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Money Market Workshop

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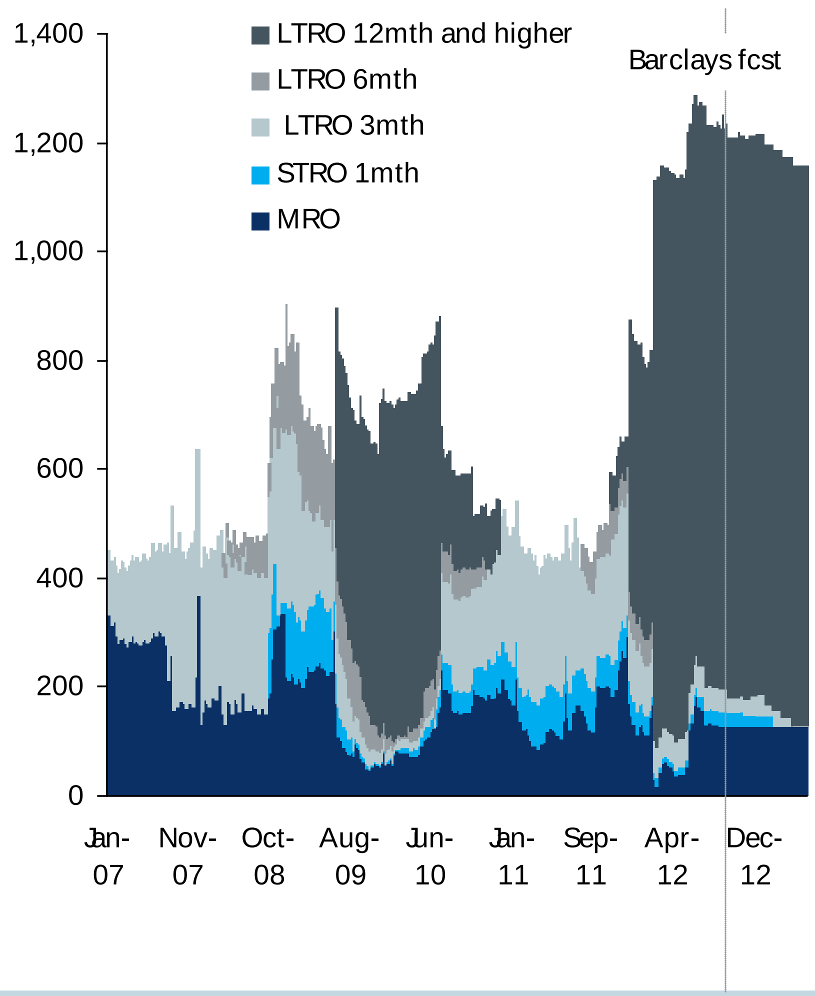
30/10/2012

Market Overview

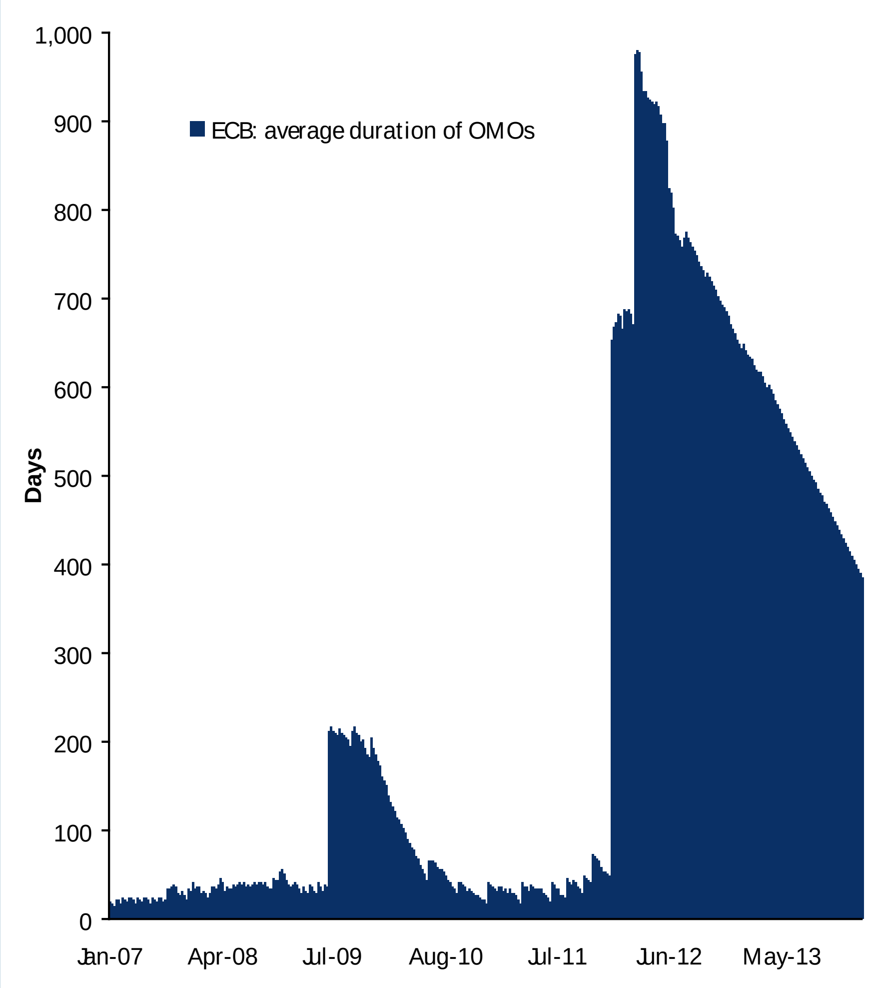
- 3y LTRO's: Increase in amount and average maturity of liquidity

ECB's operations by maturity (€bn.)



Source: ECB, Barclays Research

Average duration of OMO liquidity (days)

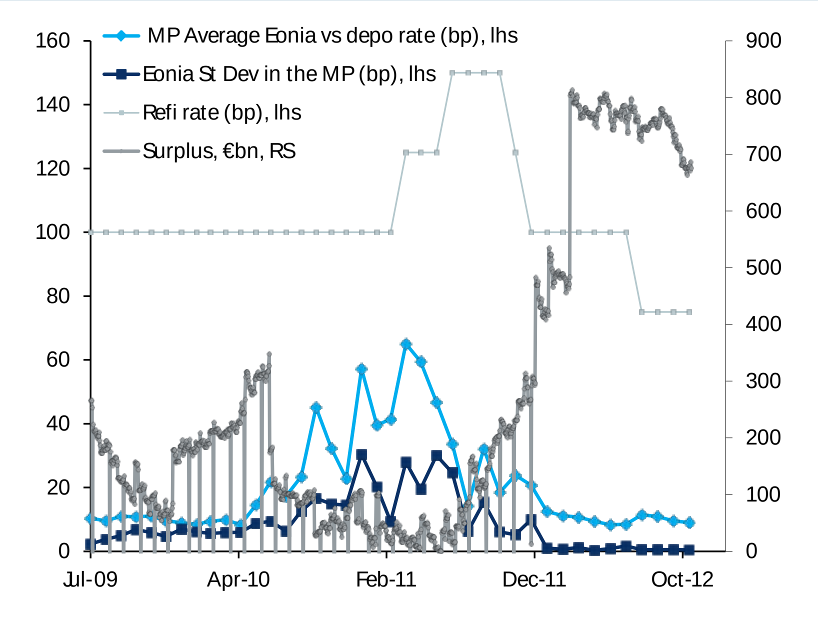


Source: ECB, Barclays Research

Market Overview

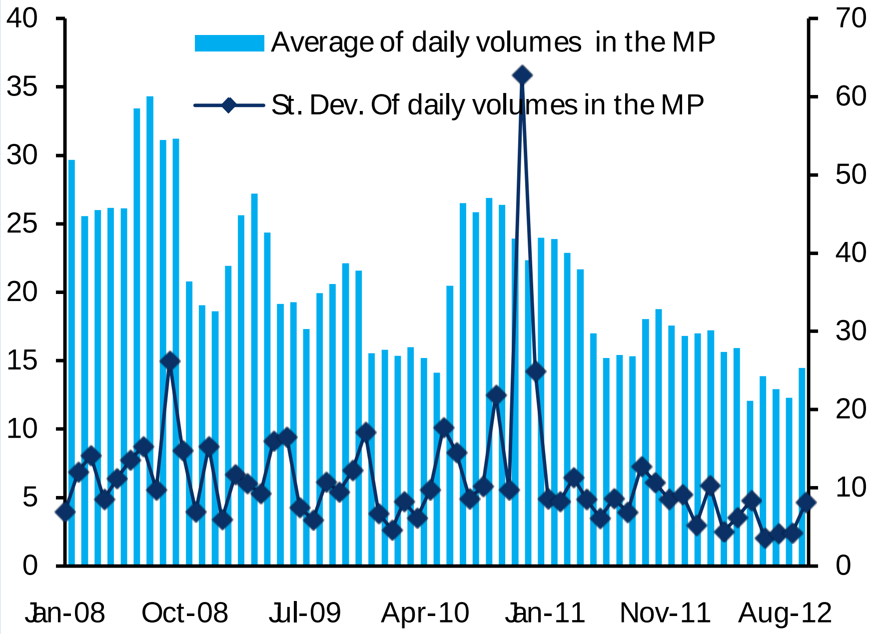
- Impact on EONIA market

Decline in the fixing and volatility



Source: EBF, ECB, Barclays Research

Drop in the volume as well (bp)



Source: EBF, Barclays Research

- The increase in the liquidity surplus has pushed the EONIA fixing down, reducing its intra-reserve period volatility
- As a consequence of the flood of the 3y liquidity, all banks have been long cash and this has reduced the volume in the EONIA market

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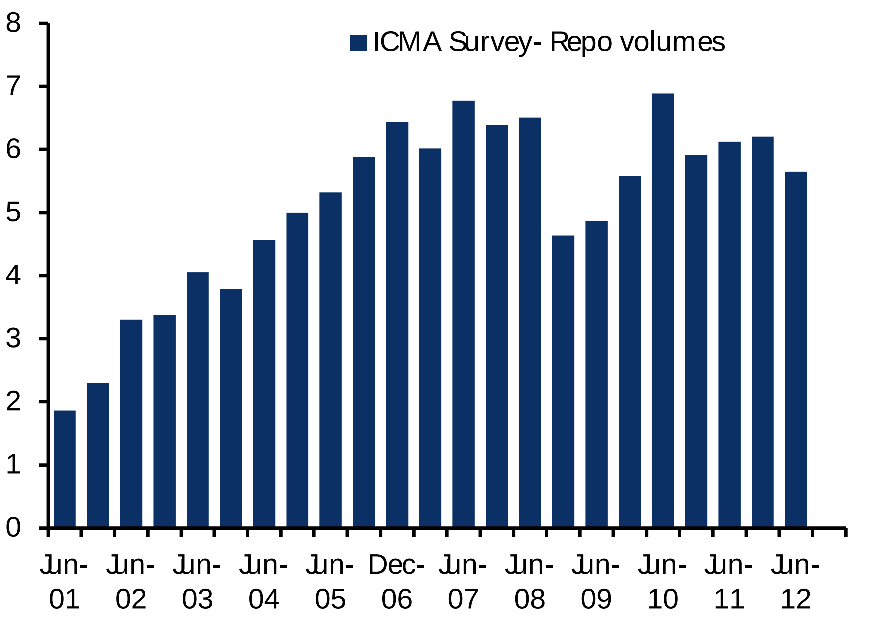
Market Overview

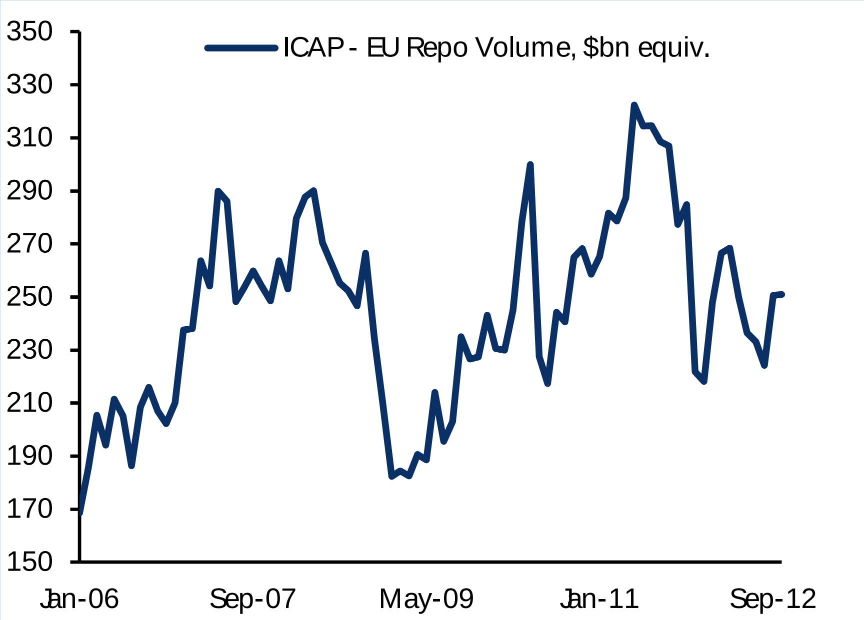
- Impact on repo market

ICMA – Repo Survey



Source: ICMA, Barclays Research

ICAP – Monthly Volume



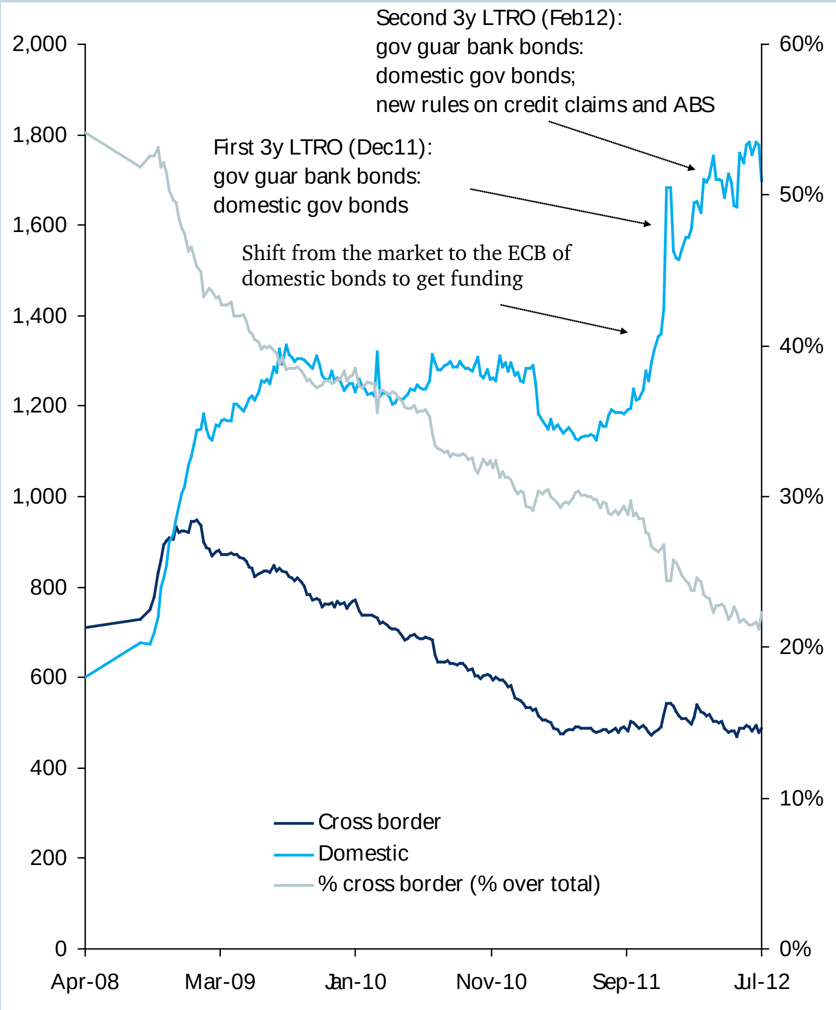
Source: ICAP, Barclays Research

- ICMA Repo survey shows a decline in the volume in the euro repo market in H1 2012. We believe that it is not related to the 3y LTRO's, but to the worsening of the eurozone debt crisis in Q2 2012
- Indeed, as ICAP monthly data show, volume increased in Q1 as the improvement in the sentiment favoured activity by Italian and Spanish banks. Volumes declined in Q2 because of the worsening of the sovereign crisis, with many Spanish banks moving from the market to the ECB for borrowing

Market Overview

- Use of collateral in eurosystem operations

Domestic vs. cross-border (€bn.)

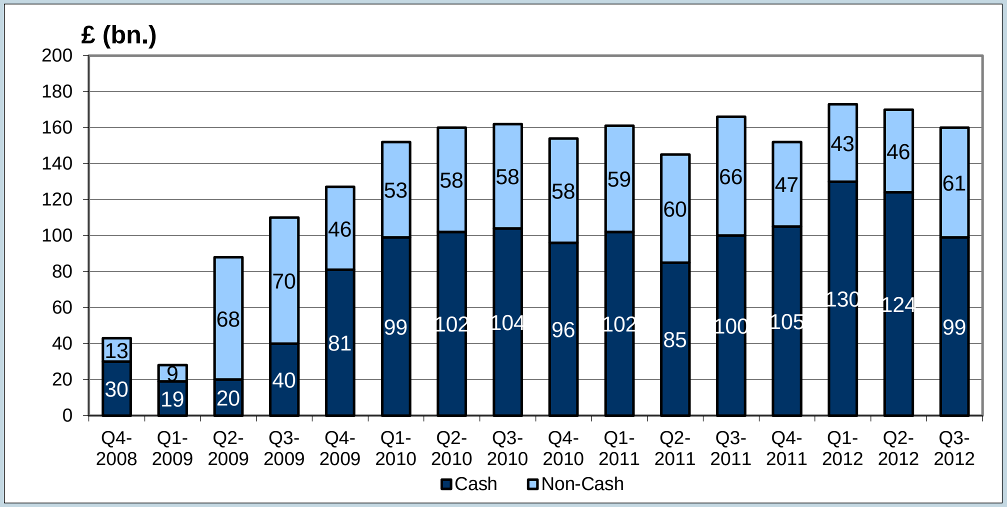


Source: ECB, Barclays Research

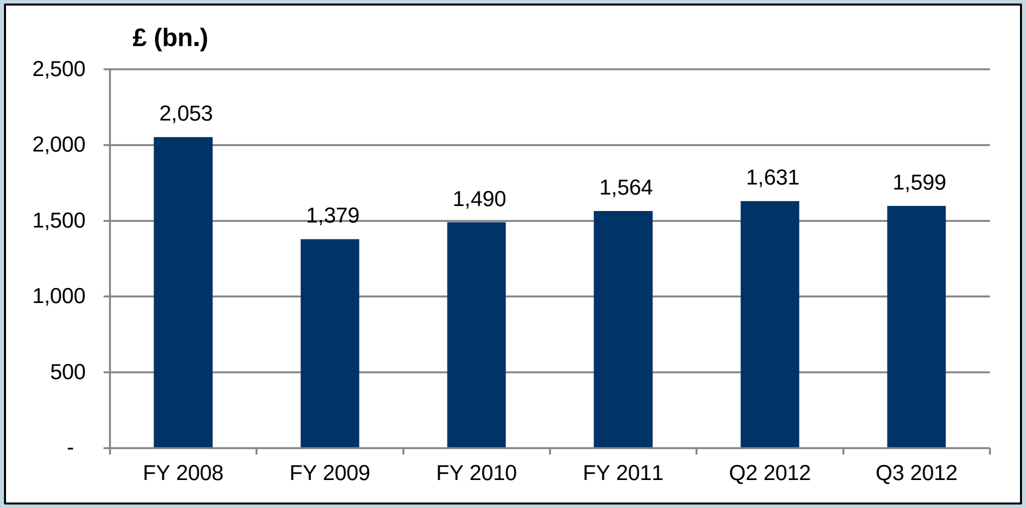
- Looking at the absolute level, the usage of cross border collateral has remained stable since Q1 2011
- The decline in cross border collateral used at the ECB is between 2008 and Q1 2011, and is probably to a large extent a reflection of the fact that the private interbank market is worried about wrong way risk (Italian bonds with an Italian counterparty for example)
- Banks tend to use more cross border collateral in private transactions and less at the ECB (where there is no penalty for wrong way risk)
- Indeed, the increase in the usage of the domestic collateral is in Q4 -11 and after the two 3y LTRO's (as shown in the chart)

Impact on Banks

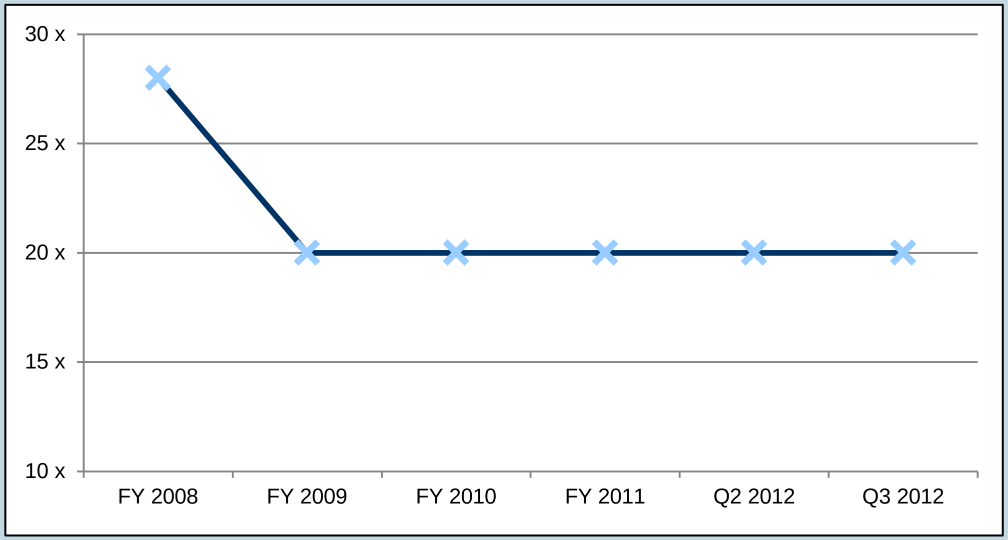
Liquidity Pool Growth



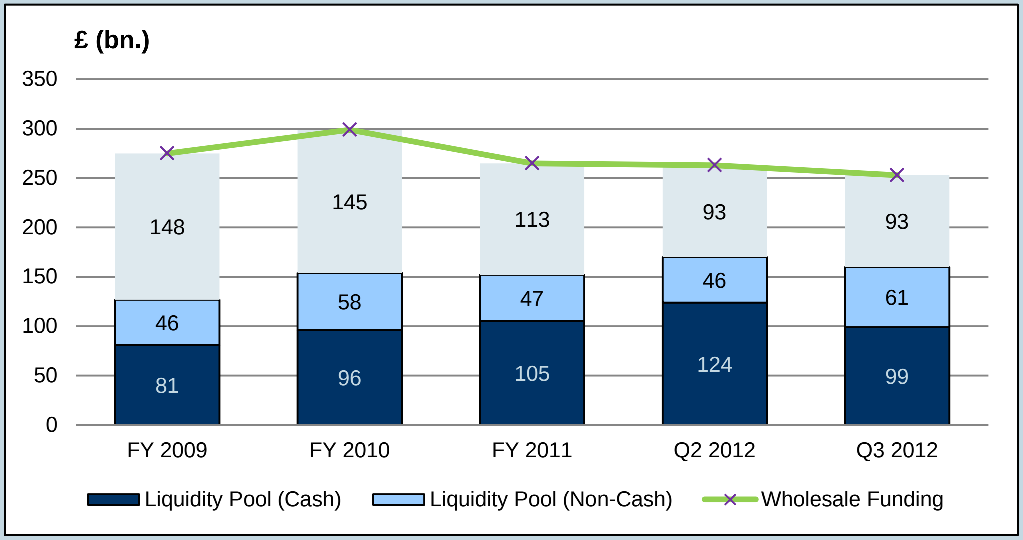
Balance Sheet Growth



Leverage

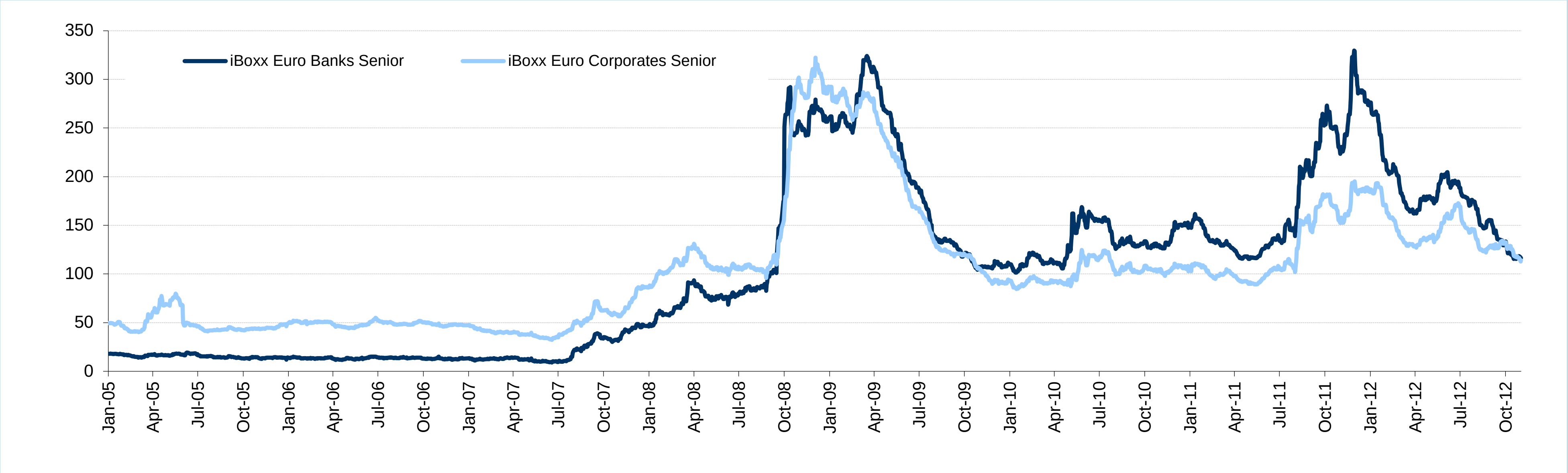


Wholesale Funding



Impact on Banks

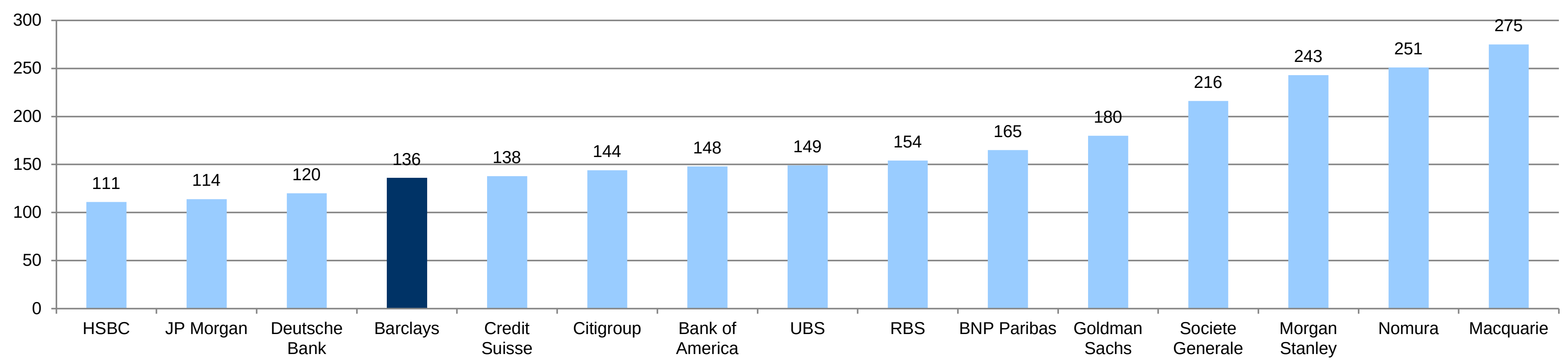
European Banks' Senior Bonds vs. Non-Financial Corporate Entities (Z-Spread to Swap, bps)



- Since the ‘08 crisis, it has started to become cheaper for corporate entities to borrow via the capital markets than directly from banks
- Banks benefit from earning fees due to bond issuance rather than net interest income from lending cash. Less capital is needed to support this activity, thus providing the potential for higher Returns on Equity for those banks that operate a capital market’s operation
- Migration of corporate loans across to the bond markets may in time reduce funding pressures on banks by causing them to use up less of their balance sheet

Funding Costs

5-year USD Z-spread (bps) - as at 28 Sep 2012



5-year CDS vs. iTraxx (bps)

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Central Bank Liquidity

- **From the FSA….**

Self sufficiency:
“A firm must at all times maintain liquidity resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due”………. “a firm may not include liquidity resources that may be made available through emergency liquidity assistance from a central bank (including the European Central Bank).”

Although, following a recent recommendation from the Financial Policy Committee, the FSA published details of the adjustments made to the liquidity and capital regimes for UK banks, confirming:

“The activation by the Bank of England of the ECTR facility has demonstrated that additional liquidity will be made available in response to actual or prospective market-wide stress”…….”Further, the Discount Window Facility (DWF) will provide liquidity to any solvent and viable bank, with pre-positioned collateral, on demand. Together, these measures should imply that banks’ need to self-insure by holding larger liquid asset buffers is lower. Therefore, for those banks that have pre-positioned collateral at the DWF, and hence are able to access this additional public insurance, the FSA will allow 50% of this value to count towards liquidity buffers up to a maximum of 10 percentage points of the firm’s ILG ratio.”

- **Stigma - Media Headlines….**

Barclays borrows £1.6bn from Bank of England:
“Barclays has been forced to tap the Bank of England's emergency lending fund after a major error in the City's trading systems wreaked havoc on the money markets.” *(The Telegraph, 31/08/2007)*

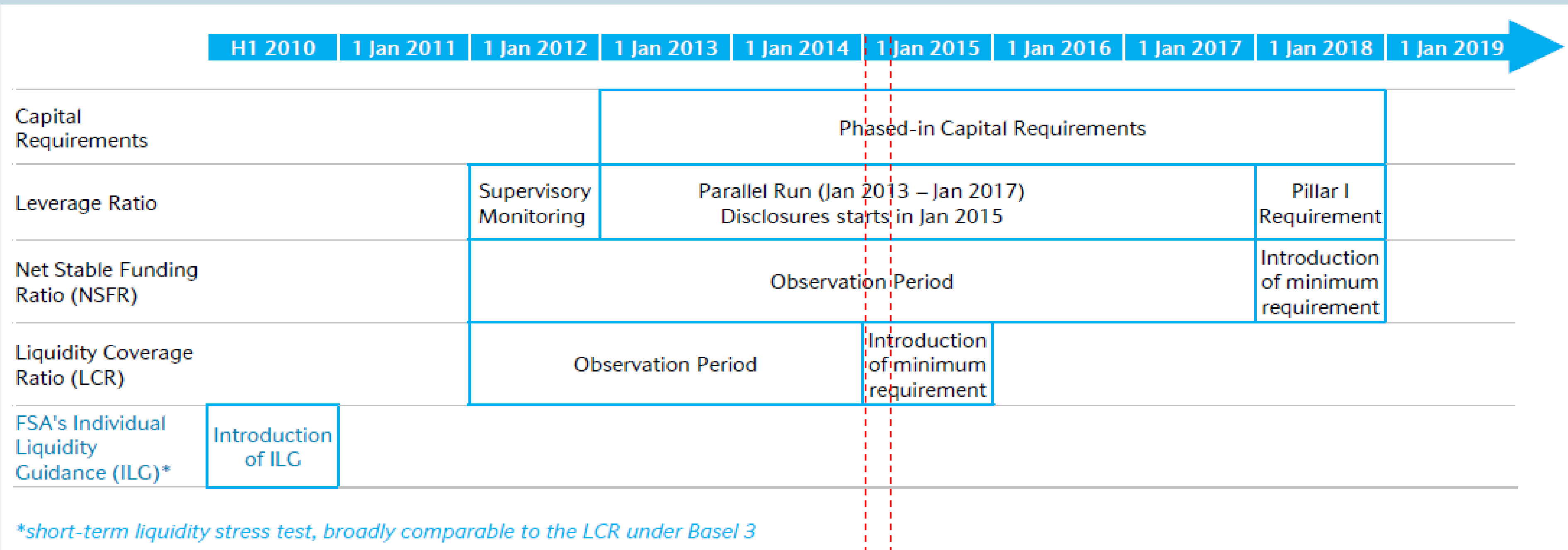
- **Barclays’ position….**
  - Have used Central Bank money (via the LTRO) to close our redenomination risks in Spain, Italy and Portugal
  - Are committed to our continuing contribution to the FLS
  - Of the belief that Central Bank liquidity (BoE, BoJ, Fed, ECB) has been incredibly crucial throughout the crisis

Excessive Dependence on Central Bank Liquidity?

- **Access to funding…**

  - Dependence on the ECB is likely to decrease for large banks, especially in terms of long term funding, as they have regular (inexpensive) access to the money market and can raise this funding with relative ease. However, small/medium sized banks - for which the market conditions are not particularly favourable, both in terms of maturity and rates – will continue to have a large reliance on ECB liquidity as it is very unlikely for them to have access to long term funding

- **Liquidity Regulation - Basel III implementation…**



29 Jan 2015: 1st 3y LTRO matures

26 Feb 2015: 2nd 3y LTRO matures

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