EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

12 December 2022

ECB Money Market Contact Group (MMCG)

Wednesday, 7 December 2022, 13:00-17:00 CET

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

Summary of the discussion

MMCG members reflected on the reactions to the October ECB monetary policy decision, including the change in TLTRO III conditions and in the remuneration of minimum reserves. The transmission of the 75 bps policy rate hike in October to short-term unsecured money markets was immediate and almost complete. MMCG members felt that the robustness of Euribor as a benchmark index has been suffering in general and acknowledged in particular that maturities up to three months adjusted sluggishly to rate changes, owing to methodological features of the Euribor calculations but also reflecting that banks avoided accepting unsecured deposits at maturities that did not confer any benefit in terms of liquidity regulation. While some participants expressed understanding for the monetary policy reasons that led to the change in TLTRO III conditions[1], several banks voiced their disappointment about these changes and felt that they had a negative impact on the credibility of the ECB. They mentioned that the change forced some of them to unwind their interest rate hedges at substantial costs. TLTRO III repayments in November were below market expectations, as there was limited time to prepare for the repayments and the majority of outstanding TLTRO III funds were still partially eligible for NSFR until December 2022. Thus, larger TLTRO III repayments were expected for December. A number of MMCG members praised the targeted nature of TLTRO as an instrument but highlighted the need for such operations to be less complex and to avoid that regulatory requirements work at cross purposes to the monetary policy aim. Members felt that the change in remuneration of minimum reserves[2] had no material impact on money markets.

[1] Press release 27 October 2022: ECB recalibrates TLTRO III to help restore price stability over the medium term

[2] Press release 27 October 2022: ECB adjusts remuneration of minimum reserves

MMCG members discussed several measures and developments contributing to the easing of collateral scarcity since the last Governing Council meeting, which was also reflected in a decline in the expected year-end tensions. These factors include i) increased collateral lending by the Deutsche Finanzagentur in repo markets, ii) TLTRO III repayments reducing excess liquidity and releasing some of the mobilised collateral to the market, iii) the increase in the Eurosystem's Securities Lending limit against cash[3], and iv) the decline in interest rate volatility and short positions, following the October Governing Council meeting. Reduced collateral scarcity was visible in repo rates, gradually closing the wedge to the DFR, as well as narrower asset swap spreads. Also the collateral premium over the year-end declined substantially, after peaking in late September/early October. The peak was also related to the substantial demand for year-end prefunding, which started earlier this year. The subsequent improvement in the year-end funding conditions was also reflected in a decline in the US dollar funding premium in FX swap markets for the year-end.

MMCG members expected some further improvements in collateral scarcity for 2023 but cautioned that it will not be fully resolved and might vary a lot by collateral issuer. On the one hand, expected higher issuance in 2023 and the expected reduction of the Eurosystem's bond portfolio holdings would further increase the supply of collateral. Also lower market volatility, margin calls and short positioning were expected to further reduce demand for collateral in 2023. On the other hand, TLTRO III repayments in 2023 will not contribute much to collateral scarcity relief, as the scarcest collateral was already released back to the market. According to MMCG members, a significant share of the mobilised collateral that would return to markets from TLTRO III repayments was classified as non-marketable assets that could not be easily refinanced in repo markets. Despite some improvements in collateral availability, the free float of government bonds was still expected to remain low in some jurisdictions, given the expected slow pace of a potential ECB balance sheet unwind. Furthermore, the demand for short-term investments will remain high, especially from MMFs due to the daily liquidity buffers that are required by MMF regulation and were further increased after the March 2020 turmoil. Furthermore, ahead of April 2023, when the temporary removal of the 0% remuneration rate cap for Government deposits with the Eurosystem[4] is set to expire, significant cash inflows could further deteriorate collateral scarcity. Balance sheet optimization pressure on reporting dates is expected to remain strong in 2023, due to regulatory ratios, taxes and bank levies. MMCG members also stressed the asymmetric

[3] Securities lending of holdings under the APP and PEPP

[4] Press release, 8 September 2022: ECB temporarily removes 0% interest rate ceiling for renumeration of government deposits.

treatment in a relevant EBA Q&A[5] of open repo transactions, counted as potential outflows (repo) under the LCR but not as potential inflows (reverse repo).

MMCG members expect ECB balance sheet normalisation driven by TLTRO III repayments and lower reinvestment of monetary policy portfolios. Repayments of TLTRO III were expected to tighten banks' funding conditions. Although liquidity ratios have declined since 2021, also linked to the rebound in economic activity and credit production, they remained well above the target requirement. Banks started to replace some of the maturing TLTRO funds, primarily with unsecured debt issuance, meeting solid investor demand but also leading to an increase in funding costs, e.g. as reflected in 12-month Euribor. Increased Commercial Paper and covered bond issuance was observed over the past months, peaking in November. Retail deposits are becoming more costly, also as the product mix is shifting towards term deposits, as uncertainty about the interest rate and inflation outlook were expected to decline. To avoid further outflows, some banks started to pay interest on sight deposits.

[5] Question 2021_6163: LCR treatment of open maturity reverse repos which can be terminated at any point in time

List of participants

Participant's organisation	Name of participant	
European Central Bank	Mr Thomas Vlassopoulos	Chairperson
European Central Bank	Ms Pamina Karl	Secretary
European Central Bank	Mr Helmut Wacket	
European Central Bank	Ms Julija Jakovicka	
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	
Deutsche Bank AG	Mr Juergen Sklarczyk	
EUREX	Mr Frank Odendall	
HSBC CE	Mr Harry-David Gauvin	
ING Bank	Mr Jaap Kes	
INTESA SANPAOLO SPA	Ms Maria Cristina Lege	
Rabobank	Mr Eric Scotto Di Rinaldi	
Société Générale	Ms Ileana Pietraru	
Unicredit	Mr Harald Bänsch	

Via Webex	**Name of participant**
Erste Bank	Mr René Brunner
Deutsche Kreditbank/BayernLB group	Mr Harald Endres
J.P. Morgan Asset Management	Mr Joe McConnell
Banco Bilbao Vizcaya Argentaria	Mr Miguel Monzón
LCH SA	Ms Corentine Poilvet-Clediere