EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

16 September 2013

Money Market Contact Group

Frankfurt, Tuesday, 3 September 2013, 15:00 – 19:00 CET

Summary of the discussion

1. Review of the latest market developments.

Jaime Comunión reviewed the main developments in the euro money market since the last meeting.

The MMCG noted that positive developments in the general market sentiment were not reflected to the same extent in all market segments. In particular, MMCG members mentioned that the continuing weakness in bank funding markets was illustrated by low bank bond issuance and limited access to long-term funding by banks in some countries. Furthermore, despite some improvement since the start of the year, repo markets remained fragmented, and in particular the Italian repo market was impacted by recent risk control measures by Central Clearing Counterparties (CCPs). Low levels of issuance volumes were also seen as a reason for recent low repayments in the 3-year very long-term refinancing operations (VLTROs). On a positive side, retail and corporate deposits in stressed countries have recovered and in June/July, growth of deposits in those countries surpassed that of core countries over the same period.

MMCG members pointed out that the maturity of the 3-year VLTROs in early 2015 was regarded as a cliff that already now weighed on market confidence and contributed to higher money market forward rates for early 2015. Therefore, several members argued in favour on another VLTRO by the ECB to be conducted early next year, when the remaining maturity of the 3-year VLTROs falls below one year. Such a measure in the MMCG view would provide confidence to the market and would in turn help to lower forward money market rates. Some MMCG members remarked that potential demand in such VLTRO might be low if it was conducted too soon.

The MMCG also discussed the impact of excess liquidity developments on money market rates. MMCG members noted that the relationship between excess liquidity and the EONIA rate was more difficult to estimate in the current market environment of market segmentation, and where several regulatory initiatives increase the value of central bank liquidity for regulatory purposes.

The leverage ratio was mentioned as one of the main concerns for the banking sector going forward, as it was expected to impair the liquidity absorbing function of banks: banks would be induced to reduce their short-term liabilities and would no longer accept short-term wholesale funds from their customers, although this was traditionally a core business of banks. Several members expressed their concerns about a potentially disappearing short term market (also in view of recent regulatory initiatives to restrict investments of Money Market Funds in short-term paper), considering the importance of this market segment for short-term liquidity management. The leverage ratio was also expected to have an impact on the short-term repo market, as repo was a balance sheet intensive funding instrument in particular if netting of repo positions was not allowed.

Some MMCG members welcomed a recent announcement by the Bank of England to reduce LCR requirements for the UK banks to support lending to the real economy as a positive sign of a more measured regulatory approach, as both the LCR and the leverage ratio imposed restrictions on lending to the real economy.

2. Q&A session with the ECB President Draghi

President Draghi emphasised the MMCG's important role as a source of market intelligence and market feedback and welcomed MMCG input in various work-streams, including the most recent transactions-based data collection exercise on money market trades. In his address, Mr. Draghi reiterated the ECB's keen interest in the efficient functioning of the money market in view of its importance for the ECB's monetary policy transmission mechanism and for financial stability. With this interest in mind, the ECB was closely monitoring various regulatory initiates and their impact on the money market as well as various market initiatives aimed at improving market functioning. Mr. Draghi addressed a number of MMCG questions on the ECB collateral framework, stating that some of the collateral measures taken during the crisis inevitably increased the complexity of the overall framework. These measures were dictated by the increased fragmentation of economic and financial conditions in the euro area. However, he reassured that these measures were temporary and the Eurosystem intended to come to a permanent and simpler collateral framework, once ongoing structural reforms on the national and European level would engender a significant reduction of fragmentation in the euro area markets. The Single Supervisory Mechanism (SSM) had a particular role in this process and Mr. Draghi strongly believed that it would contribute to restoring confidence in the banking sector across the euro area and would help to revive cross-border credit flows, with tangible effects for the real economy.

3. Presentation by LCH.Ltd on risk management framework for the repo market

Julija Jakovicka presented preliminary results of the Euro Money Market Survey for Q2 2013, illustrating a growing importance of the repo market, which represented more than 40% of the total money market turnover in Q2 2013. Furthermore, the share of CCP cleared transactions continued to rise, reaching almost 60% of the repo market turnover.

John Burke presented the repo risk management framework of LCH.Ltd and explained the rationale behind the most recent cash settlement procedure introduced to Italian repo service of LCH.Clearnet. The cash settlement procedure was introduced on 5 August this year in the context of preparations for EMIR compliance and intended to prevent a possible contagion in the event of a default of one CCP. Some

MMCG members noted that the new procedure was limiting the benefits of the CCP and might adversely impact pricing and liquidity in Italian repo market. Pro-cyclicality of CCP risk measures has been a major market concern during the peaks of the crisis and in response to this, LCH introduced changes to its risk framework to avoid large and sudden changes in initial margins.

4. Presentation by Eurex Clearing on risk management framework for the repo market

Cesar Matos presented the repo risk management framework of Eurex Clearing and outlined envisaged future steps by Eurex Clearing to increase transparency of their risk management framework with regard to sovereign risk and counterparty risk. With regard to pro-cyclicality of CCP risk measures, Cesar mentioned a trade-off between procyclicality and non-reactiveness to market developments, explaining that Eurex Clearing tried to address this issue by having both a floor and a dynamic margin component in their framework.

5. Main developments in the EONIA OIS market

Danielle Sindzingre reviewed recent developments in the EONIA OIS market as well as a number of structural features of this market segment, such as market liquidity, main market participants, trading venues etc.

During the group discussion, some members expressed concerns that low EONIA trading volumes, which serve as basis for the EONIA OIS market, might undermine the importance of this market segment and may necessitate a search for alternatives, possibly in the repo space.

6. Update on money market benchmarks and on the on-going reform process

Roberto Schiavi informed the MMCG at the dinner about Phase II of the transactions-based data collection exercise on money market trades and encouraged active participation of the MMCG members.

7. Other items

The next MMCG meeting will take place in Frankfurt on 10 December.

Annual Dinner

At the dinner Cornelia Holthausen explained the rationale behind recent changes to the Eurosystem collateral framework announced on 17 July 2013, noting that these adjustments were made within the context of the regular (biannual) review of the Eurosystem risk control framework.