EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS 9 July 2015

Money Market Contact Group

Paris, Wednesday, 17 June 2015, 14:00 – 18:00 CET

Summary of the discussion

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

Franck Carminati reviewed the main developments in the euro money market since the last meeting. The presentation was then followed by an exchange of views on those developments as well as on a set of issues that had been submitted to members prior to the meeting. Issues for discussion covered, among other things, (i) the impact of developments in Greece on the euro area money market, (ii) the drivers of recent market volatility and repricing of euro money market rates, (iii) the initial market experience with negative three-month EURIBOR rates, (iv) market expectations of future money market rates and market activity under steadily increasing levels of excess liquidity, and (v) an update on the foreign exchange swap market.

With regard to developments in Greece, several members of the Money Market Contact Group (MMCG) indicated that banks had taken precautionary measures and increased monitoring in order to anticipate the potential adverse impact on banks' liquidity situation and funding conditions. Banks were particularly vigilant about developments in the foreign exchange swap market and the possible reaction of US investors to the developments in Greece.

Members of the MMCG attributed recent episodes of repricing in the financial markets to risk considerations, which were amplified by a number of other factors such as (i) a heavy issuance calendar in Spain, (ii) a reduction of banks' balance sheets and the inability to "warehouse" risks, thus passing on risk to the market instead, (iii) recent stronger HICP data for the euro area, and (iv) a repositioning of fast money investors, which reportedly explains the rapidity of market movements. In the Group's view, the repricing was exacerbated by generally lower market liquidity. Going forward, market participants did not exclude more episodes of market volatility, not least due to the forthcoming tightening of monetary policy in the United States. Furthermore, the MMCG was of the opinion that recent market developments have also increased the attractiveness of targeted longer-term refinancing operations.

With regard to market functioning, some members of the MMCG mentioned that the high level of excess liquidity is pushing down short-term unsecured and repo market rates, to levels beyond which market activity may become uneconomical compared with depositing funds directly with the Eurosystem. Higher asset price volatility may also make it more favourable to hold cash rather than invest in other assets. The quarterly Euro Money Market Survey, which is based on MMCG members' feedback on money market trading volumes, documented the resilience of the repo and foreign exchange swap markets in the first quarter of 2015, but its findings did not allow for an insight into more recent developments. According to anecdotal MMCG feedback, the repo trading volumes reported for Italy and Spain were not adversely affected by negative rates.

In addition, the Group noted declining issuance volumes for euro-denominated commercial paper and certificates of deposit, with investors reportedly preferring to switch into instruments with longer maturities or in other currencies in order to avoid negative interest rates.

Members of the MMCG enquired about the impact of negative rates on the eligibility of certain securities for use as collateral in Eurosystem credit operations. The Chairman referred market participants to Guideline (EU) 2015/732 of the European Central Bank of 16 April 2015 amending Guideline (EU) 2015/510 on the implementation of the Eurosystem monetary policy framework, which specifies conditions of eligibility for debt instruments with a negative coupon.

Despite expectations of higher excess liquidity, banks did not expect the six-month EURIBOR rate to fall into negative territory. They believed that spreads between six-month and three-month rates for both the unsecured and repo markets had already reached the lowest possible levels.

Finally, with regard to the foreign exchange swap market, the MMCG highlighted that liquidity in this market segment had been affected by the costs arising from regulatory capital requirements (related to the leverage ratio and the effective expected positive exposure with stressed parameters). Furthermore, banks both in the United States and Europe reportedly refrained from increasing their exposure to foreign assets and certain foreign currencies close to balance sheet reporting dates, which may explain the higher volatility in the foreign exchange swap market observed around the end of each quarter.

2. Rate and liquidity developments in the euro area repo market

Members representing banks based in three selected euro area countries presented their views on the repo market in their respective country, placing an emphasis on (i) the main drivers of repo market developments, (ii) fragmentation and cross-border activity, and (iii) the impact of Eurosystem purchase programmes on the repo market. Overall, higher levels of excess liquidity were identified as the main driver behind repo market rates across euro area countries and the spreads between German repo rates and those of other countries remained broadly stable, particularly in shorter maturities. The specialness of German collateral in the repo market was related to higher demand for the cheapest-to-deliver assets and an increase in the amount of special collateral could not be excluded towards the late summer/early autumn.

Roberto Schiavi provided an overview of the status of securities lending conducted by the Eurosystem for marketable debt instruments purchased under the public sector purchase programme (PSPP), noting that lending volumes had been on the low side until now, which may reflect that those assets are not urgently needed in the market. In the subsequent discussion, members of the MMCG reiterated the importance of a common and harmonised approach across all euro area countries. They also cautioned that, although there were no imminent signs of a scarcity of collateral in the market, it may emerge suddenly once Eurosystem purchases have progressed.

3. Other business

a. Update on the ECB's Money Market Statistical Reporting Regulation

Holger Neuhaus informed the MMCG about the Eurosystem's progress vis-à-vis money market data reporting under Regulation (EU) No 1333/2014 of the European Central Bank of 26 November 2014 concerning statistics on the money markets (the Money Market Statistical Reporting Regulation or MMSR) since the previous meeting. Members raised a number of issues related to the reporting of money market transactions, e.g. reporting on a T+1 basis and potential issues related to unsettled transactions, possible inconsistencies between financial and MMSR reporting, and possible use of MMSR data for benchmark purposes, which should be discussed with the European Money Markets Institute (EMMI).

b. Planning of the 2015 MMCG survey on banks' internal organisation of liquidity management

MMCG discussed various options for conducting an update of the 2014 MMCG survey on banks' internal organisation of liquidity management. More specific details regarding the options available for the format of the survey will first be considered by the ECB internally and then submitted to the members of the MMCG for their deliberation.

c. Date of the next meeting

The next meeting of the MMCG will take place on 9 September 2015 in Frankfurt am Main, starting at 15:00, and will be followed by the Group's annual dinner.