DEMAND FOR CENTRAL BANK RESERVES
FACTORS & IMPACTS

PRESENTATION TO THE ECB MONEY MARKET CONTACT GROUP

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SOCIETE GENERALE
BANK DEMAND FOR CENTRAL BANK RESERVES

- BANK DEMAND FOR CENTRAL BANK RESERVES DEPENDS ON MULTIPLE FACTORS
- ARE THESE FACTORS CONSISTENT ACROSS THE EURO AREA COUNTRIES?
- ARE THEY PREDICTABLE AND HOW CAN THEY BE MONITORED?
- HOW DO THESE FACTORS IMPACT BANKS’ MONEY-MARKET ACTIVITIES?
- WHICH MONEY-MARKET SEGMENTS COULD REGISTER SIGNS OF LIQUIDITY BECOMING SCARCE FIRST AND WHY?
SOME FACTORS ARE SPECIFIC TO EACH BANK, OTHERS ARE GLOBAL, EUROPEAN-WIDE

- MANDATORY RESERVE REQUIREMENTS
- OPERATIONAL
- REGULATORY (LCR, NSFR...)
- LIQUIDITY RISK APPETITE
- INTERNAL METRICS AND RATIOS
- INTERNAL STRESS TESTS
- OPPORTUNISTIC, MARKET RELATED
- BUSINESS MIX AND INTERNAL ORGANIZATION
- ETC
WE ARE STILL FAR FROM THE LOWER POINT OF EXCESS LIQUIDITY

- It all depends on the state of the economy and banks’ demand for excess reserves.
- Research conducted by Annette Viissing-Jörgensen (‘Balance Sheet Policy Above the ELB’) and presented at last year’s Sintra Symposium suggested a roughly €1,500bn target for excess liquidity in the euro area.
- Another popular reference for target excess liquidity is 4% of banks assets, which would correspond today to a little less than €1,600bn.
A SLOW DECREASE OF EXCESS LIQUIDITY WILL DELAY AND DILUTE SIGNS OF LOWER DEMAND FOR CENTRAL BANK RESERVES

- SOME SPECIFIC OR OPPORTUNISTIC FACTORS HAVE DEVELOPED IN A OVERLIQUID SYSTEM AND UNDER A STRONG INFLUENCE OF REGULATORY ASPECTS

- IT IS EXPECTED THAT AS THE EXCESS LIQUIDITY IN THE EURO AREA DECREASES, OPPORTUNISTIC DEMAND FOR RESERVES WILL ALSO DIMINISH
THE LCR WILL BE AN INDICATOR OF DECREASING DEMAND

- The most obvious signs of decreasing demand would be a slow erosion of liquidity ratios.
- Today inexpensive excess liquidity contributes to high liquidity ratios.
- Going forward funding cost will be a determinant factor.
- Best mix of price / efficiency.

**Source:** ECB
THE NSFR MAY BE AN ISSUE SOONER THAN THE LCR 1/3

FOR MOST EUROPEAN BANKS, NSFR EXCESS IS MORE LIMITED THAN LCR EXCESS
FOR FRANCE IN PARTICULAR, THE EXCESS NSFR IS LOW

Net stable funding ratio, EU countries

Net stable funding ratio, France

Source ECB
THE NSFR MAY BE AN ISSUE SOONER THAN THE LCR 2/3

- Keeping NSFR ratios at constant levels will most probably be achieved by long-term issuance as opposed to money-markets, and compensated, in order to limit the leverage ratio, by a decrease of short-term funding.
- Lesser demand for short-term unsecured would further depress ESTR / DFR spreads.
- But may steepen the term structure of the EURIBOR curve. Any increase towards the max since 2014 may indicate that liquidity decrease is biting into NSFR.

Term structure priced by EURIBors since 2014

Source: SG Cross Asset Research/Rates, Bloomberg
EURO AREA MONEY MARKET FUNCTIONING EFFICIENTLY AND SHOULD CONTINUE SO AT LEAST THROUGH 2024 AND EARLY 2025

Marginal increase so far of MRO and 3M LTRO liquidly provisions since June 2023

Italian banks represent 80% of volumes
REPO RATES TO PUSH HIGHER ABOVE ESTR WITH IMPLICATIONS ON BANKS’ HOLDING OF CASH VS HQLA

Repo rates have more than normalised from the peak dislocations of 3Q22

We target ESTR+8bp for German RepoFunds Rate (+ watch a MRR decision)

Bund scarcity is ending

Source: SG Cross Asset Research/Rates, ISDA.
THE NSFR MAY BE AN ISSUE SOONER THAN THE LCR 3/3

- Watch out for the end of the repo NSFR exemption granted on short term funding of HQLAs in June 2025.
- If this exemption is not renewed, possible important impacts on repo markets could occur.
- This could include a hike in funding rates for the French and more globally European government debt.
- The possible transfer of holding of European debt to non-domestic purchasers, who may be inclined to sell faster in times of trouble.
FURTHER INCREASING LIQUIDITY COST IS TO BE EXPECTED

- ANY ACCELERATION OF THE WIDENING OF THE 3M / ESTR BASIS SHOULD SHOW THAT DECLINING LIQUIDITY IN THE EURO AREA IS STARTING TO MATERIALIZE IN UNSECURED MONEY-MARKETS

3M / ESTR FORWARDS CONTINUE TO PRICE A WIDENING OF THE BASIS

Source: SG Cross Asset Research/Rates, Bloomberg
LONG-TERM IMPACTS FOR EUROZONE BANKS

- Higher cost of funding
- Lower excess liquidity buffers
- Lower liquidity ratios
- Possible return of the fragmentation story
- Some banks may be excluded from the market and reliance on LTRO may increase, with the associated issue of the central bank dependency stigma
- The question of non-core European government debt placement and its possible political stability implications may prove a concern again, as was the case in the pre-COVID period
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