EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

ECB-PUBLIC

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ECB Money Market Contact Group (MMCG)

Tuesday, 12 March 2019, 13:00-17:00 CET, Frankfurt am Main

SUMMARY OF DISCUSSION

1. Introductory remarks

Cornelia Holthausen (Chair) noted that Marco Antonio Bertotti (Intesa Sanpaolo) and Julija Jakovicka (secretary) had stepped down from the MMCG and she thanked them for their contributions. Andreas Biewald (Commerzbank) and Maria Cristina Lege (Intesa Sanpaolo) were welcomed as new members and Maria Encio (ECB) was welcomed as the new secretary. MMCG members were reminded that compliance with competition law guidelines contributed to the effective functioning of the MMCG.

2. Discussion on market conditions

i. Market expectations regarding central bank policy and measures

David Tilson (Bank of Ireland) observed that the pervasive uncertainty about the global environment and political risks had led to a stronger than expected dovish reaction from the ECB's Governing Council. MMCG members responded critically to the set of measures announced by the ECB on 7 March 2019. This was mainly because the prospect of "stable policy rates for a longer period of time" weighed more on banks' profitability than the new two-year funding facility, which the MMCG currently considered to be an insufficient mitigating factor. Some MMCG members explained that banks had largely been able to preserve the net interest margin (NIM) at a reasonable level until now by rescaling deposits, repricing loans and obtaining favourable funding through the second series of targeted longer-term refinancing operations (TLTRO-II). However, the scope to continue doing so was vanishing given that about one-third of NIM was related to interest rate levels. It was also noted that, after the ECB press conference on 7 March, the first increase in interest rates was only priced for the end of 2020. The announcement of a new series of targeted longer-term refinancing operations (TLTRO-III) was seen as rushed by several MMCG members. The two-year maturity was considered to be too short to revive banks' lending activity, and the remaining uncertainty about the price of the operation meant that members were unable to ascertain whether it was a backstop or a stimulus measure. Several MMCG members noted with concern that US banks were benefiting from policy normalisation while euro area banks would continue to suffer from severe pressure on margins, limited demand for new loans and the end of carry-trade activities, which would put them at a disadvantage. Other

MMCG members also expressed doubts about the remaining options in the ECB's toolkit to address a possible pronounced slowdown.

ii. US dollar funding conditions at 2018 year-end in the foreign exchange swap market

Maria Cristina Lege (Intesa Sanpaolo) explained the drivers of the benign US dollar funding conditions at 2018 year-end, including advance preparations by the market and a number of structural changes. It was explained that the sharp widening by 20 and 60 basis points in the final weeks of 2016 and 2017 had prompted market players to cover their US dollar market funding needs for the end of 2018 by pre-funding in October and November. It was also noted that the pressure caused by the US money market fund reform in 2016 and by the uncertainty about the US tax reform in 2017 were no longer present in 2018. Maria Cristina Lege also pointed out a number of different factors affecting the availability of US dollars in general terms: (i) the US Treasury cash balance with the Federal Reserve System had decreased in 2018, hence there were more US dollars in the market; (ii) more investors had turned to US domestic paper in the aftermath of the tax reform; and (iii) new trade matching services introduced by CCPs had increased the attractiveness of the US dollar repo market. MMCG members mentioned several other reasons why US dollar funding conditions remained favourable. They pointed out (i) reduced demand from Asian investors to borrow US dollars in the forex swap market as the narrowing of the forex swap basis reduced the attractiveness of US dollar assets and favoured euro-denominated assets; and (ii) the emergence of very short bond funds which are allowed to invest in bank commercial paper with longer tenors in the United States. It was also mentioned that the ECB's US dollar operations and swap lines were an important backstop. Nevertheless, one MMCG member stressed that a very large part of the US dollar market was dominated by a very small number of banks, which determined the availability of US dollar funding in the market and made the market vulnerable to the idiosyncratic behaviour of those banks. Finally, a number of MMCG members indicated that in some smaller currency areas, such as those for the Swedish krona, the Danish krone and the Polish zloty, year-end was still a big concern and a cause of volatility.

iii. Repo rates across European underlying collateral

Harald Bänsch (Unicredit) opened the discussion by stating that repo rates across euro area jurisdictions converged as core countries collateral became less expensive. He attributed the convergence of repo rates mainly to (i) the end of QE, improving the availability of core securities, (ii) the unwinding of short-term positions on German government bonds by hedge funds as they could no longer bet on German collateral becoming expensive, and (iii) the broadening of collateral schedules by some counterparties in bilateral repo trades to include a wider range of sovereign issuers. MMCG members considered that the mild conditions over the 2018 year-end were also attributable to early preparations by the market. MMCG participants referred in particular to counterparties with no access to the ECB's facilities, as some of them had reportedly started to approach banks to ask for secured committed lines that would allow them to invest their securities at reporting dates. Furthermore, the advance pre-funding led to over-warehousing of collateral by some counterparties; when this collateral was released in the market around the year-end, collateral became cheaper. Although Eurosystem securities lending facilities helped to ease tensions, one MMCG member remarked that their size was not sufficient to alleviate tensions and improvement in collateral availability was mainly a result of readjustment by the market to find ways of obtaining collateral from hold-to-maturity investors. The difference in the year-end reaction in repo rates for Spanish and Italian collateral was attributed to the different investor bases (an international investor base in Spain compared with a domestic investor base in Italy). As a result, the increase in Italian repo rates at year-end was driven by the need to fund this collateral, whereas the decline in rates in the Spanish market was driven by collateral demand.

3. Brexit

MMCG members reported that their preparations for Brexit were ongoing but highlighted the high levels of uncertainty about the outcome. According to various MMCG members, preparations included the following: (i) new contracts and credit lines had been set up with newly established euro area-based entities of European banks; (ii) European banks with branches in the United Kingdom had mostly relocated to the euro area or transformed those branches into third-country subsidiaries; (iii) some pre-funding had taken place to cover the end of March; and (iv) CCP activity in the repo market had been migrated to LCH in Paris, although a move to continental Europe was considered less likely to happen for derivatives. For repo contracts, the standardised UK law-based market agreement (the Global Master Repurchase Agreement (GMRA)) continued to be used in the market. The Bank of England's new Liquidity Facility in Euros (LiFE) was welcomed but was seen as slightly expensive by one MMCG member.

4. Update on euro money market benchmark reform and the working group on euro risk-free rates

Cornelia Holthausen informed the MMCG that the ECB had just published a press release announcing that "ESTER", the acronym for the ECB's new euro short-term rate, was to be replaced with the "€STR" with immediate effect.

Jaap Kees (ING) provided a summary of the recommendations being prepared by the working group on euro risk-free rates. On the euro overnight index average (EONIA), the working group intended to make the following recommendations: (i) on the day of the launch of the €STR, which should be no later than October 2019, the administrator of the EONIA, the European Money Market Institute (EMMI), should modify the current EONIA methodology to become the €STR plus a spread in order to give market participants sufficient time to transition to the €STR before the discontinuation of the EONIA at the end of 2021; (ii) market participants should gradually replace the EONIA with the €STR for all products and contracts, making the €STR their standard reference rate and making certain adjustments to their IT systems. The complete set of recommendations and the reasons behind them were made available in the EONIA transition report published in December 2018.[1] Furthermore, the working group intended to recommend – from all the methodologies it had studied – the OIS tradable quotes-based methodology as the preferred methodology for calculating a €STR-based forward-looking term structure that could be used as a fallback in EURIBOR-linked contracts. In addition to a recommendation on a forward-looking methodology, the working group would at a later stage also analyse backward-looking methodologies (i.e. methodologies derived from €STR-compounded rates) as potential fallbacks for EURIBOR.

Jaap Kees recalled that these draft recommendations by the working group on euro risk-free rates had been published on the ECB's website in December 2018, with a call for feedback from market participants.[2] The

[1] See: https://www.ecb.europa.eu/paym/pdf/cons/euro_risk-free_rates/ecb.eoniatransitionreport201812.en.pdf

[2] See: https://www.ecb.europa.eu/press/pr/date/2018/html/ecb.pr181220.en.html

summaries of the feedback received had subsequently been published in February 2019.[3] Following the positive feedback and strong support for these draft recommendations, the working group was expected to publish its final recommendations on 14 March 2019, both on the EONIA transition and on a forward-looking methodology for EURIBOR fallbacks based on the €STR derivatives market.

The Chair urged banks to proceed with their preparations, in particular to adapt their systems to a T+1 publication in October 2019, to prepare to use the €STR as soon as possible and to replace the EONIA with the €STR in any contracts that referenced EONIA, especially those that extended beyond 2022.

5. Demand for central bank reserves

Pontus Aberg (ECB), Olivier Vergote (ECB) and Vincent Grossmann-Wirth (Banque de France) opened a discussion among MMCG members about the determinants, composition and fluctuation of banks' liquidity buffers. It was agreed to postpone the discussion to a later stage and in the meantime to prepare a list of questions that will serve to structure the dialogue and gain a better understanding of banks' various reasons for holding central bank reserves in the future.

6. Other business: planning of the next meeting

The next meeting will take place in Amsterdam on Tuesday, 25 June 2019 and will be hosted by ING.

[3] 97% of the respondents considered the recommended approach for the transition from the EONIA to the €STR to be the most appropriate for ensuring a smooth and orderly transition. 77% of respondents agreed that the OIS quotes-based methodology offered the best prospect of producing a viable EURIBOR fallback rate. See: https://www.ecb.europa.eu/paym/initiatives/interest_rate_benchmarks/WG_euro_risk-free_rates/html/index.en.html

List of participants

Money Market Contact Group meeting

Participant's organisation	Name of participant	
European Central Bank	Ms Cornelia Holthausen	Chairperson
European Central Bank	Ms Julija Jakovicka*	
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	
Deutsche Bank	Mr Juergen Sklarczyk	
DZ Bank	Mr Oliver Deutscher*	
Erste Group	Mr Neil Mcleod	
HSBC	Mr Harry Gauvin	
ING	Mr Jaap Kes	
Intesa Sanpaolo	Ms Maria Cristina Lege	
LBBW	Mr Jan Misch	
Nordea	Ms Marjo Personen*	
Société Générale	Ms Ileana Pietraru	
UniCredit	Mr Harald Baensch	

*Alternates agreed via the MMCG secretariat

National central banks	Name of participant
Nationale Bank van België/ Banque Nationale de Belgique	Mr Kristof Vandermeersch
Banque de France	Mr Vincent Grossmann-Wirth
Deutsche Bundesbank	Mr Karsten Stroborn
Banco de España	Mr Enrique Esteban
De Nederlandsche Bank	Mr Tom Hudepohl
Národná banka Slovenska	Mr Peter Andresič

Via teleconference	Name of participant
Central Bank of Cyprus	Mr Andreas Mylonas
Bank of Greece	Ms Chrysoula Giannakou
Banca d'Italia	Mr Salvatore Nasti
Banque centrale du Luxembourg	Mr Achim Hillen
Central Bank of Malta	Ms Josette Grech
Oesterreichische Nationalbank	Ms Bettina Moser
Banco de Portugal	Mr Luís Sousa
Banka Slovenije	Ms Sandra Jurisevic
Suomen Pankki – Finlands Bank	Mr Jukka Lähdemäki