EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

14 September 2022

ECB Money Market Contact Group (MMCG)

Wednesday, 14 September 2022, 13:00-17:00 CET

Hybrid meeting: in-person with the option of remote login

Summary of the discussion

ECB Executive Board member Philip R. Lane addressed the MMCG, providing explanations of the monetary policy decisions taken on 8 September 2022 and on the transmission of recent interest rate changes in money markets.[1]

MMCG members discussed the monetary policy decisions taken by the ECB in July and September. In particular, the decision in September contributed to an increase in interest rate expectations for the euro area. Members pointed out the immediate pass-through of the 50 basis point policy rate hike in July to the €STR and expected a similarly complete pass-through of the September hike, based on market pricing. The end to the ECB's forward guidance was acknowledged**.** Levels of interest rate volatility remained historically high, comparable to those last seen in 2008. Uncertainty about the inflation outlook and central banks' responses were seen as the drivers of interest rate volatility. This high level of volatility led to a higher investor demand for floating rate investments as well as instruments with shorter maturities.

MMCG members reported that the repo market for high-quality euro collateral, which was already structurally scarce, had exhibited heightened volatility since the re-introduction of positive ECB policy rates. First, with rates in positive territory, many investors returned to the market seeking (secure) investments for funds previously left dormant. These funds primarily came through the secured money market, contributing to additional demand for collateral. However, other markets, including the T-bill market, were also affected. Second, higher margin requirements from CCPs in response to (i) current historically high volatility and (ii) increased position taking, due to interest rate uncertainties, intensified pressure on the repo market trading high-quality collateral. Other segments of the money market, including unsecured and FX swap, were also exposed to the reverberations in the secured money market, albeit to a far lesser extent.

While welcoming the ECB decision to temporarily remove the 0% interest rate ceiling for the remuneration of government deposits[2], members mentioned that the lack of clarity regarding whether that ceiling was also being removed for deposits of foreign central banks contributed to increased market nervousness. The ECB clarified that the

[1] https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220914~79c898d157.en.html

[2] https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220908~0705913289.en.html

remuneration arrangements for foreign central bank accounts are not public, but that the Governing Council had considered the risks of the 0% remuneration ceiling more broadly.

The transition from a negative to a positive rate environment will be accompanied by structural shifts in the euro money market, as also witnessed in other jurisdictions. MMCG members reported that banks in the euro area allegedly displayed some inertia in passing through the interest rate hike to some deposit segments. Thus, there could be a risk of deposit outflows towards more appealing alternatives, including money market funds. This pattern had been observed in other jurisdictions that were further ahead in the tightening cycle, including the United States and Australia.

Structurally high collateral scarcity premia, with additional pressure coming from new investors since the introduction of positive rates, suggest that the secured money market may be exposed to more stress going forward relative to previous years. MMCG members expressed concerns about the forthcoming year-end, noting that regulatory constraints exacerbate year-end tensions. Other sources of pressure, relating to the implementation of SA-CCR for the US banks, would add to the previously acknowledged balance sheet constraints. Under pressure to limit regulatory costs and levies, banks could deflect euro liquidity with low or negative regulatory value to non-banks, in particular, money market funds. This may further increase tensions in the repo market. With regard to other money market segments, the FX swap market could be exposed to a rise in US dollar funding premia related to the “regime transition” to higher interest rates in money markets. MMCG members also noted other factors, such as the weakness of the Japanese yen and higher demand for US dollar-denominated commercial paper at the current interest rates.

MMCG members discussed a number of potential measures to address the structural collateral scarcity in the euro area from their perspective. In this context, the issuance of ECB debt certificates, central bank securities lending facilities and a special reverse repo facility (along the same lines as the Federal Reserve overnight RRP facility) were mentioned. ECB debt certificates were seen as a way to increase the supply of high-quality collateral. Central bank securities lending facilities were already playing a crucial role in mitigating collateral concerns, but some members noted that limits applied by some NCBs were restrictive at times. In relation to the year-end, the Fed’s experience with the overnight RRP facility had proven successful in absorbing liquidity with low or negative regulatory value that banks otherwise pass on to non-bank financial institutions. Members also mentioned that the facility contributed to shielding money markets from high rate volatility around balance sheet reporting dates and could be a model for the ECB as well. Some MMCG members also called for an improvement in the collateral/cash fungibility for meeting margining requirements, which would ease pressure stemming from margin requirements during episodes of financial market volatility. Finally, it was noted that the repo market turnover backed by EU-issued debt has improved considerably as end-investors put this collateral to use in the repo market.

List of participants

Participant's organisation	Name of participant	
European Central Bank	Mr Thomas Vlassopoulos	Chairperson
European Central Bank	Mr Christian Lizarazo	Secretary
European Central Bank	Mr Helmut Wacket	
European Central Bank	Ms Julija Jakovicka	
European Central Bank	Ms Pamina Karl	
European Central Bank	Ms Carolina D’Ambrosio	
Amundi Asset Management	Ms Cécile Mouton	
Bank of Ireland	Mr David Tilson	
Barclays	Mr Bineet Shah	
Belfius Bank	Mr Werner Driscart	
BNP PARIBAS	Mr Patrick Chauvet	
BPCE/Natixis	Mr Olivier Hubert	
Crédit Agricole (CACIB & CASA)	Mr Pierre Le Veziel	
CaixaBank	Mr Xavier Combis	
Commerzbank AG	Mr Andreas Biewald	
DZ Bank AG	Mr Michael Schneider	
Erste Bank	Mr René Brunner	
ING Bank	Mr Jaap Kes	
INTESA SANPAOLO SPA	Ms Maria Cristina Lege	
J.P. Morgan Asset Management	Ms Olivia Maguire	
Coöperatieve Rabobank	Mr Eric Scotto Di Rinaldi	
Société Générale	Ms Ileana Pietraru	

Via Webex	Name of participant	
European Central Bank	Mr Philip R. Lane	Board Member
European Central Bank	Mr Fabian Eser	Counsellor
Banco Bilbao Vizcaya Argentaria	Mr Miguel Angel Monzón	
Deutsche Bank AG	Mr Jürgen Sklarczyk	
Deutsche Kreditbank	Mr Harald Endres	
EUREX	Mr Frank Odendall	
HSBC CE	Mr Harry-David Gauvin	
LCH SA	Ms Corentine Poilvet-Clediere	
Unicredit	Mr Harald Bänsch	