EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

15 December 2021

ECB Money Market Contact Group (MMCG)

Tuesday, 7 December 2021, 13:00 - 15:30 CET

Webex conference

Summary of the discussion

1) Developments in OIS and EURIBOR since September 2021

Miguel Monzón (BBVA) reviewed the main developments in money markets since the last meeting on 15 September 2021. The discussion focused on the expectations for the evolution of interest rates reflected in the overnight interest swap (OIS) forward and EURIBOR futures rates.

The MMCG attributed the divergence of the timing of the lift-off of ECB policy rates, as embedded in OIS prices, from that reflected in analysts' views and the ECB's forward guidance to the existence of technical factors. According to MMCG members, fundamentals alone would not justify the current OIS pricing of the lift-off date for ECB policy rates. While harmonised index of consumer prices (HIPC) increases may be slightly more persistent and push short-term inflation expectations higher, medium-term inflation expectations and the current formulation of the ECB's forward guidance would still suggest a later lift-off date. The MMCG attributed this difference to technical factors, which they believed played a relevant role, especially in the second half of October 2021. According to MMCG members, communication by several central banks around mid-October 2021 was perceived as signalling an earlier removal of accommodative policy than previously expected and was followed by a sizeable unwinding of previous speculative positions which had been based on expectations of "low rates for a long time" in the OIS market. As the OIS market was relatively illiquid, trading volumes were not large enough to absorb such a significant unwinding of positions in a short time. In addition, some market players may have been prevented from taking positions due to internal risk limits. Hence, increases in OIS rates are likely to also reflect such position unwinding activity rather than pure expectations of an early lift-off date for ECB policy rates.

The MMCG was of the view that the expected decrease in excess liquidity as of June 2022 may be the main driver behind increasing spreads between EURIBOR forward rates and OIS rates. EURIBOR futures spreads over forward OIS are more a reflection of the outlook regarding excess liquidity and its cost rather than ECB rate expectations. According to MMCG members, early repayments of the third series of targeted longer-term refinancing operations (TLTRO III) in June 2022 may result in EURIBOR increasing by about 15-20 basis points over the next fifteen months. The MMCG predicted an increase in banks' issuance of commercial paper to pre-COVID-19 levels. For the last operation of TLTRO III to be allotted in December 2021, a limited rollover from past operations was expected. MMCG members noted that extending the maturity of central bank funding in this way would carry a cost in terms of pricing, as the special rate of -1% would apply for a shorter period (i.e. six months less).

2) Prospects for the 2021 year-end and 2022

Ileana Pietraru (Société Générale), Jürgen Sklarczyk (Deutsche Bank) and René Brunner (Erste Group) presented their expectations for the year-end in the secured and foreign exchange swap segments and for 2022 in the unsecured segment.

The MMCG perceived the 2021 year-end for the secured segment to be as challenging as the 2016 one, as it was extremely difficult to place excess liquidity held by non-banks. According to MMCG members, non-banks were unwilling to trade in the unsecured money market, and at the same time, banks were unwilling to trade reverse repos with them over the year-end. The attitude of non-banks was motivated by general credit risk aversion, while banks were driven by their already excessive liquidity positions and internal pressures to reduce balance sheet size at balance sheet reporting dates so as to reduce costs, e.g. related to contributions to the Single Resolution Fund. These factors, combined with the lower availability of government bonds in view of higher Eurosystem holdings, were leading to tensions in the repo market. MMCG members welcomed the Eurosystem decision of 16 November 2021 to increase the limit of the overall Eurosystem securities lending facilities from €75 billion to €150 billion. The Eurosystem securities lending facilities have provided some relief since then, but this may not be enough to alleviate tensions due to additional restrictive limits, e.g. at the individual security or counterparty level and the significant demand. MMCG members expressed the view that tensions in the secured money market were likely to increase over the next few weeks, especially for trades backed by specific securities.

The MMCG highlighted that higher US dollar premia in the foreign exchange swap market were also driven by contagion from the collateral shortage in the secured segment. Given that banks were turning away money market funds' (MMFs) excess liquidity holdings to reduce their own balance sheets for the year-end, some MMFs turned to investing in US Treasury bills, hedging these positions through the foreign exchange swap market. Despite some increase in foreign exchange swap market premia, US dollar liquidity was considered abundant. Hence MMCG members expected the year-end prices in 2021 to be largely in line with those of the previous three years, unlike for the secured segment.

The MMCG predicted that banks would lengthen the maturities of future commercial paper issuances. According to MMCG members, unsecured rates were expected to see a mild decline around the turn of the year-end, especially for the short tenors, i.e. between one week and one month. For 2022, the issuance costs of commercial paper were foreseen to gradually increase – pushing respective EURIBOR rates up – and their maturities were expected to lengthen. It was noted that both developments would happen at a pace largely driven by TLTRO early repayments and the reduction of the Eurosystem asset purchase programmes.

3) Incorporating climate change considerations into the Eurosystem collateral framework

Jana Aubrechtova (ECB) presented some initial considerations, associated questions and ongoing issues in the effort to incorporate climate change considerations into the Eurosystem collateral framework, as announced in the ECB action plan published in July 2021. Harald Endres (Deutsche Kreditbank) presented a banking sector perspective on this matter and elaborated on how his own institution was incorporating climate change and environmental, social and governance (ESG) considerations more broadly into its lending practices.

Banks are not yet incorporating climate change considerations in a systematic way into their money market business. MMCG members expressed support for and interest in the subject, while admitting that internal work within their institutions was not very advanced, in particular as regards their money market and liquidity businesses. Most MMCG members did not seem to incorporate climate risk considerations into the processes and conditions of their secured lending, with interventions largely focused on instruments with a green or ESG-compliant label or classification. Some members recalled the nascent stage of the Eurex Repo Green Basket, and that it was illustrative of the challenges of taking into consideration climate change implications in the (short-term) repo market segment. One MMCG member stated that they were taking into consideration the targets set out in the Paris Agreement in the provision of their collateralised financing, in step with the more advanced climate-related reporting requirements in the respective jurisdiction. The ECB welcomed the growing issuance of ESG bonds in the market while clarifying that only climate change was part of the ECB action plan.

Some MMCG members were concerned that the implementation of climate change considerations in the Eurosystem collateral framework might affect collateral availability. Several MMCG members expressed their apprehension that there might be discrimination against assets issued by “high polluting” entities and voiced their concerns about the implications of such a move for collateral availability. They stressed that the exercise should not result in an exclusion or serious penalisation (haircuts) of assets in their use as collateral. The ECB explained that it was carefully assessing the possible trade-offs to ensure that changes would not hamper the smooth conduct of monetary policy, and that changes were to be introduced with sufficient lead time, which would also allow for adjustments by the institutions concerned. It was also mentioned that beyond a simple measure of a point-in-time carbon footprint, the Eurosystem assessed the relevance and feasibility of a range of criteria that also reflected a contribution to an orderly transition, such as the alignment with the targets set out in the Paris Agreement. Some MMCG members pointed to green TLTROs as a potentially effective tool to incentivise green lending.

4) Miscellaneous: upcoming changes to the ECB Survey of Monetary Analysts

An ECB representative (Claus Brand) informed the MMCG about the upcoming review of the panel composition of the ECB Survey of Monetary Analysts (SMA), aimed at improving its representativeness and quality.

The upcoming change in panel composition will likely result in some banks being replaced with other banks or asset managers. The SMA currently collects information on market expectations from 30 banks selected from three ECB market contact groups (Money Market Contract Group (MMCG), Bond Market Contact Group (BMCG) and Foreign Exchange Contact Group (FXCG)). 89% of the panellists respond to the survey on a regular basis and 68% in a complete manner, answering all questions. The ECB is considering replacing the less active contributors with other banks or asset managers to increase responsiveness and to further enhance the quality and consistency of survey results.

List of participants

Money Market Contact Group meeting

Participant's organisation	Name of participant
Bank of Ireland	Mr David Tilson
Barclays Bank	Mr Bineet Shah
Bayern LB (DKB subsidiary)	Mr Harald Endres
BBVA	Mr Miguel Angel Monzón
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 Jan Misch
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)