EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

24 June 2020

ECB Money Market Contact Group (MMCG)

Tuesday, 16 June 2020, 14:00-16:30 CET

(meeting held by teleconference)

Summary of the discussion

1) Review of developments in the money market

With money market stress somewhat receding, the discussion focused on the money market segments most affected by the coronavirus (COVID-19) pandemic. Michael Schneider (DZ Bank) presented the latest developments on euro money market rates, including EURIBOR, Harald Endres (BayernLB) and Olivier Hubert (Natixis) on the issuance of commercial paper and Patrick Chauvet (BNP Paribas) on US dollar funding conditions.

The MMCG noted that EURIBOR acted as a lagging indicator during the crisis. A complete suspension of the 3-month euro money market trading from mid-March to end-April 2020 was reported. During this period there was a persistent disruption of the term money markets due to investors' groups facing liquidity risks. Money market funds (MMFs) and small and medium-sized enterprises suffered significant liquidity stress while liquidity of retail and institutional clients remained stable. MMCG members considered MMFs' liquidity constraints had a disproportional upward impact on EURIBOR given the low volumes supporting its calculation. This implied that EURIBOR only reflected market conditions with some delay during the crisis.

The issuance of commercial paper was mainly sustained by the public sector. Short-Term European Paper and Negotiable European Commercial Paper markets have seen overall stable volumes during the crisis but with very uneven behaviour across types of issuer. In March, financial institutions notably reduced volumes and maturities of new issuances of commercial paper in the primary market due to numerous requests to buy back former issuances held by MMFs suffering cash withdrawals. In the meantime, public issuers increased volumes and maturities of new issuances of commercial paper from March to May. The offsetting effect of both developments meant that the total issuance level remained stable. In May financial institutions returned to the primary market with new issuances in volumes similar to those before the COVID-19 crisis but still with lower average maturities. The MMCG noted that, since May, MMFs have been slowly and gradually recovering their holdings of commercial paper with longer average maturities.

MMCG members praised the European Central Bank (ECB) for its fast, decisive and prompt actions. According to MMCG members, the ECB's multiple actions were decisive in containing volatility in the very short tenors of money markets while the effects on longer tenors took more time to materialise. The inclusion of commercial paper in the pandemic emergency purchase programme (PEPP) was considered instrumental for alleviating tensions in the unsecured market for short-term securities. The MMCG regretted that a level playing field on the additional credit claim (ACC) frameworks has not yet been completed, which was, according to some members, the most important collateral measure decided by the ECB. Finally, it was reported that ample liquidity in the repo market throughout the COVID-19 crisis had accelerated the recovery of the euro money market.

US dollar liquidity provision by the swap line network of central banks was still considered necessary as a backstop even if usage had declined. The expansion of US dollar liquidity provision, in terms of pricing, maturities and frequency, efficiently and quickly halted US dollar funding stress and brought it down to below the 2008 levels. The large injection of liquidity provided by the Federal Reserve helped to normalise liquidity conditions in the shorter maturities, but 3-month LIBOR rates and 90-day commercial paper issuance took more time to normalise. As commercial paper issuance slowed and shortened sharply, several LIBOR panel members had to resort to expert judgement in their contributions. This in turn created an unprecedented dislocation in the LIBOR-OIS spreads. By mid-June US dollar funding conditions returned to the pre-COVID-19 levels and MMCG members expected no major dislocations during the forthcoming quarter-end. Overall, MMCG members noted that the US dollar funding situation was much less acute for euro area banks compared to their foreign counterparties in other jurisdictions. Nevertheless, swap lines were still considered an important backstop even if usage is reduced due to improved market pricing and alternative usage of collateral for the upcoming targeted longer-term refinancing operations (TLTROs).

The MMCG mentioned that the announcement from European banking supervision on the temporary leeway on compliance with the liquidity coverage ratios was not used widely by banks. Some MMCG members noted that the European banking supervision announcement helped, while others claimed that, due to high reputational risks associated to different interpretations of the level of tolerance, the leeway was not used in practice and did not achieve the desired effect.

2) Remote working arrangements and banks' liquidity management

Harry-David Gauvin (HSBC) reviewed the main organisational developments in the banking industry during the COVID-19 crisis and made a preliminary reflection on the future impact on productivity of home working and virtual teams.

The COVID-19 exercise had shown that flexible working arrangements may be feasible even on a large scale and productivity of teams can be sustained. The MMCG noted the need to draw a distinction between the amount of flexible working arrangements needed during the COVID-19 crisis and what is envisaged for the future on a more permanent basis. The COVID-19 working experience was affected by an externally imposed lock-down, which was amplified by supplementary stress (home-schooling, insufficient equipment or physical space in houses) and with the perspective of contained duration. The experience showed that flexible working arrangements were feasible even on a large scale and that teams remained productive. On the one hand, a MMCG member mentioned that there were significant benefits to flexible working arrangements which should not be lost, such as improving the scope for diversity within teams. On the other hand, it was also noted that the point had not yet been reached where market-making teams were fully effective working from home. These observations pave the way for a future MMCG debate on whether, and to what extent, larger flexibility in working arrangements may be extended in the future.

3) Market views on the recent ECB monetary policy measures

Xavier Combis (Caixabank) presented the market expectations for TLTRO III and pandemic emergency longer-term refinancing operation (PELTRO) uptakes. Frank Beset (Rabobank) presented market insights on further ECB policy measures.

The MMCG did not interpret expected large take-up in TLTRO III as a signal of banking sector weakness, rather the MMCG interpreted it as an opportunity. According to MMCG members, up to 50% of the circa €3 trillion to be offered may be already taken by 24 June 2020. Others expect a lower take-up, in the range of €1-1.2 trillion, limited by the individual distribution of eligible collateral available in the system. The take-up is expected to be broad and diverse, stemming equally from core and non-core banks as well as big and small banks. According to MMCG members, pricing and conditions of TLTRO III made it attractive for all type of banks because it served to alleviate the negative effects of the COVID-19 crisis on profitability by maintaining new yielding strategies or replacing more costly funding, such as cover bonds issuance. Most MMCG members did not attribute any stigma or regulatory concerns about banks' high reliance on the ECB funding via TLTRO III. Others drew some attention to consequences of large take-up on minimum requirements for own funds and eligible liabilities, and total loss-absorbing capacity compliance and banks' exposure to sovereign non-core bonds.

MMCG members saw PELTROs as a backstop facility. According the MMCG, most banks did not plan to use the forthcoming PELTROs on 24 June 2020. Still, they considered its availability as a useful backstop for EURIBOR or short-term non-core money market rates. Members pointed to the simplicity and higher frequency of the operations compared that of TLTRO III as a positive, especially for banks that exhaust their TLTRO III borrowing capacity.

Looking ahead, the MMCG expected an increase of the two-tier system multiplier in 2020. Most members expected the new multiplier to be between 9 and 10 times the minimum reserve requirement, while some mentioned that a multiplier up to 15 times the reserve requirement would be possible. In the MMCG's view, the increase of the multiplier would provide further relief for banks facing frictions with negative rates and would also limit the downward pressure on money market rates triggered by growing excess liquidity and entities with no access to ECB standing facilities. Trading with unused allowances of the two-tier system was seen positively by MMCG members, as a way to avoid further drying out interbank money market trading in reaction to the high levels and heterogeneity of excess liquidity across euro area jurisdictions and banks.

As lessons learnt for future crises, MMCG members would encourage the ECB to ensure similar ACC frameworks in all euro area countries and to define European banking supervision flexibility on regulatory ratios using clear numerical thresholds to make the guidance more operational. Furthermore, the market expects no changes in the ECB monetary policy rates or asset purchase volumes in the near future.

4) Developments related to the euro short-term rate (€STR) benchmark

Jaap Kes (ING) reviewed the main developments of the €STR during the COVID-19 pandemic.

The drop of volumes on swaps linked to the €STR was not a cause for concern at the current stage. €STR volumes and rates were only slightly increased during the COVID-19 crisis and have already returned to previous levels. The observed decrease in swap volumes linked to the €STR was explained by the switch of participants to more liquid instruments linked to EONIA swaps. As both rates were directly linked, MMCG members did not consider the drop in volumes to be a problem. The central counterparty discounting shift (now moved by five weeks to July) was still seen as the main event supporting the switch from EONIA to the €STR.

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 Fernando Soriano
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 Michael Schneider
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 Helmut Wacket
European Central Bank	Ms Maria Encio (Secretary)