DG Market Operations
Money Market and Liquidity Division

ECB-PUBLIC
8 June 2018

Meeting of the Money Market Contact Group (MMCG)

Paris, 7 June 2018, 14:00-18:00 CET

SUMMARY

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

(i) Drivers behind the recent developments of USD LIBOR-OIS spreads and risk of potential spillovers to other money markets

Jürgen Sklarczyk (Deutsche Bank) reviewed the main drivers of recent developments in the three-month USD LIBOR-OIS spread and potential spillovers to other money markets. Three main factors had contributed to the significant widening of the spread since the fourth quarter of 2017: (i) an increase in the issuance of T-bills by the US Treasury since December 2017; (ii) the introduction of the base erosion and anti-abuse tax (BEAT), which had led to an increased need for money market funding in the US domestic market by both foreign banks and US banks; (iii) market expectations of a tightening of US monetary policy. In contrast to the widening USD LIBOR-OIS spreads, reduced demand for USD liquidity in the FX swap market had resulted in a substantial narrowing of the FX swap basis. Looking forward, the market was pricing a narrowing of the USD LIBOR-OIS spread to levels around 35-37 basis points.

The normalisation of the monetary policy stance in the United States and the reaction of money markets were being closely monitored by market participants as there had been several structural changes in the US money market, including regulations affecting liquidity circulation between jurisdictions. The recently announced measures, such as the expected change in the interest on excess reserves (IOER) rate, were expected to help lower the Fed funds effective rate to around the middle of the Fed funds target range.

Contrary to the developments in the United States, the EURIBOR-OIS basis in the euro area remained at very low levels, showing a limited reaction to the developments in Italy. This had been attributed to the high level of excess liquidity in the euro area. The drivers of the developments in the United States were considered to be fundamentally different from those in the euro area, which would limit comparison across the two currency areas even in the event of monetary policy normalisation in the euro area.

(ii) Functioning of the euro area repo markets: main drivers of recent developments.

Harald Bänsch (Unicredit) opened the MMCG discussion on the main drivers of the latest developments by focusing on the Italian repo market. He mentioned that the Italian repo market had weathered the recent tensions in the broader financial markets following the outcome of the Italian elections, with trading volumes demonstrating a remarkable resilience and repo market rates remaining relatively stable, particularly in the short-term segment. Developments in the repo market during the period of tension associated with the situation in Italy were reportedly linked to an increased demand for Italian collateral, as reflected in the increased amount of bonds trading special in the repo market. In terms of liquidity, market conditions remained stable in the short-term repo market, whereas in longer tenors volumes declined significantly as market participants avoided from trading in the market in view of high volatility and uncertainty. There had since been a return to normal liquidity conditions in the Italian repo market, with most of the activity being concentrated in shorter tenors.

MMCG members indicated that, contrary to the market tensions in Italy in 2010 and 2011, the repo market had shown more resilience owing in part to a number of structural changes that had occurred in recent years, namely: (i) the percentage of domestic ownership of Italian debt had decreased; and (ii) a large liquidity surplus had incentivised a search for yield and increased foreign demand for Italian debt, something which had also been reported during the recent period of market tension. However, in the view of the MMCG the changing regulatory landscape had reduced the intermediation capacity of banks, as reflected in smaller inventories of securities and a more limited ability to intermediate the market, thus amplifying the magnitude of recent market volatility over the period of market tension.

Looking forward, MMCG members concluded that they expected increased volatility in the repo market over the summer, driven by domestic political developments.

2. Market expectations regarding central bank policy and measures: main indicators, recent developments and implications for euro money market functioning and liquidity

David Tilson (Bank of Ireland) provided an update on market expectations regarding central bank policy and measures. He mentioned the various drivers of recent developments in market expectations such as (i) weaker than expected economic data; (ii) European political uncertainty; (iii) weakness in some emerging markets; (iv) geopolitical risks; (v) oil price volatility; and (vi) recent speeches by members of the Executive Board of the ECB. In terms of expectations, market participants expected the asset purchase programme to come to an end before the end of 2018, with more details to be provided at Governing Council meeting in June. In terms of expectations regarding a monetary policy rate hike, the timing of the first ECB rate hike could be delayed owing to higher market volatility on the back of recent tensions in Italy; it would also depend on whether the weakness in economic data proved to be transitory. Furthermore, some MMCG members remarked that higher market volatility might have an impact on early repayment amounts of the targeted longer-term refinancing operations (TLTRO).

3. Money market funds and the impact of the EU money market fund reform

Jaap Kes (ING) provided an update on the latest developments regarding the impact of the EU money market fund (MMF) reform. He recalled the context and the timeline of the upcoming reforms as well as their possible impact on the market. The market estimated that low volatility net asset value (LVNAV) funds would become the largest segment of the MMF industry after the reform, followed by standard variable net asset value (VNAV) funds. These funds were particularly important as a source of bank funding and their importance was expected to increase with the TLTRO repayments.

Overall, the impact of the EU MMF reform on bank funding and market conditions was estimated to be smaller than that of the recent US money market fund reform and no major changes in money market fund customers were to be expected. The peak of the money market fund conversions was expected to occur in the fourth quarter of 2018.

4. Update on money market benchmarks and latest announcements by the ECB

Jaap Kes (ING) and Holger Neuhaus (ECB) gave brief presentations on the work of the working group on euro risk-free rates (RFRs) and on the ECB's euro short-term rate (ESTER), respectively. Holger Neuhaus recalled that the Governing Council of the ECB had decided that the new ECB unsecured overnight rate would be called ESTER and mentioned that the ECB planned to present the features of ESTER at the fourth meeting of the working group on euro RFRs on 11 July 2018.

MMCG members discussed the current status of working group discussions and, in particular, the forthcoming public consultation on a shortlist of candidate RFRs. It was recalled that the decision on the RFR would ideally be made in autumn 2018 after having received market feedback over the summer via the public consultation.

A few MMCG members pointed out the challenge posed by the timing of the EONIA transition, which was due to be completed by 2020, and enquired as to whether some form of legislative support would be possible, either by extending the use of EONIA beyond 2020, in spite of its non-compliance with the EU benchmark regulation, or by providing some legal continuity between EONIA and the new RFR. Working group discussions had so far indicated that, owing to political and time constraints, such legislative support should not be the main working scenario for the transition.

Some members remarked that a transition between EONIA and the new RFR would require the new RFR to be available on a daily basis in the first quarter of 2019. Furthermore, MMCG members emphasised the importance of historical data availability in facilitating the transition to the new RFR in derivatives markets. The member from the ECB explained that once the methodology had been finalised, regular publication of data would be possible but at a lower frequency. The ECB was currently finalising the methodology for ESTER and designing its pre-ESTER publication policy. However, given the lead times required to set up IT systems and processes for producing the daily rate that are compliant with the standards of the benchmark regulation, publication could not be expected before the second half of 2019.

5. Money market and regulatory ratios of banks as a reaction to a future ECB balance sheet decline

Ileana Pietraru (Société Générale) outlined the plan for further work on the topic and engagement on the part of the MMCG members to better understand how the money market might develop in a policy scenario of declining liquidity, taking into account changes in the regulatory environment. MMCG members provided their views on (i) the regulatory/internal ratios they considered to be most susceptible to a decline in the ECB's balance sheet, (ii) which sources of market funding would be used to substitute liquidity provided via the targeted longer-term refinancing operations, and (iii) what the likely impact would be on money market rates and bank funding after the end of net purchases under the ECB's asset purchase programmes. It was noted that the repayment of TLTROs may lead to the repricing of banks' short-term liabilities linked to corporates and retail depositors in view of their attractiveness for the regulatory ratios. They had, until that point, been covered by TLTRO funds. The feedback would be used to inform discussions at the September meeting of the MMCG.

6. Other business: planning of the next meeting

The next meeting will take place on 25 September 2018 in Frankfurt am Main.

List of participants at the 7 June MMCG meeting

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 Sascha Weil	
Bayerische Landesbank	Mr Harald Endres	
BBVA	Mr Miguel Monzon	
Belfius Bank	Mr Werner Driscart	
BNP Paribas	Mr Patrick Chauvet	
Caixabank	Mr Xavier Combis	
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 Neil McLeod	
HSBC France	Mr Harry Gauvin	
ING Bank	Mr Jaap Kes	
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 Harald Bänsch	

National central banks	Name of participant
Nationale Bank van België/ Banque Nationale de Belgique	Mr Kristof Vandermeersch
Deutsche Bundesbank	Ms Stephanie Broks
Banco de España	Mr Pablo Lago Perezagua
Banque de France	Mr Pierre Guerin
Banca d'Italia	Ms Patrizia Ceccacci
De Nederlandsche Bank	Mr Daniel Overduijn
Národná banka Slovenska	Mr Peter Andresič

Via teleconference	Name of participant
BPCE/Natixis	Mr Olivier Hubert
Central Bank of Ireland	Mr Patrick Haran
Central Bank of Cyprus	Ms Ioanna Tchopourian

Banque centrale du Luxembourg	Ms Christina Rivellini
Oesterreichische Nationalbank	Ms Belinda Sperch
Banco de Portugal	Mr Luís Sousa
Banka Slovenije	Ms Tina Ritonja