EUROPEAN CENTRAL BANK
EUROSYSTEM

DG Market Operations
Money Market and Liquidity Division

ECB-PUBLIC
25 September 2018

Meeting of the Money Market Contact Group (MMCG)

Frankfurt am Main, 25 September 2018, 14:00-18:00 CET

SUMMARY

1. Address by Benoît Cœuré, Member of the Executive Board of the ECB

In a speech entitled "Waiting for ESTER: the road ahead for interest rate benchmark reform", published on the ECB website[1], Mr Cœuré highlighted the importance of money market benchmarks for monetary policy and the ECB's commitment to providing a new, robust and reliable euro short-term rate by October 2019 at the latest. He also urged financial market participants to reinforce their efforts to ensure a smooth transition from the benchmarks that are not compliant with the EU Benchmark Regulation, in particular from EONIA towards ESTER. For EURIBOR, while the private sector is currently reforming the benchmark, sufficient safeguards should be established in all contracts to mitigate the risk of potential adverse scenarios. Finally, Mr Cœuré encouraged MMCG members and banks to spread information about benchmark reforms to smaller and less sophisticated market participants to facilitate the transition process for the entire market.

2. Review of the latest market developments and other topics of relevance: recent developments in market expectations for the ECB's monetary policy, including market-based and survey indicators

Toshi Nakamura (ECB) presented developments in the market measures of the ECB monetary policy expectations, based both on euro money market derivatives and OIS rates, as well as on market surveys of market participants. The two indicators displayed some divergence in market expectations. MMCG members discussed both measures, tending to prefer OIS rates as a more precise reflection of market expectations as, in their view, these rates reflected real trades and market activity, whereas the motivation of economists taking part in the surveys could vary. Some members, however, noted that the current pricing was relatively neutral and did not reflect large rate increases and/or a decline in excess liquidity. MMCG members emphasised the effectiveness of the ECB's forward guidance, which anchored market expectations for the first rate increase to occur after the summer of 2019.

The impact of developments in Italy on the euro money market

Marco Antonio Bertotti (Intesa) provided an update on developments in Italy. With regard to the approval of the state budget, he noted that the most important milestone was the finalisation of the budget law, followed by the submission of the budget to the European Commission, rating reviews, the Commission's review of the budget and the final approval. Political developments would become particularly important in weeks marked with large issuance activity. Looking ahead, net issuance activity was expected to be very low in the remainder of 2018,

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[1] https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp180925.en.html

whereas in 2019 the increase in net issuance would have to be absorbed by the market. Foreign ownership of Italian government bonds had decreased since May.

The money market remained well-shielded from political developments. The lower liquidity in August was linked to seasonal patterns and was little affected by the developments in the sovereign bond markets. In terms of monetary policy expectations, some flattening of the OIS curve was observed during the summer as markets postponed the timing of the policy rate increases somewhat in view of the higher political risk.

3. Implications of Brexit for the euro money market, euro area banks' Treasury activities and liquidity management

Dave Tilson (Bank of Ireland) recapped that in June this year the European Banking Authority had published an opinion on Brexit planning and had set out a range of actions which banks should consider in order to be prepared. MMCG members mentioned that, despite the large amount of uncertainty in the market about the new regulatory and institutional framework, preparations were ongoing. Several European and UK-based banks were undergoing organisational changes to reorganise their UK and euro area-based activities and update legal documentation and issuance programmes. This was also the case for other market players, such as UK-based asset managers.

Several areas were mentioned as surrounded by uncertainty with potentially large implications for the money market. For instance, the issue of UK banks’ access to the ECB was expected to impact market rates, in particular in the FX swap market. It was also expected to affect the risk-weighted capital treatment of UK and EU government bonds, possibly leading to a shift towards higher rates for euro area sovereign bonds and, in view of reduced trading activity by UK investment banks, impacting market liquidity in the government bond market. It was noted that developments around Brexit had already led to higher market volatility which would be further exacerbated as March 2019 approaches.

Another area of concern is the interest rate derivatives market in view of uncertainty about the capital treatment of exposures to the London-based clearing houses and its implications for market liquidity. Some counterparties had reportedly already moved part of their derivatives clearing activity to the euro area-based clearing houses, although such a shift in activity was seen as difficult for the legacy contracts. These developments were seen as posing the risk of liquidity bifurcation in the derivatives market and market fragmentation into the onshore and offshore markets. Fragmentation of the clearing venues was also expected to reduce netting capabilities, leading to higher prices for derivative instruments, which were used by a wide range of market players, including banks’ corporate and institutional clients.

4. Impact on the TLTRO-II repayments on the euro money market, bank funding and liquidity management across several euro area jurisdictions. An update on developments with regard to the net stable funding ratio (NSFR) and its role in the TLTRO-II repayment considerations

Several MMCG members presented their expectations in terms of the repayments of the targeted long-term refinancing operations (TLTRO) highlighting aspects specific to their national jurisdictions. It was noted that, so far, TLTRO repayments had little influence on the money market. The implications of the maturing TLTRO amounts differed across countries: countries with larger participation were expected to be more affected by higher costs of market funding to replace the attractively-priced TLTRO funds. In addition to pricing considerations, market access was also seen as an important factor. Besides funding, TLTRO funds were also considered important for banks’ regulatory compliance with the liquidity ratios, such as the NSFR and the liquidity coverage ratio (LCR). This, in turn, could have implications for the timing of early TLTRO repayments, as banks could be incentivised to repay TLTRO funds in advance, once the residual maturity of the TLTRO funds falls below 12 or six months respectively. In general, however, early repayments were expected to be low, which would result in a concentration of TLTRO redemptions at the TLTRO maturity dates, which was regarded as a source of concern.

TLTRO funds were expected to be replaced by increased issuance in long-term and short-term markets. In short-term markets, this was expected to increase the pricing of funds from customers with high regulatory value, such as corporates and sight deposits, and to lead to higher issuance in maturities above one year. In the long-term funding markets, covered bonds and unsecured issuance were considered as most likely replacements. The higher cost of longer-term issuance for banks was likely to raise the cost of lending to corporates.

Jürgen Sklarczyk (Deutsche) presented an update on NSFR, pointing out that with its effective implementation, some types of money market transactions would become less favourable and would be reduced, such as short-term commercial paper and certificates of deposit markets. At the same time, the role of non-financial customers was expected to increase in the short-term market, leading to potential two-tiered pricing for non-financial and financial customers. The tiering was also expected to occur in the term premia, i.e. between the term (e.g. two to three year) and short-term (e.g. two to five month) money market rates. Although banks were already reporting their NSFR values, the effective implementation date of NSFR was expected to have a further impact on the money market, and in the view of the MMCG, the full impact of NSFR had not fully materialised yet. Linking to the TLTRO discussion, the replacement of TLTRO funds for NSFR purposes was seen as a challenge and would need to be carefully planned and included in banks' long-term funding and liquidity plans.

5. Developments in the settlement infrastructure CLSNow

Robert Hofmeister (ECB) presented the new service launched by CLS and sought feedback from MMCG members on a number of questions submitted to the MMCG in advance of the meeting. MMCG feedback suggested that while the new service may be beneficial for the banks that were clearers in foreign currencies, for most European banks, which were not foreign currency clearers, such a service would result in higher operational costs and add operational complexity in terms of managing foreign currency buffers. In particular, the following challenges were mentioned: (i) European banks, which are not clearers in foreign currencies, would find it more difficult to manage foreign intraday liquidity at times when US banks tighten the availability of credit lines, making intraday liquidity management more expensive, (ii) this could lead to a concentration of USD liquidity needs early in the US trading hours, leading to price volatility throughout the day; (iii) the need to manage each payment on an individual basis would increase credit risk and could result in a more selected choice of counterparties in the FX swap trades.

6. Other business: Planning of the next meeting

The next MMCG meeting will take place in Frankfurt am Main on Monday, 3 December 2018.

List of participants

Money Market Contact Group Meeting

Tuesday, 25 September 2018, 14:00 – 18:00

ECB Main Building, conference room C2.03

Participant's organisation	Name of participant	
European Central Bank	Ms Cornelia Holthausen	Chairperson
European Central Bank	Mr Holger Neuhaus	
European Central Bank	Ms Julija Jakovicka	Secretary
Bank of Ireland	Mr David Tilson	
Barclays Bank PLC	Mr Bineet Shah	
Bayerische Landesbank	Mr Harald Endres	
BBVA	Mr Miguel Monzon	
Belfius Bank	Mr Werner Driscart	
BNP Paribas	Mr Patrick Chauvet	
BPCE/Natixis	Mr Olivier Hubert	
Caixabank	Mr Xavier Combis Comas	
Caixa Geral de Depósitos, S.A.	Mr António Paiva	
Deutsche Bank AG	Mr Juergen Sklarczyk	
DZ Bank	Mr Michael Schneider	
Erste Group Bank AG	Mr Rene Brunner	
HSBC France	Mr Harry Gauvin	
ING Bank	Mr Sanne Meertens	
Intesa Sanpaolo	Mr Marco Antonio Bertotti	
LBBW	Mr Jan Misch	
Nordea Bank Finland	Ms Jaana Sulin	
Société Générale	Ms Ileana Pietraru	
UniCredit Bank AG	Mr Arne Theía	

National Central Banks	Name of participant
Banque Nationale de Belgique	Mr Kristof Vandermeersch
Deutsche Bundesbank	Mr Karsten Stroborn
Central Bank of Ireland	Mr Paul Kane
Banco de España	Mr Pablo Lago
Banca d'Italia	Ms Patrizia Ceccacci
De Nederlandsche Bank	Mr Dion Reijnders
Národná banka Slovenska	Mr Peter Andresič

Via Teleconference	Name of participant
Eesti Bank	Toivo Kuus
Banque centrale du Luxembourg	Mr Achim Hillen
Oesterreichische Nationalbank	Ms Bettina Moser
Banco de Portugal	Mr Luís Sousa
Banka Slovenije	Ms Sandra Jurisevic
Suomen Pankki	Ms Päivi Heinäao-Ehgartner