EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

12 March 2020

ECB Money Market Contact Group (MMCG)

Tuesday, 9 March 2020, 15:00-16:00 CET

Telephone conference

Summary of discussion

1) Recent developments in euro and US dollar money markets

The Covid-19 epidemic represents a supply-side shock affecting corporates with possible knock-on effects on banks. While some financial market segments have been impacted heavily, the impact on euro area money markets has so far been contained.

MMCG members report that euro money markets are still liquid but have been trading in a risk-off mode since Friday, 6 March. Although there had been subdued activity since Friday 6 March, overall liquidity was not yet an issue – particularly for short-term funding below one year. In the cash market, there were even stronger than usual liquidity inflows from mutual funds selling assets and depositing cash temporarily with banks, while waiting for the market to stabilise before they reinvest. Still, market participants seem to have adopted a risk-off mode not only for cash but also for derivatives. It was reported that it was difficult to get prices, as there was less market depth in interest rate swaps and bid-offer spreads were widening. The cross-currency market was particularly quiet, with the FX swap segment performing slightly better. It was also mentioned that there might be volatility around the upcoming quarter-end, which is also the Japanese fiscal year-end.

US dollar funding sentiment has improved since the Federal Reserve System announced on 9 March an increase in its overnight and two-week repo operations. In the FX swap market, the premium for borrowing USD against EUR is higher and in line with September 2019 levels. The Federal Reserve's term and overnight repo operations were oversubscribed last week. MMCG members believe that a standing repo facility in the United States would help to calm down markets and guarantee sufficient liquidity. The market still believes that the Federal Reserve will not be able to go into negative territory, and this is constraining volatility.

2) Expected policy response to recent market developments

A rate cut by the ECB is fully priced in, but MMCG members are of the view that such a measure would be counterproductive. A rate cut would not help the corporate sector and would only damage banks' profitability further. As the crisis reflects a supply-side shock, monetary policy is ineffective and fiscal policy is required. Even though most members do not think a rate cut would be useful, one participant mentioned that if the ECB were not to cut rates this could trigger negative market reactions.

In the view of MMCG members, it would be more effective to ease conditions for targeted longer-term refinancing operations (TLTRO-III), enlarge the collateral pool and put in place special measures for small and medium-sized enterprises (SMEs) as well as increasing the size of the asset purchase programme (APP) and the two-tier system multiplier. Since support for

SMEs requires sufficient equity, an easing of capital requirements would provide flexibility and a buffer to the banking system. Changing TLTRO conditions to make it easier for banks to obtain funding at a lower rate and to comply with the lending performance target was seen as most helpful, as it would provide a monetary impulse to corporates and facilitate banks' compliance with liquidity metrics. It might be challenging to meet the lending growth requirements for the favourable TLTRO rate in deteriorating economic conditions, which might be a significant constraint. Increasing the two-tier multiplier to relieve the banking sector would also be helpful. However, a higher multiplier might not be sufficient to counteract the effects of a rate cut, since the rate decreases not only affect the reserves but also large parts of banks' balance sheets. The collateral framework could include a broader set of collateral, such as unregulated covered bonds. The ECB could increase its bond purchases, particularly of corporate bonds. The ECB could move the credit curve further out by buying senior preferred bonds or other products, such as exchange-trade funds (ETFs). Should the ECB decide to provide some additional liquidity backstop measures, it would only help if these are offered at a rate similar to the market rate that is close to the deposit facility rate (DFR).

3) Bank operational preparedness in view of Covid-19

Most banks are well-prepared operationally for a pandemic scenario. Teams are split in three: (1) working from the office; (2) working from a remote recovery site; (3) working from home. Some trading floors have been disinfected over the weekend. Some banks report that up to 85% of their staff are already working from home. The only limitation to working from home is that traders have only one screen, which can make their work more difficult, and regulators do not allow trading from home. Some banks are also preparing to move entire trading books to be traded from another location in another country. If trading were to fully move from offices to homes, most banks would reduce their activity to a minimum, focusing on core tasks, which could lead to a reduction in market liquidity**.**

List of participants

Money Market Contact Group meeting

Participant's organisation	Name of participant
European Central Bank	Ms Cornelia Holthausen (Chair)
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 Andreas Biewald
Coöperative Rabobank U.A.	Mr Frank Beset
Deutsche Bank	Mr Jürgen Sklarczyk
DZ Bank	Mr Michael Schneider
Erste Group Bank	Mr René Brunner
HSBC	Mr Harry-David Gauvin
ING	Mr Jaap Kes
Intesa Sanpaolo	Ms Maria Cristina Lege
LBBW	Mr Jan Misch
Nordea Bank Finland	Ms Jaana Sulin
UniCredit Bank	Mr Harald Bänsch