EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

22 September 2021

ECB Money Market Contact Group (MMCG)

Wednesday, 15 September 2021, 13:00 - 15:30 CET

Webex conference

Summary of the discussion

1) The review of the ECB's monetary policy strategy

Patrick Chauvet (BNP Paribas) reviewed the impact on money markets of the announcement of the outcome of the ECB's monetary policy strategy review and the subsequent reformulation of its forward guidance on interest rates.

The MMCG highlighted that the ECB announcements had been helpful in preventing market volatility associated with the higher inflation readings that were published subsequently. The immediate market reaction to the conclusion of the strategy review had been muted. While recognising that it was difficult to disentangle the role of these announcements from other events, the MMCG determined that they had contributed to the absence of market volatility following the news on rising inflation in August 2021. According to MMCG members, the strategy review provided further flexibility to the Governing Council in calibrating its approach to reducing monetary policy accommodation, by allowing a temporary and moderate overshooting of the inflation target when policy rates were close to the lower bound.

MMCG members discussed the ECB's tolerance of signs of upward inflation, concluding that its reaction function was still to be fully tested. MMCG members found that the conditions for an interest rate lift-off as set out in the new forward guidance had not yet been met, despite rising inflation, because the ECB attributed this rise mainly to transitory factors that would eventually abate. Most MMCG members did not perceive the risk of overshooting the inflation target as imminent. However, several members highlighted the uncertainty surrounding inflation forecasts in the post-COVID economy. They wondered whether observed changes in consumer habits, such as higher spending on food and home-related products as opposed to social activities and travelling, would become entrenched in a structural manner. Moreover, some members highlighted the ECB's intention to consider the costs related to owner-occupied housing in the measurement of inflation, noting that it would push inflation indicators upwards. MMCG members also noted the announcement of the ECB's plan to include climate change considerations in its monetary policy strategy, but deemed it premature to evaluate its impact on money markets given the scarcity of details at this stage.

2) Exit from pandemic-related monetary policy measures

Maria Cristina Lege (Intesa Sanpaolo) presented views on a potential future exit from the unconventional monetary policy measures adopted by the Eurosystem in response to the coronavirus (COVID-19) pandemic.

The recalibrated TLTRO III was successful in supporting lending during the COVID-19 pandemic. Several MMCG members noted that the large-scale participation in the operations and the ample lending support provided during the pandemic had been a result of the appropriate incentives embedded in

TLTRO III. Some members criticised the selected end-date of the second special period, as it coincides with the year-end and related balance sheet management activities by corporates. These members were of the view that either postponing or bringing forward the end-date slightly would likely avoid a temporary reduction in bank lending related to such technical factors.

The MMCG highlighted that prospects for euro area banks are intrinsically linked to the ECB's exit strategy. MMCG members reiterated that an accelerated exit from the negative interest rate policy would support the competitiveness of euro area banks and restore their appeal for investors. If developments in inflation did not make this possible, MMCG members called for a stepping up of the relief provided to the banking system through the tiering system or other mitigating measures. From a money market functioning point of view, some members were of the view that an increase in the two-tier multiplier could lead to an unwarranted upward impact on money market rates. From this perspective, monetary transmission would be better shielded from the adverse effects on negative rates by an extension of the TLTRO special interest rate period. Some MMCG members considered, however, that there was a limit to how long a central bank could incentivise banks to act in a counter-cyclical manner without jeopardising the viability of their business models, as lending to the economy was not only a matter of funding and banks' willingness to lend, but also of capacity in terms of capital and leverage ratios.

MMCG members called for timely information on the envisaged follow-up to the pandemic-related measures, to allow them to prepare their individual funding plans. While cliff effects linked to the TLTRO III could be contained in the short term, MMCG members were counting on the ECB giving advance notice about its intended follow-up to TLTRO III and collateral easing measures. Early signalling would help banks to organise their funding plans prudently. Some members expected somewhat less generous TLTRO operations to follow, albeit at a rate below the DFR, conditional on meeting a new lending benchmark. Such new TLTROs were, however, expected to attract a more geographically concentrated participation compared with the current series. With regard to the pandemic collateral easing measures, the majority of MMCG members expected the ECB to announce an extension going well beyond June 2022. Furthermore, the cross-country heterogeneity in mobilising non-marketable collateral was mentioned. With regard to the temporary exemption of central bank reserves from the calculation of the leverage ratio (LR), some members advocated the need for an extension or even for a permanent exemption, noting that the leverage ratio was a binding constraint for lending. In the view of these members, a permanent exemption would mitigate month- and quarter-end volatility in money markets, as was reportedly observed in UK money markets.

3) The digital euro

Holger Neuhaus (ECB) presented an overview of the investigation phase of the digital euro project, focusing on its objectives, stakeholder engagement and the design elements to be determined in the future process. Andreas Biewald (Commerzbank) presented the potential impact of a digital euro on the banking system's liquidity conditions.

Some MMCG members took the view that the investigation into a digital euro should not only focus on its retail usage, as its wholesale usage would be beneficial for the banking industry. These members considered that a wholesale digital euro would limit interbank settlement risks and improve banks' intraday liquidity management capabilities, which urgently need digitalisation. They suggested considering the TARGET settlement infrastructure, including the Target Instant Payment System.

MMCG members' main concern about the digital euro centred around deposit outflows, which would lead to a structural increase in the cost of funding and a subsequent increase in the cost of credit for the economy. Members warned of the risks of a structural disintermediation. One of the reasons behind these concerns was that the digital euro could well be used as a vehicle for investment and for savings. Members were of the view that banks would find it difficult to replace the potential deposit outflows, so that their funding costs would increase, and this increase would at least partially pass through to borrowers, making access to credit more expensive. The digital euro would not only affect banks' liquidity situation but also their profitability and the regulatory landscape. One member referred to the key role that current accounts play as a profitability driver in a normal interest rate environment, which raised concerns about the impact that a loss of such deposits would have on banks' profitability. Another member pointed out that liquidity metrics such as the LCR and NSFR would likely need to be re-calibrated in response to the digital euro.

Members acknowledged that many of the points discussed would be further clarified during the investigation phase of the project and hence asked to continue the discussion on the implications of the digital euro in due course.

List of participants

Money Market Contact Group meeting

Participant's organisation	Name of participant
Bank of Ireland	Mr David Tilson
Barclays Bank	Mr Bineet Shah
Bayern LB (DKB subsidiary)	Mr Harald Endres
BBVA	Mr Miguel Angel Monzón
Belfius Bank & Insurance	Mr Werner Driscart
BNP Paribas	Mr Patrick Chauvet
BPCE/Natixis	Mr Olivier Hubert
Caixabank	Mr Xavier Combis
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 Continental Europe	Mr Harry-David Gauvin
ING	Mr Jaap Kes
Intesa Sanpaolo	Ms Maria Cristina Lege
LBBW	Mr Jan Misch
Nordea	Ms Jaana Sulin
Société Générale	Ms Ileana Pietraru
UniCredit Bank	Mr Harald Bänsch
European Central Bank	Mr Thomas Vlassopoulos (Chair)
European Central Bank	Mr Helmut Wacket
European Central Bank	Ms Maria Encio (Secretary)