EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS 21 June 2021

ECB Money Market Contact Group (MMCG)

Wednesday, 16 June 2021, 13:00 - 17:00 CET

Webex conference

Summary of the discussion

Isabel Schnabel, Member of the Executive Board of the ECB, welcomed the members of the MMCG and introduced the new Chairperson, Thomas Vlassopoulos, Deputy Director General Market Operations at the ECB. Ms Schnabel highlighted three points that are particularly relevant in the current market environment and on which she invited MMCG members to offer their views: (i) the protracted downward drift in repo rates; (ii) the resilience of markets to operational disruptions; and (iii) the prospects for banks to sustain credit supply with the support of the third programme of targeted longer-term refinancing operations (TLTRO III) and the implications for future take-up and repayments. She concluded by stressing that the MMCG regularly delivers very valuable feedback on topical developments in euro area money markets, which often features in the deliberations of the Executive Board and the Governing Council.

1) Review of money market developments

Michael Schneider (DZ Bank) reviewed recent developments in the secured segment and Philip Hartley (Bank of Ireland) provided an update on other money market segments.

The MMCG expressed mixed views about the evolution of the declining trend in repo market rates. The MMCG confirmed that the secured segment remained liquid throughout 2020 and 2021, including at the peak of the coronavirus (COVID-19) crisis. However, repo rates were sensitive to the availability of euro area government bonds, and their scarcity has led to a decline in rates. This decline was more acute on reporting dates, or when trading was disrupted for technical reasons or affected by government bond supply patterns. This was also observed during the recent technical disruption of a major trading platform in early June 2021. This disruption highlighted the inability of market participants to mobilise collateral across trading platforms. MMCG members were sceptical about whether diversifying trading activity over multiple platforms could serve as a mitigation measure for similar disruptions in the future given the significant costs and technical constraints. While the securities lending facilities by debt management offices and national central banks helped to increase the supply of bonds in these situations, they were primarily intended as backstops. Some MMCG members took the view that scarcity was confined to certain bonds during quarter-ends, specific (operational) incidents or periods of sizable redemptions. Other members considered that scarcity was of a more structural nature and hence repo rates may continue to decline. Repo rates stood at -60 basis points in June 2021, compared with -50 basis points in mid-2020, and were likely to decline further to -70 basis points over time. They expected this further decline in repo rates to materialise over the second half of 2021, driven by (i) additional net outright purchases by the Eurosystem, (ii) lower issuance of government bonds in the post-vaccination period, and (iii) the possible need to collateralise up to €300 billion of additional TLTRO III funding for the remainder of 2021. The view was put forward that the Eurosystem could mitigate this decline in repo rates either by increasing the limit for its securities lending facility or by accepting additional non-liquid assets (non-high quality liquid assets or non-HQLA) as eligible collateral (for example, additional credit claims) in its open market operations.

Unsecured term rates are expected to remain below the ECB Deposit Facility Rate (DFR) at least until June 2022. In the unsecured segment, the 3-month EURIBOR was expected to remain below the DFR until June 2022, driven by the large amount of excess liquidity and low issuance volumes of bank commercial paper. In the view of MMCG members, EURIBOR may increase only when early repayments of TLTRO become substantial, which is likely to occur from June 2022 onwards, when the special pandemic interest period is set to expire. €STR was expected to remain stable at levels below the DFR, reflecting transactions with market participants without access to the Eurosystem Deposit Facility.

Continued slow progress made on offering overnight interest swap (OIS) products linked to €STR. In the OIS segment, the transition from EONIA to €STR-linked products progressed slowly, with only seven months remaining to complete the transition (EONIA publication is due to cease on 3 January 2022). According to MMCG members, the main obstacle to a faster transition was a "wait-and-see" attitude, as traders were waiting for the mandatory conversion of all LCH-cleared trades to take place in October 2021. In addition, MMCG members mentioned that a large share of outstanding OIS transactions matured before year-end, removing the need for conversion. Furthermore, product managers were reportedly reluctant to modify contracts, as they feared the "first mover" disadvantage of making the transition, as sufficient liquidity and a critical mass was needed for customers to accept the new products and support the transition. As far as expectations regarding ECB monetary policy are concerned, , MMCG members would welcome early advance notice on the envisaged course of action by the Eurosystem, in particular, on the way forward for crisis-related measures. At the time of the meeting, markets had priced in the first 10-basis point rise in the ECB policy rate for the second quarter of 2023, which was unchanged since the Governing Council meeting of 10 June 2021, but was 1.5 years sooner than the expected date envisaged by the markets in January 2021. Although OIS rates stood at levels higher than a few months ago, the strong market reaction in early May 2021 triggered by an "inflation panic", had been partially reversed.

On the FX swap segment, the premium to borrow US dollars remained below pre-pandemic levels. The ample US dollar liquidity conditions resulting from the drawdown of the Treasury General Account kept the premium contained and no changes in the premium were expected in the near future.

2) TLTRO III assessment and expectations

Werner Driscart (Belfius), Xavier Combis (CaixaBank), Frank Beset (Rabobank) and Harry-David Gauvin (HSBC) analysed different aspects of the third TLTRO programme.

MMCG members identified three main motives for participation in TLTRO III: (1) to cover funding needs; (2) to finance asset expansion; and (3) to transform less liquid assets into more liquid ones. Members emphasised that these motives were not mutually exclusive, and that borrowers were often motivated by a combination of factors. The first motive entails participants securing long-term funding and replacing more expensive market-based funding. The second motive is particularly relevant during the special low interest period (-1% for up to two years if lending benchmarks are met). Finally, the third motive refers to liquidity transformation via collateral, whereby non-HQLA are pledged with the Eurosystem in exchange for HQLA in the form of central bank reserves. The relevance of the different motives was considered useful for forecasting expected behaviours on remaining operations and early repayment dates. In this respect, modest take-up was expected for the June and September 2021 TLTRO III operations, but a net absorption of TLTRO III injected liquidity was expected to start only in June 2022. It was also noted, however, that ultimately all TLTRO participants would need to comply with the lending benchmark, thus supporting lending to the euro area economy.

The MMCG noted strong competition in granting credit to corporates in March 2021. Looking at the bank lending volumes and rates to non-financial corporations, the MMCG noted a compression of interest rate margins and a corresponding increase in lending volume in March 2021, when the lending target of the first special lending period had to be met. This pattern was partly reversed in April 2021, once the deadline had passed. The MMCG noted that a similar phenomenon could also be expected in December 2021, when the second special lending period ends.

MMCG members highlighted potential TLTRO III-related funding cliff effects. Several members pointed out that the expiry of the TLTRO III special interest period and collateral easing measures in June 2022, might put pressure on financing conditions in short-term markets. Some members added that telegraphing in advance the ECB's intentions on addressing such potential cliff effects would provide welcome guidance to market participants to inform how they shape their funding plans.

3) Money Market Fund (MMF) regulatory reform

Ileana Pietraru (Société Générale) presented a banking perspective on the amendments to the MMF regulatory regime proposed by the European Securities and Markets Authority (ESMA). Michael Wedow (ECB) outlined financial stability considerations on the proposed reforms.

Stigma associated with the use of the MMF liquidity buffers limited their effectiveness during the recent crisis. According to current regulation, the MMF board must consider introducing liquidity gates and fees to prevent outflows when the fund breaches the weekly liquid asset (WLA) limits. In a crisis, this rule provides incentives to MMF investors to quickly redeem their holdings before such liquidity gates are established and may thus generate undesired panic runs. To avoid this risk, in March 2020 fund managers opted to fire-sell assets and avoid any breach of the WLA limits that could be perceived by the markets as a sign of liquidity stress. Therefore, MMCG members attributed the stress during the March 2020 episode to the reluctance of MMFs to use the liquidity buffers offered by the WLA limits for reasons of stigma rather than an inappropriate calibration of WLA limits, given the crisis outflows recorded.

Allowing for countercyclical WLA buffers (akin to banks' liquidity coverage ratios or LCRs) would improve the resilience of MMFs. The LCR for banks was temporarily reduced during the COVID-19 crisis, giving banks more space to absorb liquidity shocks. MMCG members suggested considering a similar countercyclical flexibility for MMFs' WLA limits to avoid such "first-mover" incentives for MMF investors.

MMCG members stressed the inherently different liquidity characteristics of bank deposits and MMF shares. Several MMCG members considered it essential to clarify to customers that MMF shares were less liquid than deposits at bank current accounts. MMF customers should understand that MMFs offer a better return but that liquidity cannot be guaranteed in crisis scenarios.

Banks' capacity to buy back short-term securities during the spring 2020 episode was not seen as a limitation. According to some MMCG members, the average liquidity position of banks in spring 2020 was sufficiently comfortable to purchase the commercial papers from the MMFs at a price reflecting the stressed conditions. However, not all MMFs – especially the Low Volatility NAV funds – were willing to transact at those prices.

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[2]
Belfius Bank & Insurance	Mr Werner Driscart
BNP Paribas	Mr Patrick Chauvet
BPCE/Natixis	Mr Olivier Hubert
Caixabank	Mr Xavier Combis
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 Continental Europe	Mr Harry-David Gauvin
ING	Mr Jaap Kes
Intesa Sanpaolo	Ms Maria Cristina Lege
LBBW	Mr Lars Stridde[3]
Nordea	Ms Jaana Sulin
Société Générale	Ms Ileana Pietraru
UniCredit Bank	Mr Harald Bänsch
European Central Bank	Mr Thomas Vlassopoulos (Chair)
European Central Bank	Mr Helmut Wacket
European Central Bank	Ms Maria Encio (Secretary)

[1] Substitute for Mr David Tilson.

[2] Substitute for Mr Miguel Monzón.

[3] Substitute for Mr Jan Misch.