EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

18 June 2024

ECB Money Market Contact Group (MMCG)

Wednesday, 12 June 2024, 14:00-16:30 CET, remote meeting

Summary of the discussion[1]

MMCG members acknowledged that bank funding conditions were currently benign, owing to the ample liquidity conditions, and discussed which indicators might provide a first signal this may be changing. These could include repo rates moving substantially above the deposit facility rate (DFR) and money market funds (MMFs) experiencing a sustained reduction in assets under management beyond typical seasonal patterns. In the unsecured market members were monitoring the spread between the €STR and the DFR, which had remained stable so far. The Chair clarified that the start of collection of money market statistical reporting (MMSR) wave 2 data from 1 July onwards would not affect €STR for the time being, as the additional data will only be integrated in the calculation from July 2025. A decline in demand for commercial paper (CP) could also signal a less ample liquidity environment. While members had observed a minor decline in the amount of CP outstanding, this was attributed to banks choosing to meet funding plans by issuing longer-duration bonds, and lower funding needs owing to muted loan demand. Members discussed the importance of the STEP label in the CP market and concluded that it remained relevant for traditional buyers like banks but was less crucial for new market participants such as corporates. EURIBOR volumes remained stable and rates reflected overnight index swap (OIS) pricing, with some volatility in the three-month maturity owing to uncertainty over the outlook for euro area interest rates. The spread between the EURIBOR and the OIS rate in forward contracts, often referred to as an indicator of credit and liquidity risks, had widened slightly following the EU parliamentary elections. Several risk premia indicators, such as credit spreads, had tightened in the run-up to the elections, partly on account of increased confidence in euro area banks and the announcement of the ECB's changes to its operational framework. Since the announcement of the upcoming French legislative elections, however, credit risk premia had widened somewhat.

Euro area repo markets were perceived as working well, with rates converging across jurisdictions and new cash lenders emerging in the segment. Members highlighted that most euro area government bonds were now funded between the €STR and the DFR. They also reported more demand for longer-term transactions. Some of these are bridging funding until September 2024, when the lower spread between the rate on the ECB's Main Refinancing Operation and the DFR will be implemented, with term repo rates currently being capped at this spread (i.e. 15 basis points above the DFR). The official sector, especially public debt management offices and foreign central banks, were noted as an increasingly important cash lender in the repo market since non-monetary policy deposits on the Eurosystem balance sheet had declined. Hedge funds had also become more active in repos, also reflecting their increasing activity in euro area government bonds, but some members perceived their

[1] The views expressed in this summary are those of the MMCG members and do not necessarily reflect the views of the ECB.

presence in the repo market as a temporary rather than a structural phenomenon. They tend to conduct relative value strategies and basis trades, exploiting differences in the pricing of government bonds between the cash and futures markets. There is also increased demand for these bonds from hedge funds around auctions. The upcoming French legislative election was seen as a potential market risk event that could lead to increases in positions in repo markets.

Members observed very benign USD funding conditions owing to ample liquidity. Both the decline in US Treasury cash balances and recourse to the Fed's Overnight Reverse Repo Facility had increased the supply of liquidity in the system, while lower Treasury issuance had reduced demand. Euro area banks had also tapped the USD funding and credit markets. Some issuance had taken place in USD and then been swapped into EUR, which further explained the benign US funding conditions in the FX swap market. In terms of interest rate expectations, members observed a strong correlation between the euro area and the US. Following stronger than expected economic and inflation data prints in the US, interest rate cuts had been priced out on both sides of the Atlantic since the beginning of the year. The ECB's press conference on 6 June was seen as having given no further hints on the outlook for policy rates, so data dependence remained the guiding principle.

Members raised several points about the impact of the new instant payments regulation on banks' liquidity management. ECB staff provided an overview of the new regulation, the obligations stemming from it and the timeline for implementation. They also explained how the Target Instant Payment Settlement (TIPS) system supports settlement of instant payments in central bank money. The regulation will require payment service providers to process instant payments, and at no extra cost for users compared with regular credit transfers. It is due to be phased in by 2027. Members reviewed the main opportunities and challenges posed by instant payments, highlighting the technological and operational challenges and the need for banks to adjust their liquidity management and treasury functions. In particular, they stressed that a significant increase in instant payment volumes would likely require larger liquidity buffers owing to the unpredictable nature and 24/7 occurrence of outflows. Broad adoption of instant payments could potentially lock liquidity out of the market and affect banks' ability to invest in other high-quality liquid assets. Members also highlighted the risks from the settlement mismatch between instant payments and the traditional repo markets that might serve as a liquidity backstop. Instant payments require 24/7/365 real-time settlement, while repo market settlement remains aligned with opening hours on TARGET2 days and typical market conventions. Finally, members stressed the discrepancy between the remuneration applied to TIPS Dedicated Cash Accounts (DCAs) and Ancillary System Technical Accounts (ASTAs).[2] They highlighted that to optimise remuneration on banks' overall liquidity holdings they currently needed to transfer liquidity manually to the deposit facility in a complex and time-critical procedure at the end of the day. Some suggested that an aggregated calculation of reserve requirements and remuneration of remaining balances in TARGET (on the Main Cash Account and DCAs) at the DFR would improve the situation. ECB staff acknowledged the comments made by members and confirmed that similar discussions had been held with market participants previously; the Eurosystem was reviewing these.

[2] TIPS DCAs are remunerated at a minimum of [0, DFR] and TIPS ASTAs at DFR currently (from December 2024 this will change to €STR). TIPS DCA balances count towards minimum reserve requirements; TIPS ASTA balances do not.

Participant's organisation	Name of participant	
Amundi Asset Management	Mr Patrick Simeon	
Banco Santander	Mr Luis Barrigon Rodriguez	
Barclays	Mr Isaac Davies	
Belfius Bank	Mr Werner Driscart	
BNP Paribas	Mr Patrick Chauvet	
BPCE/Natixis	Mr Olivier Hubert	
CaixaBank	Mr Xavier Combis	
Commerzbank AG	Mr Andreas Biewald	
Crédit Agricole/CACIB-CASA	Mr Pierre Le Veziel	
Deutsche Bank AG	Mr Jürgen Sklarczyk	
DZ Bank AG	Mr Oliver Deutscher	
Erste Bank	Mr René Brunner	
Eurobank	Mr Dimitris Psichogios	
Eurex Clearing AG	Mr Frank Odendall	
HSBC Continental Europe	Mr Harry-David Gauvin	
ING Bank	Mr Jaap Kes	
Intesa Sanpaolo	Ms Maria Cristina Lege	
Société Générale	Mr Ileana Pietraru	
Unicredit	Mr Michele Montani	
Coöperatieve Rabobank	Mr Eric Scotto di Rinaldi	
European Central Bank	Mr Thomas Vlassopoulos	Chairperson
European Central Bank	Ms Pamina Karl	Secretary
European Central Bank	Mr Helmut Wacket	
European Central Bank	Ms Julija Jakovicka	
European Central Bank	Ms Sara Testi	
European Central Bank	Ms Panayiota Pentaliotou	
European Central Bank	Ms Marta Skrzypińska	
European Central Bank	Mr Raúl Novelle Araujo	
European Central Bank	Ms Francesca Bozza	