EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS 16 June 2022

ECB Money Market Contact Group (MMCG)

Wednesday, 15 June 2022, 13:00-15:45 CET

Videoconference

Summary of the discussion

1) Developments in money markets since December 2021

Bineet Shah (Barclays), Werner Driscart (Belfius Bank) and Jürgen Sklarczyk (Deutsche Bank) presented the main developments in money markets since the last MMCG meeting on 16 March 2022. Their intervention focused on the market reaction to the ECB meetings in April and June and money market developments in view of the expected lift-off of policy rates.

Trading activity in euro money markets was characterised by high uncertainty, leading to historically high levels of volatility.

The prospects for inflation in the euro area led to a marked increase in interest rate expectations. The ECB's monetary policy meetings in April and June paved the way for lift-off after eight years of negative interest rates. The ECB-dated €STR OIS forward curve re-priced notably higher, particularly after the June meeting. The deposit facility rate (DFR) is expected to be in positive territory by Q3-2022. Members considered that the two-tier system for reserve remuneration may no longer be relevant in the context of positive rates.

The euro commercial paper (ECP) market was concentrated in short maturities, not least because MMF investors shortened duration in view of the prevailing uncertainty about the future path of interest rates. However, some participants noted that activity in the 12-month maturity had picked up for selected issuers on account of investor demand that had been stimulated by higher interest rates. Term interest rates in the commercial paper market were said to be affected by a rise in credit premia spilling over from longer-term funding markets. Evidently, financing conditions had already tightened for financials, NFCs and governments. Participants noted, however, that while EURIBOR rates had picked up alongside risk-free rates, they were not necessarily fully representative of banks' funding conditions owing to a dearth of transactions, especially in longer tenors. Financing conditions were reportedly also affected by liquidity conditions. For instance, risk-free-rate (RFR) linked issuances, i.e. securities linked to the new risk-free rates, were said to trail LIBOR related products in terms of liquidity. In the secured money market, some participants noted a pick up in activity in 6- to 12-month maturities albeit from low levels, as some borrowers were prepared to pay a sizeable premium to secure longer-term funding resulting in notably higher interest rates. The euro 12-month STOXX GC Pooling contract was trading around 140 bps above overnight interest rates.

In the FX swap market, USD funding premia eventually stabilised after the initial shock provoked by the start of the war, volatility abated, but premia were still higher compared to the pre-war levels. The shortening of duration by US MMFs bit into term funding availability for foreign banking organisations.

2) Expected evolution of excess liquidity and consequences for euro money markets

Oliver Deutscher (DZ Bank), Xavier Combis (CaixaBank) and Eric Scotto di Rinaldi (Rabobank) gave an overview of the expected evolution of excess liquidity in the euro area. Their intervention focused on the distribution of excess liquidity and the relationship between short-term rates and excess liquidity, banks' considerations for TLTRO repayments and determinants for banks' longer-term demand for central bank reserves.

The longer-term demand for central bank reserves was expected to be determined by regulations, banks' risk management choices and interest rate levels. In the absence of a more active interbank market for excess liquidity, reserve demand was likely to stay elevated. MMCG members considered that there were threshold effects when it came to the sensitivity of short-term rates to changes in excess liquidity as the latter was set to decline. They acknowledged that it was not trivial to estimate the sensitivity, nor the actual thresholds. At the same time, it was highlighted that the US experience in September 2019 suggested that the money market would give early warning signs of a looming change in sensitivity.

Regarding TLTRO III, there was an alleged expectation by market participants that there would be a follow-up longer-term operation. Banks' TLTRO III early repayment considerations centred around the loss of NSFR value that would decline with the diminishing time to maturity of TLTRO funds and leverage ratio considerations. For most banks, profitability considerations outweighed repayment considerations. Therefore, early repayments were expected to be limited.

3) The growing impact of non-bank financial intermediaries (NBFIs) in the money market

Olivia Maguire (JP Morgan Asset Management) gave an overview of MMFs investments by fund type and currency. Her intervention focused on drivers of MMF cash holdings and maturity preferences; she also discussed the ongoing MMF reform and its potential impact on the money market.

In response to the increase in interest rate expectations, MMF investors increased cash buffers and decreased duration. Issuers were bound to pay higher interest rates for longer maturities in order to make risk-adjusted returns palatable to MMF investors. The mismatch between issuers' funding needs and MMFs' investment preferences was reflected in an increase in funding risk premia (FRA/OIS) that was observable across currencies. Other factors underlying the increase in MMFs cash buffers were market risk sentiment, uncertainty around inflation expectations and longer-end swap volatility.

Participants saw some risk that policy rate increases would not be completely passed through to €STR. Participants highlighted that NBFIs were price takers in the €STR market and therefore banks' discretion over the price of wholesale deposits was an important determinant of the pass-through. In the UK, the wedge between the policy rate and the rate on wholesale overnight deposits had grown marginally larger with the initiation of the policy rate hiking cycle, suggesting a less than complete pass-through.

List of participants

Money Market Contact Group meeting

Name of participant	Participant's organisation
Ms Patrick Simeon	Amundi Asset Management
Mr David Tilson	Bank of Ireland
Mr Bineet Shah	Barclays
Mr Harald Endres	Deutsche Kreditbank/BayernLB group
Mr Werner Driscart	Belfius Bank
Mr Patrick Chauvet	BNP Paribas
Mr Olivier Hubert	BPCE/Natixis
Mr Xavier Combis	CaixaBank
Mr Andreas Biewald	Commerzbank
Mr Eric Scotto di Rinaldi	Coöperatieve Rabobank
Mr Pierre Le Veziel	Crédit Agricole/CACIB & CASA
Mr Jürgen Sklarczyk	Deutsche Bank
Mr Oliver Deutscher	DZ Bank
Mr René Brunner	Erste Bank
Mr Frank Odendall	EUREX
Mr Harry-David Gauvin	HSBC Continental Europe
Ms Sanne Meertens	ING Bank
Ms Maria Cristina Lege	Intesa Sanpaolo
Ms Olivia Maguire	JP Morgan Asset Management
Ms Ileana Pietraru	Société Générale
Mr Harald Bänsch	UniCredit
Mr Thomas Vlassopoulos (Chairperson)	European Central Bank
Mr Helmut Wacket (Member)	European Central Bank
Mr Christian Lizarazo (Secretary)	European Central Bank