Intervention at the Money Market Workshop
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Seven questions were put forward to the panellists for them to choose which one they would like to take up. As chair of this panel I feel the moral obligation to answer all of them, even if I have the same time endowment as the other panellists and therefore my answers will be extremely brief. If you do not like them as proper answers just take them as provocation to the debate.

1. **How has the role of the bank Treasurer changed with the crisis?**

Here I have two sources of information: what has happened in the ECB in the relation between the Market Operation Directorate and the Economic Directorate and contacts with market participants, telling me what happened in their banks. My conclusion is that the role of the bank treasurer has become quite more important than it was before the crisis; at the same time, the treasurer has lost some of its independence and latitude in decision making, because the guidance and control from the top management and the risk function have become tighter.

2. **How has the respective importance of availability of liquidity and its cost changed with the crisis?**

The answer to this question depends, even more than for the others among the seven, on which kind of bank one considers. For a bank in a stressed jurisdiction, I think the cost of funding has lost importance with respect to the availability of funding. Of course, this is a graduated more than a binary phenomenon, in the sense that the importance of availability with respect to cost increases with the degree of stress to which the bank is exposed. Jut to be clear, I think for Greek banks the relative importance of availability is at a maximum, for German banks it is at a minimum. On some weighted average across the euro area, though, my sense is that cost has lost in relative importance with respect to availability.

3. **Excluding cost considerations, where does central bank liquidity stand in the ranking of liquidity sources, i.e. for equal cost, is there a preference for or against borrowing from the central bank with respect to the other sources of funding?**

This is, of course, a question about stigma and before answering it directly, I would like to make two preliminary comments: first, stigma in Europe is no longer a constant equal to zero, as it had been for a very long time before the crisis, and in my sense it moves quite significantly over time; second, is not easy to measure stigma empirically, because, for the banks for which stigma is stronger there is little market funding the cost of which can be compared with the cost of Eurosystem funding so that one coukld take the difference as a measure of stigma. Having made these two comments, let me express my view that stigma is pretty high these days: I would not be surprised if a bank which was offered the alternative to either get, at the margin, market funding at X+1.00 per cent or central bank funding at X% would prefer the former, in order to free itself from he stigma that comes from borrowing from the central bank.

4. **Is there a risk of excessive dependence on central bank liquidity also past the crisis, given the foreseeable effect of liquidity regulation (in particular the LCR)?**

The short answer here is yes. The longer answer is that this depends on the difference between the set of assets eligible for the central bank refinancing and the set considered liquid according to the LCR rules. The way I see to reduce this difference and avoid too much of an overreliance on the central bank is to exploit fully the fact that liquidity is not a yes/no variable but rather a graduated variable. This would imply that assets could contribute to the LCR in different proportion according to their historical liquidity performance and that the set of LCR eligible assets could be rather large, reducing the difference with the assets eligible as collateral with the central bank.

5. **Going forward to when the crisis will have been surpassed, how broad will the ECB framework need to be? Or, to ask the same question from a different angle, will the fragmentation of the euro money market be a long term feature?**

The history here is that the ECB started in 1999 with a broad framework because it was not sure how integrated the money market would be. Then the market integrated more than expected, still the broad framework served the ECB quite well. Of course during the crisis it was very convenient to have many counterparties, a lot of collateral and very large operations. As we know, the FED which had a narrow operational framework had to broaden it in great haste.

When it comes to answering the question, of course, the critical issue is the interpretation of the words: "when the crisis will have been surpassed". What I mean by this, is a situation in which liquidity and credit risk (measured by some appropriate spreads) will have returned to normal ranges. Given this definition, my assessment is that the condition of very good integration in derivative, repo, unsecured and securities segments (in the order) of the money market will be re-established quickly once the crisis will have been surpassed. After all integration helps both private market participants, in particular banks, as well as the central bank, therefore there are incentives to remedy the fragmentation that the crisis has brought about once its causes disappear.

6. **If the ECB would come to the conclusion to lower rates, what would be more important, the reduction of the MRO rate or that of the deposit rate?**

Of course both changes would contribute to the easing of monetary policy. However, as the automatic change of both at the same time is no longer taken for granted, it is interesting to ask, for a given 100 of easing coming from the reduction of both the MRO and the deposit rate, what would be the share to be attributed to the MRO and the share attributed to the deposit rate. My guess is 70/30 share. The justification for my guess is that the MRO is the rate at which most of the Eurosystem 800 billion euro funding is granted, which predominantly goes to banks in stressed jurisdictions. A reduction of its cost would directly benefit banks in stressed jurisdictions that could either directly lower their lending rates or increase their margins, and therefore their profits, with a favourable impact on their willingness to lend going forward. The lowering of the deposit rate below zero, instead, would have its effects reduced by two factors: first, it is my understanding that there is a resistance for market rates to cross the zero threshold, so, even if the deposit rate was negative, the market rate would tend to remain positive. Secondly, the elasticity of lending by non stressed banks to either stressed banks or customers with respect to a reduction of the deposit rate is, in my view, very small as the hindrance to this kind of borrowing comes more from risk than return considerations. My reasoning also leads me to think that a reduction of rates, even if it acted on both the MRO and the deposit rate, would have an asymmetric effect, in the sense that the easing would be more significant in the stressed jurisdictions than in the rest of the euro area, which is of course welcome, given the very different macroeconomic conditions in he two regions. Finally, my reasoning also leads me to think that a reduction of rates is, in current conditions, easier to decide as it would ease monetary policy mostly in stressed jurisdictions, where there is even less of a risk of unfavourable inflationary developments and higher need of a positive macroeconomic impulse.

7. **Should the ECB be anxious for Spain to ask for an EFSF/ESM program so that the OMT could be activated?**

My answer to this question starts from noting that the ECB has sort of written a costless and unlimited but conditional put option to the market, where it commits to purchase, basically, Spanish and may be Italian, sovereign bonds at an undisclosed strike price. Of course some characteristics of this option (costless and unlimited) reinforce its effect, some others (conditionality and undisclosed strike) limit its effect (even if in a deeper sense conditionality is an element of strength of the OMT). Normally, when a private agent writes an option he/she hopes it would not be exercised, to keep the premium and not serve the insurance. Does the same apply to the ECB or should it be eager for the option to be exercised, which requires as a necessary, but not sufficient, condition that one country, Spain is mostly mentioned, asks for a program? In my sense not. Of course the ECB should comply with its commitment (deliver on the option) if it is called to, but should not press or just wish for this to happen. This assessment of mine is reinforced noting that yields on Spanish and Italian bonds (at some 2.5 and 3.5 per cent respectively on the 3 years maturity) are higher than fundamentals would probably imply but hardly unsustainable, in my view. Of course, this is also due to the existence of the put option, so the current equilibrium is an unstable one and the " strike price" could be reached and then the OMT should be activated by a request for a program from the relevant country. This does not imply, however, that the ECB should eagerly wait for this to happen.

So, these are my seven answers to the seven questions and I am anxious to hear what opinions the panellists, and of course all of you in the audience, have about them, hoping in a lively debate.