EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

ECB-UNRESTRICTED

1 July 2016

Money Market Contact Group

Munich, Thursday, 9 June 2016, 13:00 – 17:00 CET

Summary of the discussion

1. Review of the latest market developments and other topics of relevance

Harald Endres reviewed the main developments in the euro money market since the last meeting. He noted that despite the accommodative monetary policy, financial stress indicators remained at elevated levels. Among the near-term risk factors, Harald emphasised political risks related to the referendum in the United Kingdom and downward pressure on banks' margins due to the high levels of excess liquidity – albeit over the past months the pressure on margins had moderated somewhat.

Members of the Money Market Contact Group (MMCG) considered market expectations around the forthcoming participation in the series of four targeted longer-term refinancing operations (TLTRO II) and the impact on bank lending.It was pointed out that take-up in the first operation was not seen as a major market event, since the market considered the total take-up in all four TLTRO II operations to be more relevant. In certain countries, the announcement of the TLTRO II operations had already contributed to an improvement in bank lending rates. However, a number of factors could be limiting potential demand. These included (i) continuing slow loan growth in some countries, (ii) banks' willingness to retain their presence in the bank funding markets, (iii) certain regulatory restrictions, and (iv) issues regarding the accounting treatment of hedges against TLTRO II funding due to uncertainty about the final interest rate to be applied to the operation. It was noted that demand for TLTRO II funds could be spread out over several operations to take advantage of a new feature of TLTRO II (as compared with TLTRO I) – namely the different maturity dates – which would reduce the risk of having to refund large amounts on a single day.

As regards the impact of increasing excess liquidity on banks' balance sheets, on liquidity management and on money market activity, MMCG members noted that in an environment of continuing subdued lending and obstacles to passing on negative interest rates to retail deposits, excess liquidity had continued to exert pressure on banks' net interest margins (NIMs). Furthermore, a number of MMCG members reported lower liquidity in the repo market for certain sovereign debt, while higher excess liquidity had reduced incentives to trade in the interbank market.

Developments in the FX swap market and foreign currency funding were considered, as well as the impact of the money market funds (MMFs) reform in the United States on the US dollar funding of European banks. The impact of the reform on euro area banks' funding was assessed by the MMCG to be limited, as banks in the euro area were actively managing their exposure to the US MMFs and were not heavily reliant on the US MMFs for their US dollar funding needs.

Finally, the MMCG discussed the impact of the forthcoming referendum in the United Kingdom on the euro money market and was surprised to note large differences between the polls and relatively benign market pricing. The probability of an adverse liquidity event in the euro area in the event of a "leave" result was estimated to be very low due to a high level of excess liquidity, while the ECB's standing swap lines with other major central banks would provide a sufficient backstop to any potential significant increase in US dollar demand.

2. Recent developments in the euro money market – evidence from market data

Holger Neuhaus updated the MMCG on the progress and relevant milestones in the implementation of Regulation ECB/2014/48 on money market statistical reporting (MMSR), as well as on the initial findings from the reported data. In response to enquiries about the quality checks applied to MMSR data submissions, the ECB explained that a number of checks were applied to MMSR contributions; in the initial stage of reporting, these were automatic mechanical checks. They were complemented by analytical checks that would be further refined over time.

Julija Jakovicka presented the main findings of the MMCG's Euro money market survey conducted in the first quarter of 2016. This edition of the survey showed broadly stable turnover across money market segments, however the relative stability in some segments reflected divergences in individual trading volume developments across panel banks.

As part of the discussion, the members of the MMCG reviewed recent dynamics in unsecured and repo markets. The relative stability of repo market volumes was attributed to the fact that turnover had not been specifically measured on the balance sheet reporting dates when large declines in trading activity were observed. It was also noted that, for the first time, some repo rates declined below the levels of the ECB's deposit facility. This was attributed partly to the activity of certain market players who did not have access to the ECB's deposit facility and partly to a lower level of investor compensation on certain types of deposits therefore deemed less favourable for regulatory ratios, thus exerting pressure on money market interest rates.

3. Update on euro money market benchmarks and the ongoing reform process

Several MMCG members voiced their view that public authorities should further support the EURIBOR reform process. In particular, they felt it necessary that the public sector be involved in supporting the transition to the new transaction-based EURIBOR, including the approach towards a potential spread between the two benchmarks and towards the volatility of the new benchmark. MMCG members also strongly supported the position that contributions to the EURIBOR should be mandatory, (i) in order to address the potential risks of additional banks leaving the EURIBOR panel, and (ii) as a necessary condition to ensure that the benchmark was representative. In response to concerns expressed by several members of the MMCG, the ECB representatives emphasised Mr. Cœuré's message urging banks to support the reform process for the public good.[1]

MMCG members were informed that the European Money Markets Institute (EMMI) had set up a working group responsible for analysing legal issues relating to the transition. They were also advised that they could reach out to private associations such as the International Swaps and Derivatives Association (ISDA) to increase preparedness for potential issues concerning the legal continuity of contracts.

4. Other business: next meeting

The next meeting of the MMCG will take place on 27 September 2016 in Frankfurt.

[1] "…the ECB expects banks as active users of Euribor to take responsibility for the benchmark and to stand behind its production as contributors with the launch of the new calculation methodology...", from the keynote address by Benoît Cœuré to the Government Borrowers Forum in Paris on 3 May 2016.