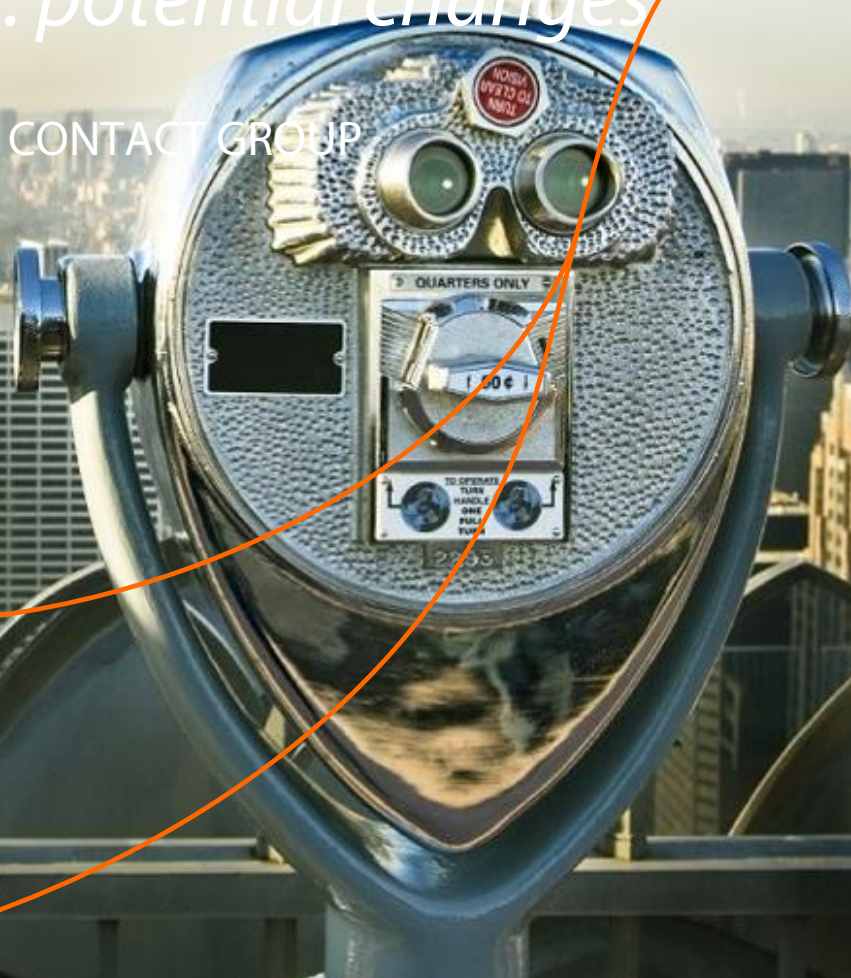


Developments ECB framework for steering short-term interest rates: potential changes

Presentation to the ECB MONEY MARKET CONTACT GROUP

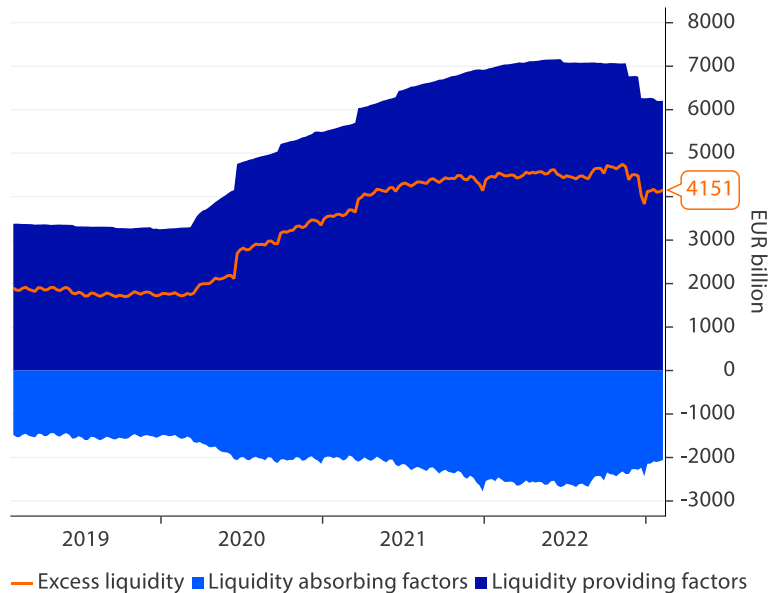
Thursday, March 2nd 2023



Excess liquidity and collateral scarcity

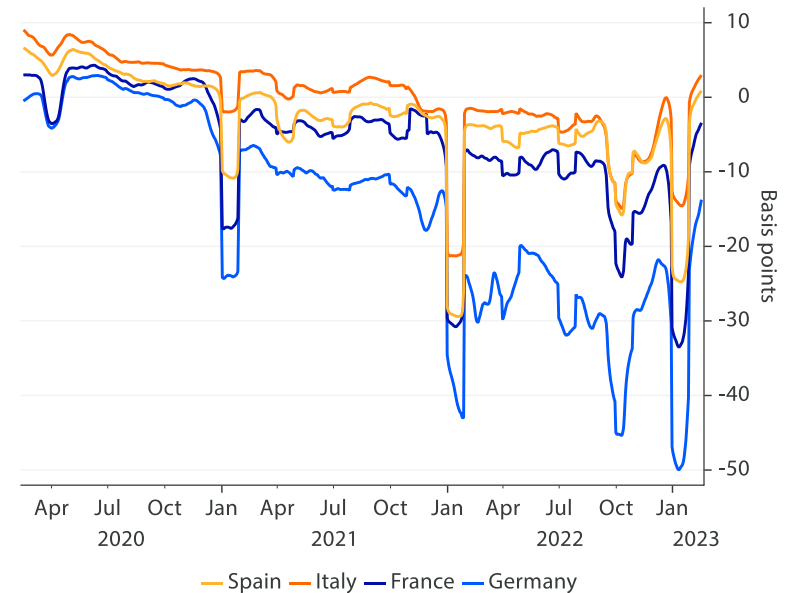
These are some of the main challenges in steering short-term interest rates post QE

Excess liquidity in the Eurosystem



Source: ECB, RaboResearch

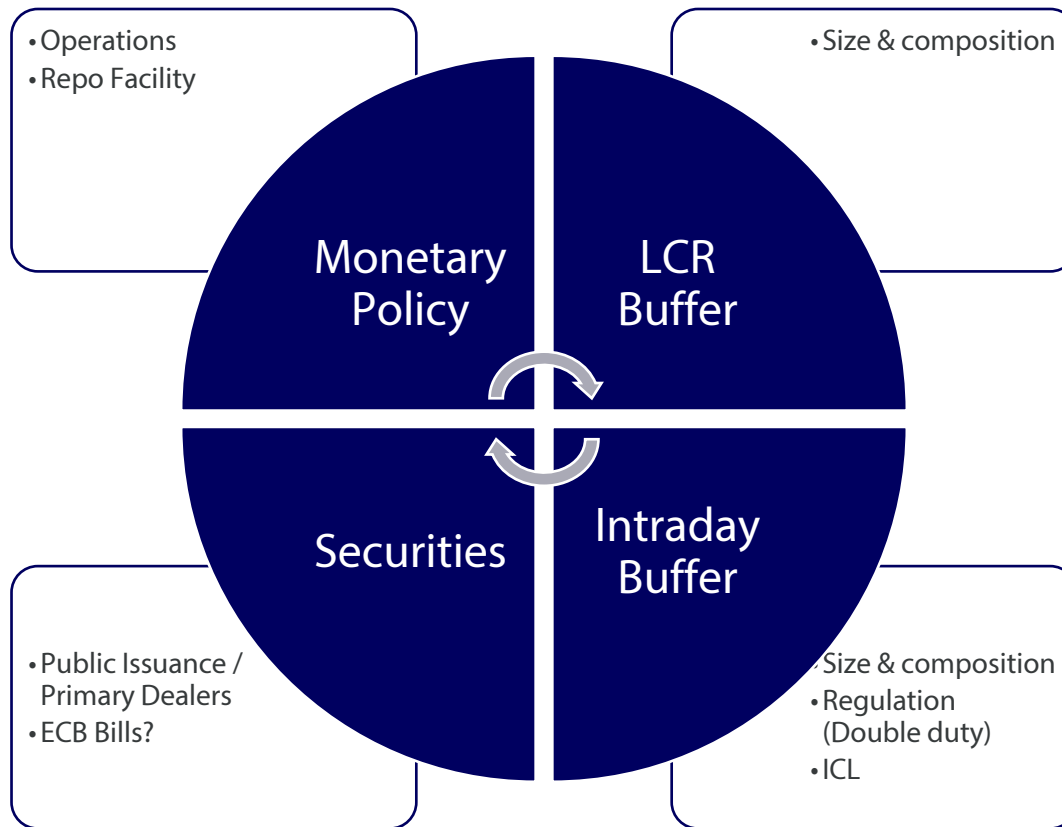
RepoFundsRate, spread over €STR



Source: RepoFundsRate

Excess liquidity and collateral scarcity

These will be structural, the “right” level of excess liquidity may support financial stability

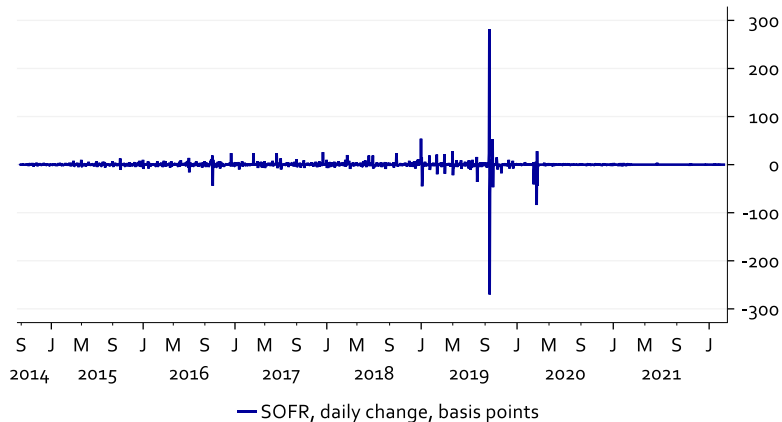


Source: Research paper NY Fed

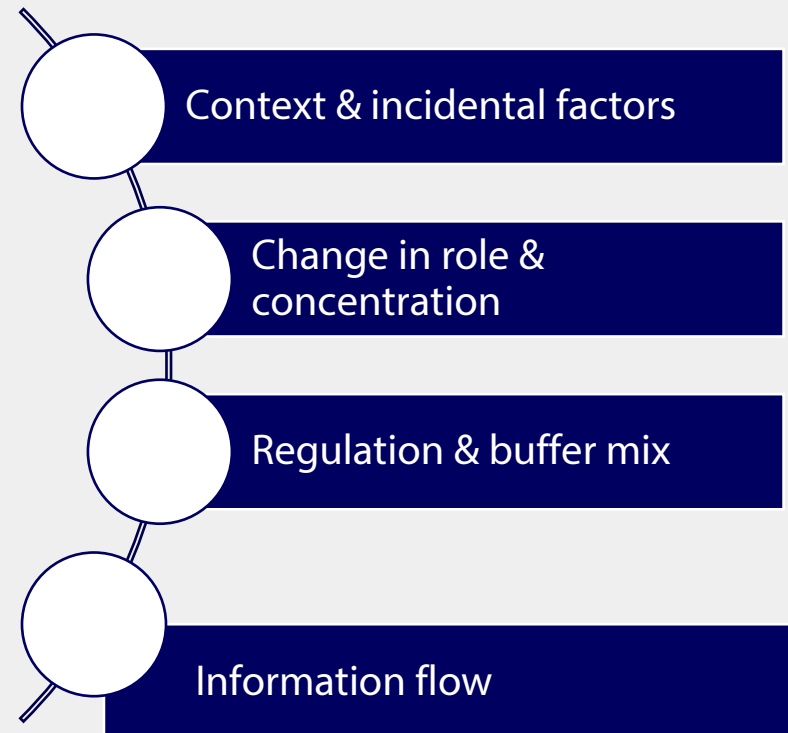
A lesson from the 2019 SOFR spike

An ECB equivalent of the Fed Standing Repo Facility (SRF) to introduce structural support?

The limits of the repo market microstructure were tested



Source: NY Fed



Collateral scarcity: an alternative is required

An ECB equivalent of the Fed Reverse Repo (RRP) facility?

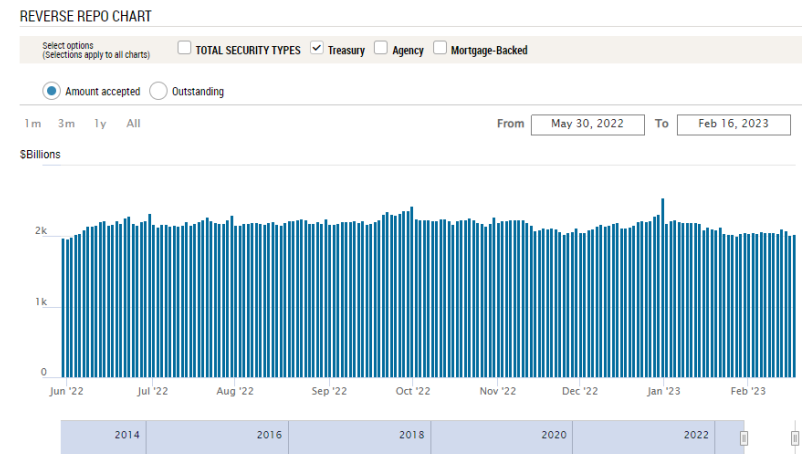
“Granting OTC customers access to interdealer repo markets would decrease dealer market power and improve the pass-through of the policy rate.

Moreover, if the central bank gave OTC customers access to a secured deposit facility, like the Federal Reserve’s RRP, policy rate pass-through to non-dealer banks and nonbanks could be further enhanced. Notably, the RRP can improve pass-through even without an actual take-up of the facility in equilibrium.” ([ECB working paper](#))

Not so fast:

- *Dealers face high balance sheet costs (e.g. regulatory) , netting bilaterally is difficult*
- *Implementation may take a long time due to operational considerations*
- *Requires careful balance in regulatory context, eligibility, limits and pricing*
- *Could create concentration risks and reduce volumes in other parts of money markets.*

The example of the Fed RRP – peaks on reporting dates are clearly visible



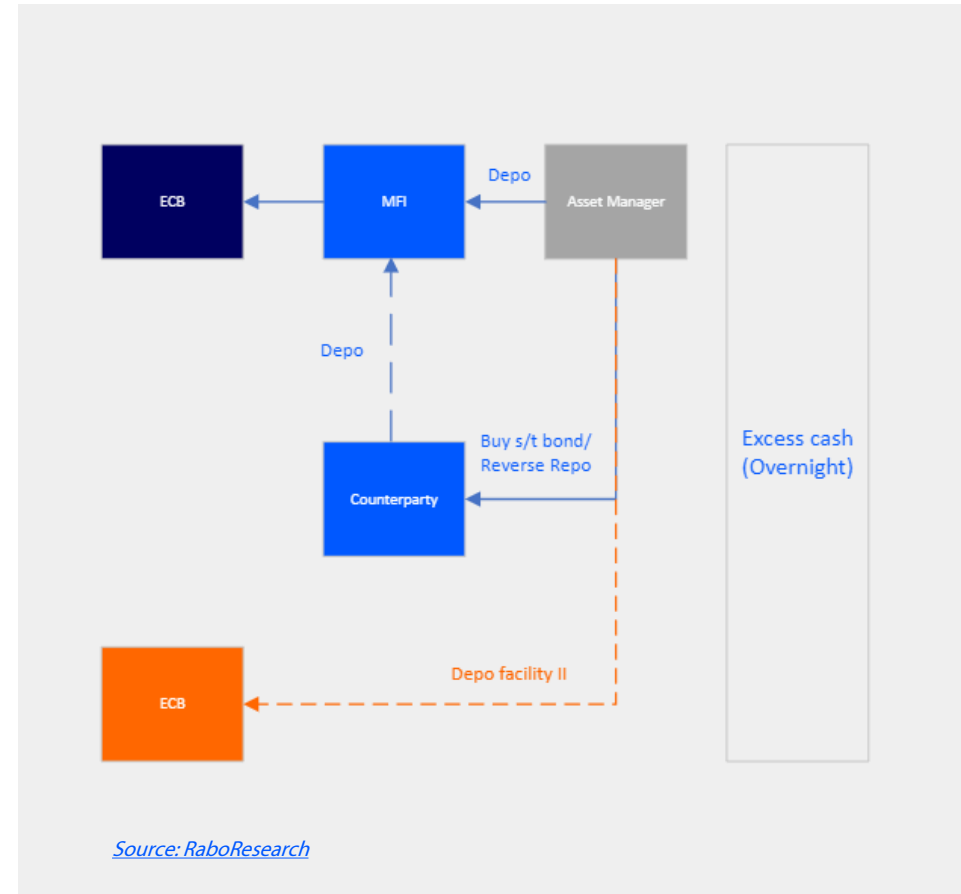
Source: NYFed RRP

Collateral scarcity: an alternative is required

A new deposit facility for NBFIs and government deposits?

An alternative route to place excess cash and put a floor under short-term assets

- Legally challenging but not insurmountable
- Balance sheet neutral for the ECB
- Pricing must be tailored to maintain level playing field with MFIs
- Introduces a soft floor and therefore anchors short-term bond yields
- Supports more efficient monetary policy stance transmission in repo
- May tighten ESTR-DFR spread



Excess liquidity and collateral scarcity: killing two birds with one stone?

ECB Bills to absorb liquidity on term and create a deep pool of a new high quality tradeable asset

General impact

- Liquidity draining to be more orderly than active selling of bond holdings following capital key
- Potential crowding and rebalancing effects due to supply of a new high quality collateral
- High quality collateral scarcity alleviated
- Flexibility of term of issuance, starting with short maturities
- Flexibility to target issuance (e.g. banks first)

Potential side effects

- The importance of euro as a reserve currency may grow
- Although part of the ECB toolbox, its use could lead to some political questions

