ECB MMCG

Impact of Volatility on Money Markets

Harry GAUVIN – 14/09/2022

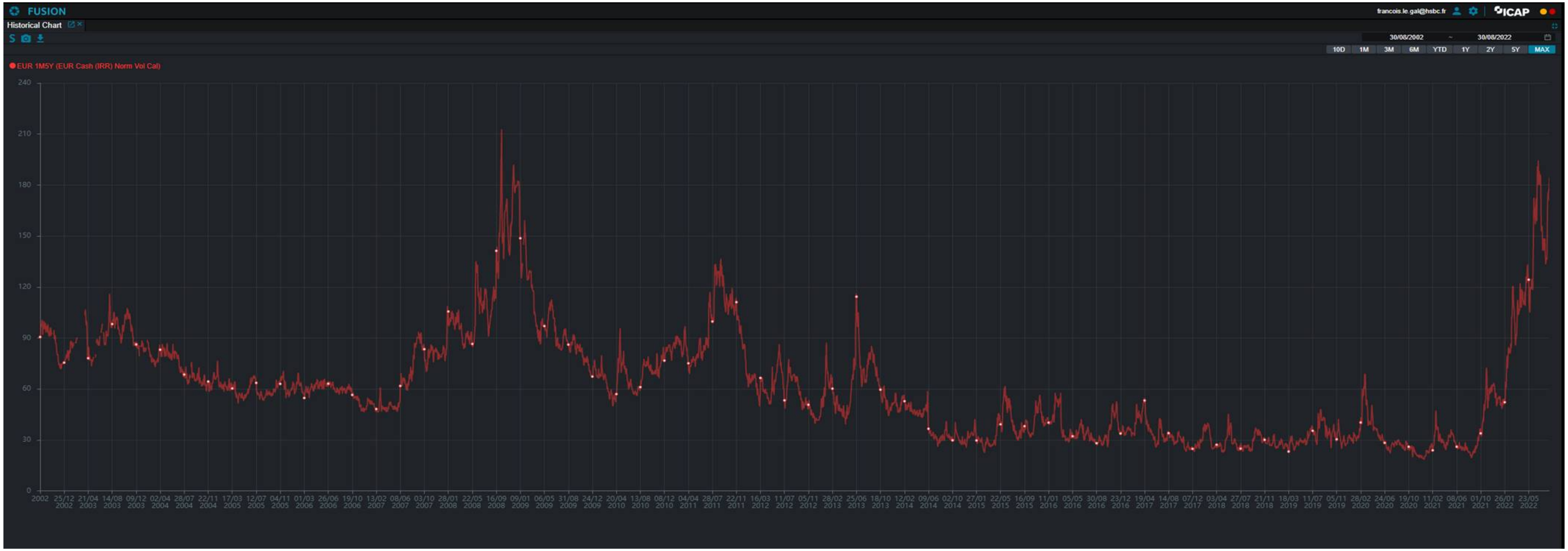
Agenda points

- The Underlying drivers behind the record high levels of implied and realised volatility in interest rates
- Market expectations for volatility in response to the change in the ECB’s approach to forward guidance
- Practical implications of the elevated volatility environment on ALM activities
- Overall perspective on the interaction between record high volatility and money markets

HSBC

Impact of Volatility on the Money Market

Level of Volatility is Comparable to 2008



- key market driver is the level of uncertainty on rate direction and magnitude. Markets were highly unpredictable in crisis time (2008 Lehman, 2011 Sovereign, 2020 Covid19)

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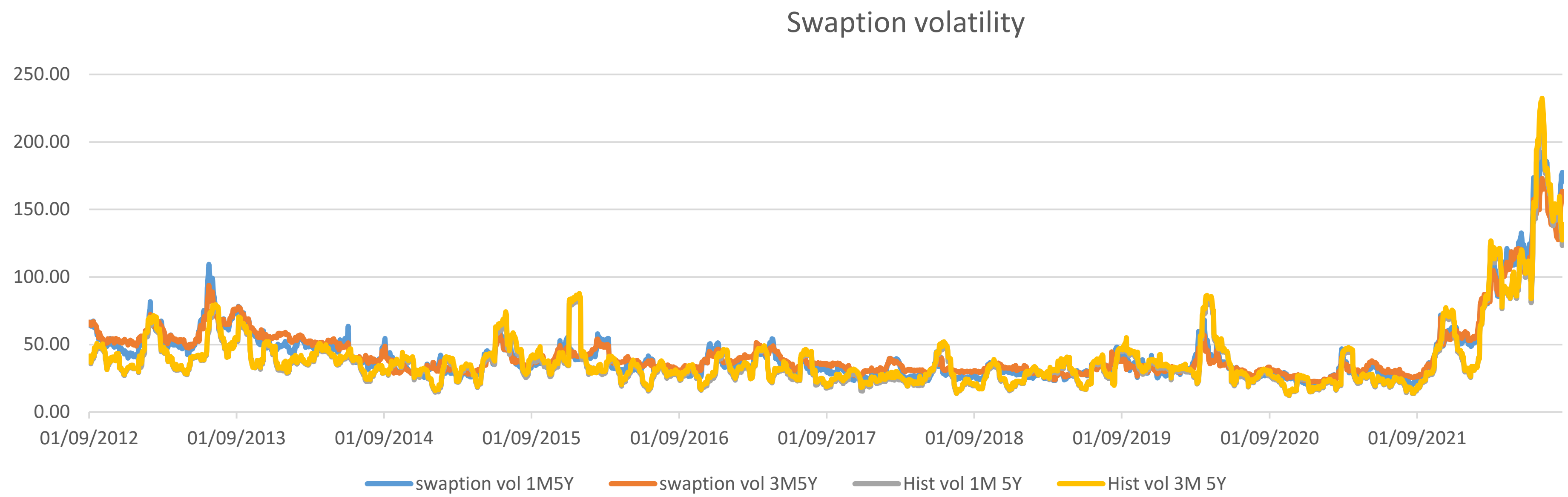
Swaption Volatility jumped since October 2021



- Currently high level of uncertainties on inflation, path of Central Bank rates and economic activity

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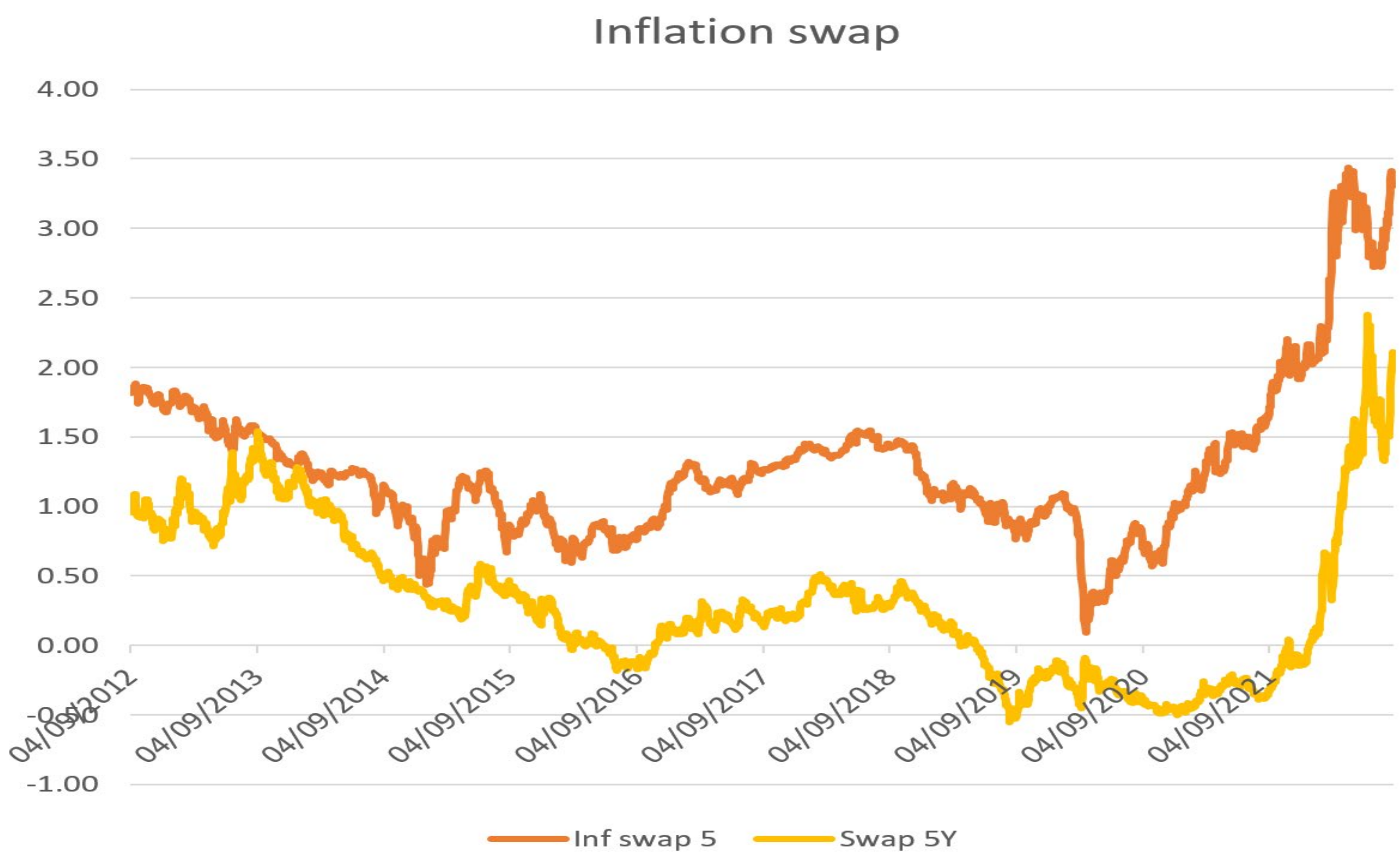
5Y swap rate jumped after inflation swap broke above 2%



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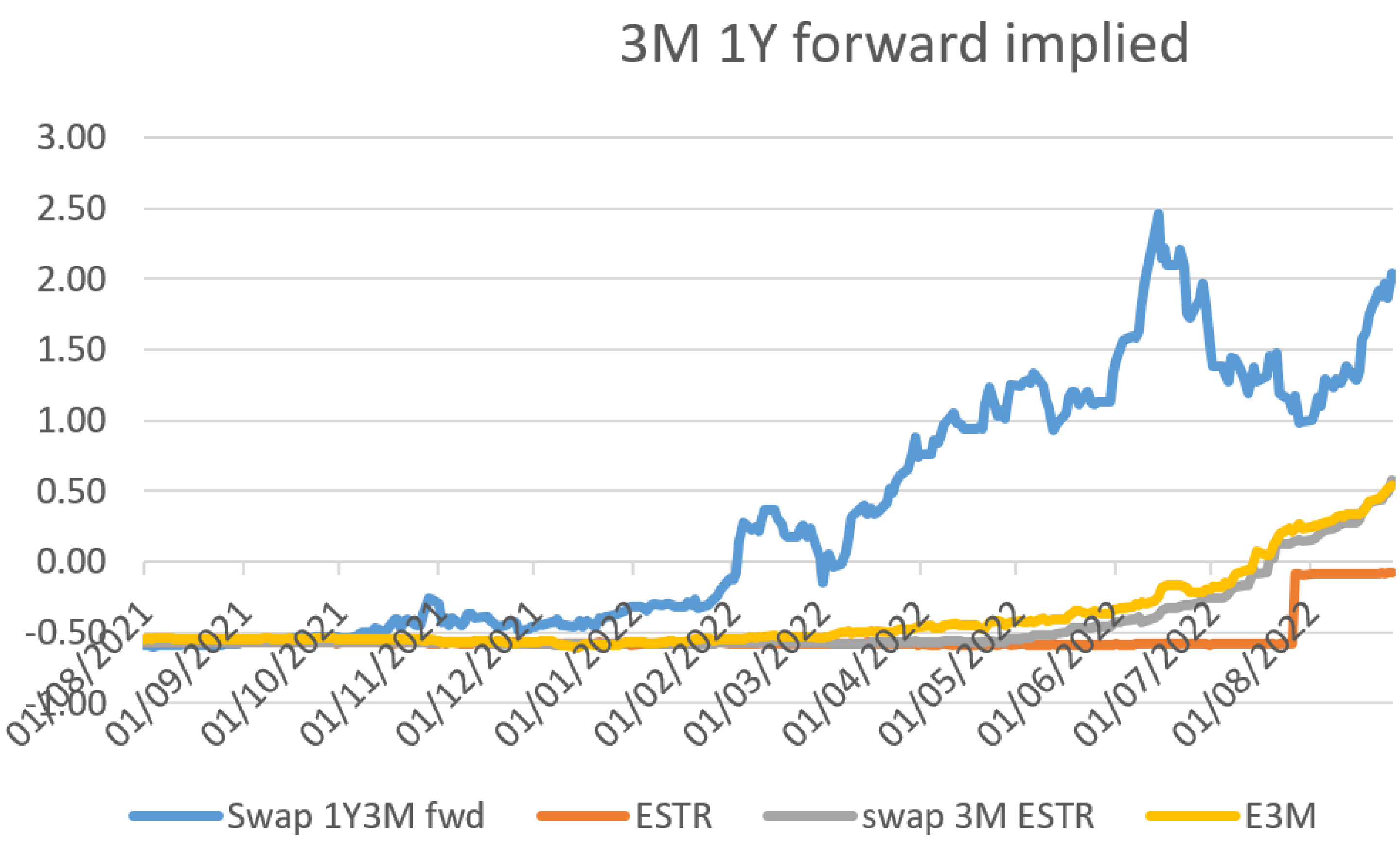
Highest 3-month 1Y ahead implied Eurozone Interest Rates



Impact of Volatility on the Money Market

Implications of the elevated volatility environment on asset-liability-management (ALM) activities

The main changes in ALM are driven by higher rates, rather than rate volatility *per se*.

- Review of of deposit pricing
- Lower deposit duration in behaviouralisation
- Increased cost of regulated savings (France) and deposits in general elsewhere
- Lower prepayment and renegotiation of fixed rate retail home loans, lengthening behaviouralisation
- Reduced need by banks to enter into receiver swaps / more need for payer swaps

Impact of Volatility on the Money Market

Implication of volatility on the money market

- Higher spread in the CD/CP market – bid/ask widens due to market-makers' higher uncertainty on price movements (intra or multi-day) to close out risk.
- Higher investor demand for floating rate CD/CP
- Repo market maturity adjusting to ECB dates – investors seeking to avoid risk on policy rate movements
- Demand among securities lenders shifting from open maturity repos to floating rate repos as operationally simpler than re-booking fixed rates.
- Some customers preparing to return to the repo markets when rates are positive. Especially public sector entities with access to NCB accounts with a zero-rate ceiling.