EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

25 March 2021

ECB Money Market Contact Group (MMCG)

Tuesday, 16 March 2021, 13:00-17:00 CET

Webex conference

Summary of the discussion

1) Review of money market developments and TLTRO III.7 expectations

Maria Cristina Lege (Intesa Sanpaolo) reviewed the upcoming targeted longer-term refinancing operations (TLTROs) and an ECB representative updated the MMCG on some technical aspects of the third series of TLTROs (TLTRO III). Jürgen Sklarczyk (Deutsche Bank) briefed members on developments in the overnight index swap (OIS) segment, Olivier Hubert (Natixis) on the secured segment and Bineet Shah (Barclays) on the foreign exchange swap segment.

Frontloading expected in the March 2021 TLTRO III and call for transparency on the use of additional credit claims (ACCs) by jurisdictions. The MMCG forecast the take-up of TLTRO III.7 in March 2021 to be between €200 billion and €500 billion, compared to €100 billion altogether for TLTRO III.8, III.9 and III.10. The main reasons put forward for such strong frontloading were linked to the design of the operation itself, as (i) "*entering early and staying in*" is more advantageous than shifting amounts from "old" into "new" TLTROs, (ii) its *attractive pricing* of -1% would last three months longer when entering in March than when entering in June, and (iii) the *worst case scenario* had a neutral cost, as the deposit facility rate (DFR) is the maximum price for the next fifteen months. Other reasons cited by the MMCG for interest in the operations were: (i) the *regulatory value of liquidity transformation* through collateral by pledging non-high-quality liquid assets (non-HQLA) as collateral with the ECB; and (ii) *economic momentum* due to the reportedly widespread interest of banks in remaining competitive during the post-vaccination economic recovery. On the other hand, the main deterrents to participation in TLTRO III were: (i) *uneven collateral availability*, in particular in euro area countries with limited ACC frameworks; and (ii) *uneven ability to increase balance sheets* either via loans or via securities holdings. The MMCG called for more transparency on the use of credit claims and ACCs by jurisdiction. It was noted that, while all euro area countries had net loan growth in March 2020, banks have continued to grow their loan portfolio on a net basis in only a few jurisdictions since October 2020. Some MMCG members added that early repayments of loans granted in March 2020 remain a source of uncertainty.

Negligible reaction of the money markets to the March 2021 Governing Council meeting. According to the MMCG, the ECB fulfilled market expectations by announcing that it would step up purchases under the pandemic emergency purchase programme (PEPP). There were no expectations of policy rate changes, as MMCG members do not expect changes in the DFR until 2022-24. According to the MMCG, market attention was mainly focused on (i) the monthly pace of purchases under the asset purchase programme (APP) and the PEPP, (ii) the use of TLTRO III, and (iii) potential adjustments to the two-tier system multiplier. In the OIS segment, the MMCG noted that volumes remain low and that the forward OIS curve was not affected by the most recent ECB decisions. In the unsecured money market segment, excess liquidity, which was expected to remain ample and reach €5 trillion by the end of 2021, could drive the 3-month the euro interbank offered rate (EURIBOR) below the euro short-term rate (€STR).

Eurosystem Securities Lending Programme praised. MMCG members explained that government bond scarcity in the market was more acute on certain dates. On those dates, recourse to the securities lending facilities of national central banks helped did not fully offset the scarcity of certain bonds. Such instances occurred at the end of 2020, when balance sheet restrictions restrained trading, and in early March 2021 with large redemptions in several euro area countries. The scarcity of euro area government bonds led to a sharp decline in repo rates well below the DFR. Downward pressure on repo rates is expected to continue as the scarcity of government bonds is expected to increase with (i) larger PEPP monthly purchases, (ii) lower government issuances, (iii) the high TLTRO III take-up, and (iv) uneven availability of collateral across jurisdictions owing to differences in the eligibility of ACCs. In this environment, the MMCG noted that Eurosystem securities lending facilities and, when in place, the repo facilities of national debt management offices would play a crucial mitigating role and should therefore be further expanded.

Central banks' foreign exchange (FX) swap lines could be gradually reduced. According to the MMCG, in contrast to the second quarter of 2020, the FX swap market remained widely accessible to European banks with good supply of US dollars from US banks. Although the premium for borrowing US dollars against euro at the end of 2020 was higher than at the two preceding year-ends, MMCG members attributed the surprisingly large year-end effect mostly to the lack of prefunding and complacency of some market participants. Market participants had expected a quiet turn of the year owing record-high US dollar liquidity, which induced dealers to wait until mid-December instead of prefunding positions throughout the fourth quarter of 2020 in line with previous years' practice, resulting in higher premia for US dollar funding in the FX swap market in December. The MMCG praised the crucial role of the central banks' swap line network in ensuring stable US dollar funding conditions in the second part of 2020. In the MMCG's view, the reduction in pricing from 50 to 25 basis points above the US dollar overnight index swap (OIS) rate helped to remove the stigma associated with participation in US dollar-providing operations and strengthened their role as a viable backstop. Some MMCG members regarded the swap lines as an effective cap on market pricing volatility, despite their limited use, and argued in favour of continuing central bank support via the swap lines. As US dollar funding conditions remain favourable, other MMCG members were of the view that the swap lines performed their function well during the crisis but could be scaled down as they were no longer needed. The relief provided to US banks by the exclusion of US Treasuries and deposits with the Federal Reserve System from the Supplementary Leverage Ratio calculation was effective in boosting US dollar supply and is expected to be extended beyond March 2021.

2) Role of non-banks in euro money markets

Ileana Pietraru (Société Générale) reviewed the growing importance of non-banks in euro money markets and how this affects market liquidity conditions.

The MMCG confirmed the strong presence of non-banks in the unsecured segment. MMCG members referred mainly to two types of non-bank counterparties: (i) money market funds (MMFs), whose assets under management (mainly commercial paper) were very large, and (ii) governments, whose deposits in the market were at record levels. They attributed these developments to the fact that non-banks could offer investors higher returns than those of bank deposits owing to their lower regulatory burden.

The MMCG noted that, in the coronavirus (COVID-19) crisis, MMFs triggered a knock-on effect on unsecured market segment liquidity. As corporates withdrew cash from MMFs at the outbreak of the COVID-19 pandemic, MMFs raised liquidity by selling commercial paper (CP) issued by corporates and financials, leading to a temporary freeze of the term unsecured market segment – CPs and EURIBOR. The ECB measures – the PEPP, the corporate sector purchase programme (CSPP) and TLTROs – helped to restore market confidence and functioning.

The MMCG felt that developments similar to those seen during the COVID-19 crisis could not be excluded in the future. In order to prevent a negative impact of non-bank behaviour on financial stability, some MMCG members mentioned that regulation should be strengthened for non-banks, such as MMFs, and other players, such as asset managers and hedge funds, which increasingly compete with banks for intermediation business but are subject to heterogenous regulatory regimes. MMCG members noted that increased transparency about MMF stress testing and MMF liquidity modelling methodology would boost market confidence. Others noted that MMFs became more vulnerable to sporadic liquidity shocks, as they have a high share of corporate investors. Retail clients, previously a stable investor base for MMFs, have increasingly moved their liquidity away from MMFs in light of the negative interest rate environment.

3) Brexit and its effects on euro money markets

Jana Sulin (Nordea) presented the market's views on the impact of Brexit on the money market.

Brexit has had a smaller-than-expected impact, with the OIS and secured money market segments being most affected owing to the involvement of central counterparties (CCPs). LCH Ltd located in London remains the main clearing house for euro interest rate derivatives, including OIS. Decentralisation of LCH's business to several smaller euro area CCPs could lead to a loss of efficiency in terms of posting initial margins, higher spreads and liquidity management. While the UK CCP will benefit from the temporary equivalence status granted by the European Commission until June 2022, some MMCG members argued in favour of a further extension of the equivalence to ensure smooth derivatives trading.

4) Benchmark transition

Bineet Shah (Barclays) and Helmut Wacket (ECB) provided an update on the discontinuation of the London interbank offered rate (LIBOR) and the transition from the euro overnight index average (EONIA) to the €STR for OIS derivatives.

On 5 March 2021 the United Kingdom's Financial Conduct Authority announced the date for the cessation of LIBOR fixings. US dollar LIBOR fixings for the 1-week and 2-month tenors will also be published only until 31 December 2021, while the remaining tenors will continue to be published until 30 June 2023. Regulators from many jurisdictions put additional pressure on the transition efforts.

OIS transition from the EONIA to the €STR progressed very slowly, with €STR OIS outstanding volumes accounting for less than 10% so far. Euro area banks have less than 10 months remaining before the EONIA will cease to be published on 3 January 2022.

The MMCG was confident that transition would take place towards the third quarter of 2021, boosted by the conversion of outstanding CCP positions from the EONIA to the €STR. The lack of swift progress was explained by the following factors: (i) there was no pressing need for transition, as most outstanding OIS contracts would mature before the end of 2021; (ii) €STR transition was deprioritised compared to the LIBOR and other COVID-19 related tasks; (iii) markets preferred to wait until trades cleared by CCPs are converted to €STR in October 2021; and (iv) other technical reasons, such as adjustments in internal systems. MMCG members believed that none of the above factors would endanger a successful transition to the €STR, as 90% of OIS trades were cleared by CCPs. The remaining 10% were bilateral trades and were more vulnerable to the risk of late transition, but market focus on the transition was expected to pick up towards the summer of 2021.

List of participants

Money Market Contact Group meeting

Participant's organisation	Name of participant
Bank of Ireland	Mr Philip Hartley[1]
Barclays Bank	Mr Bineet Shah
Bayerische Landesbank	Mr Harald Endres
BBVA	Mr Fernando Soriano
Belfius Bank & Insurance	Mr Werner Driscart
BNP Paribas	Mr Patrick Chauvet
BPCE/Natixis	Mr Olivier Hubert
Caixabank	Mr Xavier Combis Comas
Commerzbank	Mr Andreas Biewald
Coöperative Rabobank U.A.	Mr Frank Beset
Deutsche Bank	Mr Jürgen Sklarczyk
DZ Bank	Mr Michael Schneider
Erste Group Bank	Mr René Brunner
HSBC	Mr Harry Gauvin
ING	Mr Jaap Kes
Intesa Sanpaolo	Ms Maria Cristina Lege
LBBW	Mr Jan Misch
Nordea	Ms Jaana Sulin
Société Générale	Ms Ileana Pietraru
UniCredit Bank	Mr Harald Bänsch
European Central Bank	Ms Imène Rahmouni-Rousseau (Chair)
European Central Bank	Mr Helmut Wacket
European Central Bank	Ms Maria Encio (Secretary)

[1] Substitute for Mr David Tilson