, in the MMCG’s view, the year-end tensions in 2013 were amplified by a combination of a reduction in excess liquidity, regulatory constraints, the timing of Italian tax payments, and some banks’ intentions to limit their recourse to central bank funding at the year-end. Market pricing at the time of the MMCG meeting implied overnight unsecured money market rates at the year-end of 50 basis points and above. In the repo markets, especially in Spain and Italy, the turn of the year premium, as priced in the one-month repo rates, was even higher, in part reflecting the forthcoming large tax payments in December in Italy. Nevertheless, a number of MMCG members expected the actual EONIA rate over the year-end to be lower than was implied at that time in the market rates.

The topic of negative rates on the deposit facility as a potential monetary policy measure was revisited and a number of MMCG members warned of a possible adverse impact on money market activity, although one member noted that it could improve market fragmentation across euro area countries.

3. The ECB’s comprehensive assessment of the euro area banking system and its impact on the money market

Edward O’Brien (ECB) presented the main elements of the ECB’s comprehensive assessment and addressed MMCG members’ questions on the subject. In particular, he stated that:

- (i) The Leverage Ratio will be used as an additional qualitative indicator in the ECB’s comprehensive assessment, but not as a fixed assessment parameter. This is in part due to the continuing uncertainty with regard to the final definition of the Leverage Ratio.
- (ii) Bank funding issues, liquidity ratios and central bank funding will not be covered in the Asset Quality Review exercise.
- (iii) The purpose of the assessment is to ensure a harmonised treatment of sovereign bond holdings, and these holdings will only be assessed on the basis of consistency in accounting treatment.

Finally, he assured the members that room for national discretion in the comprehensive assessment is very limited and consistency in the assessment across banks and countries is deemed to be of high importance so as to ensure the credibility of this exercise.

4. Update on the current status of regulatory work

Michael Wedow and Jürgen Kirchhof (ECB) provided an update on the ongoing regulatory work on the Leverage Ratio, Liquidity Coverage Ratio and Net Stable Funding Ratio.

MMCG members expressed their concerns about a lack of clarity with regard to the exact definition of the ratios and their impact on the financing of the economy and on monetary policy. In particular, MMCG members stated that:

- (i) The regulatory ratios were already widely used by banks and analysts but the exact definitions of these ratios were still under discussion in the regulatory fora and some critical issues had not yet been clarified.
- (ii) There was a large variety of liquidity ratios, including national ratios and the Liquidity Coverage Ratio, all of which the banks had to comply with.
- (iii) Under the current definition of the Liquidity Coverage Ratio, there could be an increase in market demand for central bank funding for regulatory purposes, particularly if mitigating measures, such as Committed Lending Facilities, were not implemented.
- (iv) The Leverage Ratio was preventing banks from fulfilling their role in safekeeping customers' money, as banks were forced to reject customers in order to comply with the ratio.
- (v) Concerns regarding the international level playing field could arise if regulations were not uniformly implemented across different jurisdictions, e.g. in the euro area, the United States and the United Kingdom.

The ECB participants stated that the ECB shares the objectives of the regulatory initiatives to strengthen the resilience of banks and contribute to enhancing the stability of the financial system. At the same time, the ECB recognises and monitors the impact of regulatory initiatives on participation in central bank operations, on monetary policy implementation and on the functioning of market segments, which are relevant for monetary policy implementation, including the money market.

5. Other business:

a. Update on money market reference rates and on the ongoing reform process

Holger Neuhaus (ECB) updated the group on the current status of the transaction-based data collection exercise conducted by the ECB and thanked MMCG members for their cooperation.

b. Update on the STEP+ initiative

Benjamin Sahel (ECB) reviewed the main facts of the market initiative aimed at supporting the unsecured money market (also known as STEP+). He also informed the MMCG that in line with the ECB's involvement in the earlier STEP initiative, the ECB will act as an observer in the STEP+ initiative and will host the first meeting of STEP+ in January 2014. The market initiative is seeking volunteers to support the workstreams and the steering task force, which will be chaired by Francesco Papadia, and MMCG members were asked to express their interest in participating via the MMCG Secretariat.

c. Money Market Statistical Reporting initiative

Guido Della Valle (ECB) informed the MMCG about the Eurosystem's Money Market Statistical Reporting (MMSR) initiative. The initiative is useful from a monetary policy perspective and aims at filling the increasingly evident gap in money market data in order to better interpret the environment in which the monetary policy transmission mechanism operates. As a preparatory step, the Eurosystem (via the national central banks) will ask market participants to complete a fact-finding questionnaire.

Some MMCG members questioned whether the MMSR would further increase the reporting burden on banks. Guido Della Valle reassured the MMCG that the Eurosystem intends to exploit synergies and avoid overlaps with other reporting obligations to the extent possible. The MMSR would also make some of the current ad hoc and regular surveys and reporting redundant.

d. Timing of the next meeting

The next MMCG meeting will take place in Frankfurt am Main on 18 March 2014.