



EUROPEAN CENTRAL BANK

DG MARKET OPERATIONS

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DGM/FRO/2007/38

Money Market Contact Group

Frankfurt, Wednesday 14 February 2007, 13:00 – 16:00

SUMMARY OF THE DISCUSSION

1. The main features of the repo market in Spain

Jaime Comunion (Caja Madrid) provided a presentation about the main features of the Spanish repo market.

The presentation started with a general introduction to the Spanish debt markets (i.e. the collateral base for the repo markets). Thereafter Jaime characterised the main features of the Spanish repo market, also putting the data into a European perspective by using the data of the latest ICMA repo market survey and highlighting the main discrepancies between the two. At the end of his presentation Jaime listed some future developments that are expected to have an impact on the Spanish repo market.

The subsequent discussion centred around the following issues:

- First, the unusually high share of retail investors' direct participation in the Spanish repo market (around 50 percent);
- Second, the negative spread of Spanish domestic repo rates versus Eurepo, which can at times exceed 40 basis points and which seems to be mainly liquidity driven; and
- Third, the pre-requisites for foreign banks to participate in the Spanish Treasury's repo auctions.

Related to the last point the members of the group asked the ECB, if it would be possible to have, in one of the following meetings, an overview presentation regarding the various national Treasuries' activities in the euro money market. The Chairman offered to take up this suggestion in one of the meetings in the second half of the year.

2. Round up on market developments during the last few months

The Secretary provided a short summary of the latest developments in the money markets, focussing on current interest rate expectations and the ECB's liquidity management since the previous meeting, especially during the Christmas/New Year period.

The Chairman started the discussion by asking the members, if it was correct to assume that market participants did not need much central bank guidance beyond a time horizon of maybe three months. This seemed to be suggested by the current low volatility implied in options on the Euribor futures maturing in late 2007. Members however recommended some caution in this respect as the low (and declining) volatility was not necessarily only linked to a good (and improving) predictability of the

ECB's interest rate policy. Nevertheless, they were generally of the view that the ECB's current communication strategy was the best possible and should be maintained.

Regarding the ECB's recent management of the liquidity situation in the euro area, some banks suggested that the allotments around the Christmas / New Year period should have been even more generous. Such a strategy could, in their view, have helped to avoid the negative impact on the spread developments caused by adverse autonomous factor changes. Others were less critical, stressing the fact that this time of the year was always very special for banks and that the calendar effect (i.e. the very long Christmas weekend) might also have contributed to the widening of the Eonia spread.

In this context there was also a discussion on the possibility of having a 2-week operation at this specific time of the year that would cover both the Christmas period and New Year. Overall, this idea faced more scepticism than support, as members argued that such a 2-week operation would further increase the uncertainties related to the autonomous factor forecasts, which might prove to be detrimental in the day-to-day liquidity management.

Against the background of this discussion it was suggested to include a new qualitative question in the next money market survey, asking banks if they are able (according to internal rules) to make full use of the averaging mechanism of the minimum reserve framework, or if they rather have to hold certain minimum amounts on a daily basis regardless of the market developments.

At the end of the discussion the Chairman mentioned that the ECB had further investigated some issues regarding the publication of the tender calendar. He said that it appeared likely that national holidays would no longer be automatically taken into account – in the future a shift of the regular tender dates might only take place, if there is a holiday in a certain minimum number of euro area countries. Moreover, he confirmed that it is the ECB's aim to publish the tender calendar for 2008 around 2 months earlier than previously.

3. The development of banknotes since the introduction of the euro

Paul Mercier presented the development of banknotes in circulation since the introduction of the euro. He first provided the balance sheet context in which the ECB looks at the development of banknotes and the resulting impact on the size of the ECB's refinancing operations. After taking a closer look at some special periods of time he focussed at the structural factors and the main determinants contributing to the increased demand for banknotes. Moreover, Paul showed a breakdown of the denominations of the euro banknotes (also in comparison to the USD and the CHF), identified some seasonal patterns and elaborated on the way the ECB forecasts the development of banknotes.

The following discussion focussed on the link between the continued rapid growth of the banknotes in circulation and the size of the ECB's tender operations. Several members mentioned that a continued growth of these operations (due to a further increase in banknotes) was undesirable, as it would raise, at least over the medium-term, questions regarding the sufficient availability of collateral. Some members suggested the Eurosystem should consider to increase its portfolio of domestic assets (similar to the Fed), in order to limit the size of the outstanding refinancing operations to reasonable levels. Paul replied that the Eurosystem was indeed taking a close look at the structure of its balance sheet but that it was premature to come-up with a concrete reply as regards these suggestions.

As there was some interest in the development of other autonomous factors since the introduction of the euro it was agreed to have a similar presentation with a focus on government deposits in another meeting in the second half of the year.

4. Initial feedback on the use of credit claims

Paul Mercier provided some brief feedback on the use of credit claims following the introduction of a single list of collateral. His general feedback from the viewpoint of the ECB was complemented by several members providing further insights from their own experience.

The main messages from the various interventions seem to be as follows:

- On the side of the banks there is significant interest in the possibility of using credit claims as collateral for ECB operations/intra day credit.
- The use of credit claims (or the additional use in countries where they have been already eligible) is however rather limited so far.
- This discrepancy is apparently explained by technical factors (internal infrastructures still need to be established) and, in particular, by the fact that Internal Rating Based models for the assessment of the credit quality of the respective claims have not yet been approved.
- Once these hurdles will have been overcome, the share of credit claims used to receive (intra-day) liquidity from the ECB is expected to grow significantly.

Several members expressed an interest to have a deeper discussion about this topic at a later stage – a request that the Chairman answered by referring to the tentative idea for a common COGESI / MMCG workshop on collateral issues (see second bullet point in the “Other items” section below).

5. Other items

- Annemieke Bax, the Secretary of the OMG provided some feedback from the last OMG meeting (held on 7 February) and shared the latest info on the upcoming Global Conference (23/24 April) with the group.
- The Chairman informed the members that the two Directorates of the ECB that are involved in collateral management issues, namely DG-M and DG-P, are considering to organise a workshop on collateral issues. The main addressees of this workshop would be the members of the two respective contact groups, namely the MMCG and the COGESI. The tentative length of such a workshop could be 1 – 1.5 days and it might be hosted by one euro area NCB. The main focus of the workshop would probably be the recent changes in the ECB’s collateral framework (i.e. the introduction of credit claims), but one could also imagine to look more generally at collateral management issues.
- The next meeting will take place on Thursday 31 May 2007 in Frankfurt from 13:00 to 16:00 CET.

The following agenda items were tentatively agreed:

- The regular review of market developments
- The relationship between the ECB tender rates (ECB eligible collateral) and the 1-week repo rate (Euro GC)
- An update on the STEP initiative
- An update on TARGET 2 Securities (in case there are new developments)