



EUROPEAN CENTRAL BANK
EUROSYSTEM

ECB-PUBLIC

COURTESY TRANSLATION

Mario DRAGHI
President

Mr Marco Valli and Mr Marco Zanni
Members of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt, 14 December 2016

L/MD/16/526

Re: Your letter (QZ-099)

Honourable Members of the European Parliament, dear Mr Valli and Mr Zanni,

Thank you for your letter, which was passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 15 November 2016.

The repo market¹ plays an important role in the financial system of the euro area, given its relevance for supporting the availability of collateral and cash to address short-term liquidity needs. This is why the ECB carefully and regularly monitors developments in this market segment.

The ECB is therefore aware that there is growing pressure on some sovereign repo market segments related to the reduced availability of securities in the respective bond markets. Such pressure is observable both in “general collateral” (GC) repo rates and in repo rates on specific securities.² This is a result of imbalances between supply of and demand for collateral, which are especially pronounced in certain repo market segments.

¹ A repurchase agreement (repo) combines two financial transactions taking place at different times. It involves the sale of a security at the spot price and a forward contract to buy back the same security on a specific future date at an agreed price. The difference between the two prices is the repo rate. The repurchase agreement may imply the buy-back the next day (overnight repo) or at a later date, usually up to one year. Generally, repo transactions that take place on electronic trading platforms have very short maturities (up to one week), while bilateral repos agreed over the counter tend to have longer maturities.

² There are two basic types of repo: special repos and general collateral (GC) repos. In special repos, the party delivering the security must deliver a specific asset, whereas, in GC repos, he/she can choose from among a basket of possible assets.

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On the supply side, the ECB is aware that the imbalances in the market partly reflect the impact of its asset purchase programme (APP). At the same time, these imbalances are also a consequence of increasing demand. This increasing demand is caused by changes in the market structure and regulatory developments. New regulatory requirements have, in particular, affected demand for high quality liquid assets, such as German government bonds.

Please note that the overall level of GC repo rates is also linked to a number of other factors, including the level of excess liquidity in the euro area banking system. In addition, spreads between various GC repo rates and the ECB's deposit facility rate also reflect, to some extent, the different credit ratings of the underlying collateral.

In view of the above-mentioned changing repo market conditions, concerns about the availability of collateral have increased. However, there is no evidence that the increasing collateral specialness³ is a reflection of a shortage of collateral or repo market stress. If that were the case, the downward pressure on repo rates would have been associated with declining volumes in repo markets and lower reuse of the collateral. In fact, market participants report that overall repo market functioning has not been impaired, despite observed declines in repo rates in certain repo market segments on particular days.

As I had the opportunity to discuss with your honourable colleague, MEP Siegfried Mureşan,⁴ on 28 November 2016, the Eurosystem's securities lending programme plays a very important role in addressing these concerns. The Eurosystem launched its securities lending arrangements for the explicit purpose of mitigating any potentially negative impact on the supply of collateral in repo markets that could be attributable to the APP.⁵ Shortly after the inception of the public sector purchase programme (PSPP) in March 2015, the Eurosystem made its holdings under the PSPP available for securities lending. Through its various formats and channels, securities lending allows market participants to borrow securities from the Eurosystem. On 8 December 2016, the Governing Council decided⁶ that Eurosystem central banks will have the possibility to also accept cash as collateral in their PSPP securities lending, without having to reinvest it in a cash-neutral manner. This is intended to further enhance the effectiveness of the securities lending framework as well as euro area repo market liquidity and functioning.

³ "Specialness" is the spread between GC repo rates and repo rates on specific securities and is a measure of the scarcity premium for procuring a specific security.

⁴ Monetary dialogue with Mario Draghi, President of the ECB. The transcript is available at https://polcms.secure.europarl.europa.eu/cmsdata/upload/130c5b63-8dfd-4971-a347-bc986a3f5c3d/Monetary%20dialogue%2028112016_EN.pdf

⁵ More information is available on the ECB's website at <https://www.ecb.europa.eu/mopo/implement/omt/lending/html/index.en.html>

⁶ See the press release at https://www.ecb.europa.eu/press/pr/date/2016/html/pr161208_2.en.html

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To conclude, let me reassure you that we closely monitor the repo market and the Eurosystem's securities lending activities in order to ensure their stability and ongoing effectiveness.

Yours sincerely,

[signed]

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