EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

ECB-CONFIDENTIAL

7 October 2019

ECB Money Market Contact Group

Tuesday, 24 September 2019, 14:00-18:00 CET, Frankfurt

SUMMARY OF DISCUSSION

Opening remarks by ECB Vice-President Luis de Guindos

See link to the speech on the ECB's website.

1. Market sentiment regarding the ECB's monetary policy stance

Ileana Pietraru (Société Générale) and Jürgen Sklarczyk (Deutsche Bank) presented market feedback on the 12 September ECB Governing Council decisions and their impact on the money market.

The Money Market Contact Group (MMCG) perceived the decisions to be rather dovish, exceeding expectations on: (i) state-contingent forward guidance; (ii) the extension of the third series of targeted longer-term refinancing operations (TLTRO III); and (iii) the magnitude of the two-tier system multiplier. There was scepticism about whether the announced stance would boost growth or inflation at a time when financial conditions were quite expansionary and the slowdown had been triggered by external global factors.

The low take-up of the first TLTRO III operation came as no surprise to the MMCG given the tight schedule to adapt to the new conditions. In its view, it should not be read as a lack of interest in the TLTRO III series as the large TLTRO II borrowers are expected to participate in December 2019 and March 2021. TLTRO III may also attract new participants, as the maturity matches the length of small and medium-sized enterprise loans and the pricing is no longer a backstop. Some members appreciated the indirect effects on capital markets: as long as TLTRO facilities exist, banks are able to issue senior unsecured bonds without mobilising collateral at historically low costs. TLTRO III was, however, considered of little help to support lending by banks without demand for new loans and with capital constraints or countercyclical buffers activated.

The MMCG stressed that no tier system could fully solve banks' vulnerability to a protracted period of negative rates. The ECB's flexibility to change the multiplier was perceived as dovish because future increases were more likely than reductions. While the initial multiplier was larger than expected, the relief to banks' profitability was seen as insufficient to offset the cost of negative rates, which affect their entire balance sheet.

The MMCG offered two explanations for the upward movement in some market rates following the Governing Council decisions. The first suggests a correction to price out prior expectations of a larger rate cut or asset purchases. The second attributes it to the introduction of the two-tier system, as market participants with unused allowances might borrow cash above the deposit facility rate (DFR). While some MMCG members saw repo rates for Italian collateral as being the most likely ones to rise, others saw little scope for trading unused allowances through the repo market as the new asset purchase programme would increase excess liquidity and reduce collateral supply. As long as more than €1 trillion of excess liquidity is subject to the DFR, trading unused allowances may not be profitable enough to overcome the low risk appetite to reopen reverse repo business with certain banks or jurisdictions. The MMCG discussed whether the tiering system could also trigger volatility. While some members expected some tensions at the beginning of the next maintenance period, others were confident that the averaging provision would prevent it or confine it to the end of the maintenance period.

2. Monetary policy developments in the United States and spillovers to global financial conditions

David Tilson (Bank of Ireland) and Bineet Shah (Barclays) discussed how the conduct of monetary policy in the United States had multiple spillover effects on global financial conditions, including for jurisdictions which have a flexible exchange rate such as the euro area. While increased financial integration has multiple benefits, it also raises the question of whether the cost of funds in the euro area can remain independent from developments in the United States, possibly undermining the ability of the Eurosystem to set appropriate monetary conditions given its internal macroeconomic stance. Current tensions in the US repo market served as another example of an American shock with potential spillover effects on the euro area.

MMCG members agreed that disturbances in the US repo market were temporary and not the result of an overall shortage of USD liquidity, but of the uneven concentration of excess reserves among a few market participants, which also reflects a feature of the Federal Reserve’s operational framework. When liquidity shrinks (e.g. in the recent case, due to a combination of quarter-end corporate tax payments and the settlement of a USD 75 billion US Treasury issuance), a small number of banks continue to hoard substantial excess liquidity to comply with internal rules beyond regulatory requirements. As a result of such a combination of factors, repo rates recently spiked. MMCG members inferred that the unwillingness of market participants to distribute a lower level of excess liquidity made it difficult for the central bank to anticipate and prevent it.

The MMCG considered it unlikely that the squeeze observed in the US could spill over to the euro area. Every Member State issued its own debt at a different point in time and sudden massive outflows of liquidity were unlikely. Moreover, euro funding was more diversified among a wider range of market participants.

3. Developments in payment systems: TARGET Instant Payment Settlement

Maria Cristina Lege (Intesa), Oliver Deutscher (DZ Bank) and Harald Endres (Bayerische Landesbank) reviewed the usage of the Eurosystem’s TARGET Instant Payment Settlement (TIPS) service in comparison to RT-1, an infrastructure solution for the processing of instant SEPA (Single Euro Payments Area) credit transfers. TIPS is an open and scalable system, while RT-1 has membership fees and fixed windows for new joiners. The settlement in central bank money and the full integration in the TARGET2/TARGET2-Securities consolidation project could increase the importance of TIPS in the near future.

While TIPS usage was modest and concentrated, all members concurred that it would eventually bring about a change of the bank business model. All euro area banks were experiencing strong demand from their customers to access the service. Once corporate clients got access to instant payments, working capital management would become more efficient. Rolling out the service also to retail clients would imply competition for the business of credit card providers. If instant payments were to also include wholesale market transactions currently settling on a T+1 or T+2 basis, instant settlement would move treasury management from a forecast flow view to an intraday business view. As a result, the volume of TIPS could exponentially increase to billions of euro.

4. Effects of the transition of risk-free rates for derivatives markets

Xavier Combis (Caixabank) and Rene Brunner (Erste Bank) provided an update on the work of the working group on euro risk-free rates, focusing on the plans to establish a liquid €STR (euro short-term rate) derivatives market and on the discussions on possible EURIBOR (euro interbank offered rate) fallback rates.

Given the imminent start of €STR, some central clearing counterparties have announced the creation of new €STR-linked market instruments and their pricing models. MMCG members believe that the establishment of a liquid €STR derivatives market will be rapid in the euro area, much quicker than in the United States and closer to the United Kingdom experience. Because EONIA (euro overnight index average) will become a tracker of €STR from October 2019, the market risk of the existing EONIA products would automatically move to €STR and hence almost all euro OIS (overnight index swap) liquidity could soon be €STR-based.

While SONIA (Sterling Overnight Index Average) and SOFR (Secured Overnight Financing Rate) were set to replace LIBOR (London Interbank Offered Rate) in the UK and the US respectively, the liquidity of the euro-denominated derivatives market might be spread between €STR-based derivatives and EURIBOR-linked ones. While not certain, EURIBOR was expected to continue given its importance for variable-rate mortgage loans. On the question about whether FX swaps would keep referencing EURIBOR when other currencies would switch to overnight rates, MMCG members conveyed the view that they believed so.

5. Other business: planning of the next meeting

Cornelia Holthausen (Chair) warmly thanked Holger Neuhaus, who will change responsibilities inside the ECB, for his extensive contribution to the group during many years.

The next meeting will take place in Frankfurt on Tuesday, 3 December 2019.

List of participants

Money Market Contact Group meeting

Participant's organisation	Name of participant	
European Central Bank	Ms Cornelia Holthausen	Chair
European Central Bank	Mr Holger Neuhaus	
European Central Bank	Ms Maria Encio	Secretary
Bank of Ireland	Mr David Tilson	
Barclays Bank	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	Mr António Paiva	
Commerzbank	Mr Peter Schmidt*	
Deutsche Bank	Mr Jürgen Sklarczyk	
DZ Bank	Mr Oliver Deutscher*	
Erste Group Bank	Mr René Brunner	
HSBC	Mr Harry Gauvin	
ING	Mr Jaap Kes	
Intesa Sanpaolo	Ms Maria Cristina Lege	
LBBW	Mr Jan Misch	
Nordea Bank Finland	Ms Jaana Sulin	
Société Générale	Ms Ileana Pietraru	
UniCredit Bank	Mr Harald Bänsch	

*Alternate agreed via the MMCG secretariat

National central banks	Name of participant
Banca d'Italia	Mr Salvatore Nasti
Banco de España	Mr Juan Martinez Hellín
Banque de France	Ms Natascha Rocher
Banque Nationale de Belgique	Mr Kristof Vandermeersch
De Nederlandsche Bank	Mr Dion Reijnders
Deutsche Bundesbank	Mr Karsten Stroborn
Národná banka Slovenska	Mr Peter Andresič

Via teleconference	Name of participant
Banco de Portugal	Mr Luis Sousa
Bank of Greece	Mr Michail Sfakianakis
Banka Slovenije	Ms Sandra Jurisevic
Central Bank of Cyprus	Mr Marios Karsoumas
Central Bank of Malta	Ms Josette Grech
Eesti Pank	Ms Karoline Jostov
Oesterreichische Nationalbank	Ms Bettina Moser
Suomen Pankki – Finlands Bank	Ms Päivi Heinäaro-Ehgartner