EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

2 October 2014

Money Market Contact Group

Frankfurt am Main, Tuesday, 9 September 2014, 3 p.m. to 7 p.m. CET

Summary of the discussion

1. Review of the main findings of the Euro Money Market Survey

Pascal Nicoloso (ECB) reviewed the preliminary findings of the ECB annual Euro Money Market Survey on interbank trading activity in the second quarter of 2014. The preliminary results showed an increase in the total money market turnover across various segments, i.e. in the unsecured, secured, OIS and FX swap markets. Unsecured market turnover showed the first tentative signs of recovery, interrupting the downward trend observed since 2007, although the signs of improvement were mainly observed in the core countries. The survey also indicated that credit policies were no longer having a strong contractionary impact on market turnover and the number of respondents that expected market turnover to expand due to credit policies exceeded those that expected the turnover to contract. One member of the Money Market Contact Group (MMCG) commented that the results of the comprehensive assessment could be a turning point for the re-establishment of credit lines among money market counterparties.

Nevertheless, some members of the MMCG were also wary of the tentative signs of improvement. First, they expected that the ongoing balance sheet adjustments and regulatory pressures (such as the leverage ratio) could continue to exert a downward pressure on money market activity. In this respect, a number of MMCG members also mentioned the bank levies that are to be introduced in some countries next year. These factors were expected to make it more costly (in balance sheet terms) to participate in the unsecured and secured money market, not least because of the low returns generated in these particular market segments. As revealed during the group discussion, the size of bank levies varies between different countries and the way in which they were applied were very heterogeneous. The members of the MMCG therefore called for harmonisation across euro area countries. Second, higher trading volumes in some segments, for example, the OIS market, did not necessarily reflect better market functioning but rather greater hedging needs against falling interest rates. Finally, in the MMCG's view, the survey no longer reflected the "true" unsecured funding market, which has shifted from the pure interbank market to include the wholesale market, in which corporates and other non-bank investors play a greater role.

In the secured money market, the MMCG mentioned the two diverging forces at play with a great deal of uncertainty about the final impact on market turnover. On the one hand, balance sheet optimisation due to regulatory requirements had led to a decline in the repo activity at banks' investment desks while on the other hand the use of repos by banks' treasuries for liquidity management (including management of high-quality liquid assets (HQLA)) was rising.

2. Review of the latest market developments and other topics of relevance

Sean Crowe presented a review of the main developments in the euro money market since the last meeting. As reflected in the subsequent discussion, recent announcements of the ECB’s measures had had a positive impact on market levels, even prior to the deployment of the latest measures. TLTROs were expected to contribute to lower funding costs for banks and subsequently to lower the cost of credit, in particular, in the non-core euro area countries. As a result of heightened uncertainty, participation in the December operation is expected to be higher, allowing for more time for banks to assess lending potential.

The ECB’s decision in June to lower the policy rates brought the deposit facility rate into negative territory. The impact was most pronounced in the unsecured money market, as interbank unsecured transactions started trading at negative levels. Other non-bank investors, for example corporates and public entities, were reportedly avoiding negative rates by expanding into longer maturities. In the repo market, negative rates were nothing new. Following the decisions taken in June, repo rates in core countries structurally declined to enter into negative territory, whereas general collateral repo rates in non-core countries declined, but remained largely in positive territory. With regard to market activity, the decision has had no negative impact on market functioning. In fact, trading volumes in the short-term unsecured market (EONIA) and in the secured market even increased.

It was deemed too early to assess the full impact of the decision in September to lower further the deposit facility rate and the group suggested that a more thorough assessment be made at the next MMCG meeting. It remained uncertain as to whether banks would be able to pass negative rates on to their customers, as at least retail deposits remained floored at zero. The members of the MMCG reported on the legal challenges of charging negative rates to retail depositors in a number of countries, and were wary about passing the cost on to those customers on account of the risk of deposit outflows.

Other uncertainties were raised in relation to the functioning of the money market fund industry, as it was not clear if there were further scope for those market players to lengthen maturities and expand the credit spectrum of investments. There had reportedly already been some signs of disintermediation of corporate customers from money market funds into banks and the trend could be expected to continue over the next six months. Finally, some concerns were expressed with regard to technical issues relating to the application of negative rates in the derivatives market, where a uniform approach still needed to be found.

3. Single Supervisory Mechanism: supervisory set-up and impact on the euro money market

Stefan Walter, Director General of Micro-Prudential Supervision I, and Giuseppe Siani, Deputy Director General of Micro-Prudential Supervision IV briefly introduced the supervisory set-up of the Single Supervisory Mechanism (SSM) and opened the floor for questions and issues of relevance for the euro money market.

Among the issues raised by the group, the MMCG appealed for the harmonisation of rules across national competent authorities (NCAs) on supervision and regulation, as, in their view, diverging national interpretations of rules had been fostering unfair competition across Member States.

The MMCG also reiterated concerns about national practices of ring-fencing intragroup liquidity flows to and from subsidiaries and branches.

Finally, the MMCG was keen to understand how market feedback on the regulatory impact on money market functioning could be taken into consideration by both the ECB’s monetary policy areas and the SSM and how the two sides interacted with the regulatory standard-setting bodies.

4. Main developments in the FX swap market

Patrick Chauvet provided a comprehensive overview of structural and recent developments in the FX swap market, which was highly appreciated by the group. Patrick gave an overview of the different market players active in the FX swap market, explaining different dynamics and drivers in the short-term and longer-term segments. In particular, the short-term FX swap market is an important liquidity and treasury management tool for banks. In view of diverging rates on the remuneration of excess reserves held at global central banks, the FX swap market has also become a widely-used instrument for market participants looking to optimise the management of their liquidity buffers. For some banks, which need to meet Liquidity Coverage Ratio (LCR) requirements in various currencies, FX swaps are also an important instrument for regulatory purposes. Market expectations of central bank measures have been a major driver of developments in the short-term FX swap market. For instance, the basis has re-widened since April 2014, as rising expectations of additional measures in the euro area, which contrasted with the expected tightening in the United States, as well as geopolitical concerns, increased the attractiveness of the US dollar in the FX swap market.

5. Other items: Planning of the next meeting

The next MMCG meeting will take place on Friday, 21 November 2014 in Frankfurt am Main, starting at 1 p.m.

Annual MMCG dinner with Executive Board Member, Mr Benoît Coeuré

Speech by Mr Benoît Coeuré

The Executive Board Member, Benoît Coeuré, attended the annual MMCG dinner and in his speech entitled “Life below zero: learning about negative interest rates” he provided an initial assessment of the ECB’s experience with the negative deposit facility rate.