REDISTRIBUTION OF LIQUIDITY IN THE MONEY MARKET IN THE FACE OF A DECLINING EUROSYSTEM BALANCE SHEET

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BNP PARIBAS

Santander

Unsecured

Interbank

Market is limited to below 1 week and will remain so
- RWA costs
- Limits
- Regulators focus on counterparty risk

Retail

Intra group liquidity: where do we stand?
- National regulators still present
- 1 single regulator: communication between regulators improved
- Local regulations may limit intra group flows in case of stress
- Periph banks issue significantly reduced?
  - Sector consolidation in Spain and Italy (less banks, bigger banks)

EDIS: European market is still country based
- EDIS would create competition
- EDIS could create consolidation as money could move faster like in US?

Corporate

- Still favouring biggest banks, with a national bias

MMFs

- Is there a level playing field?
  - In Europe?
  - In US?
    - Periph banks still out?

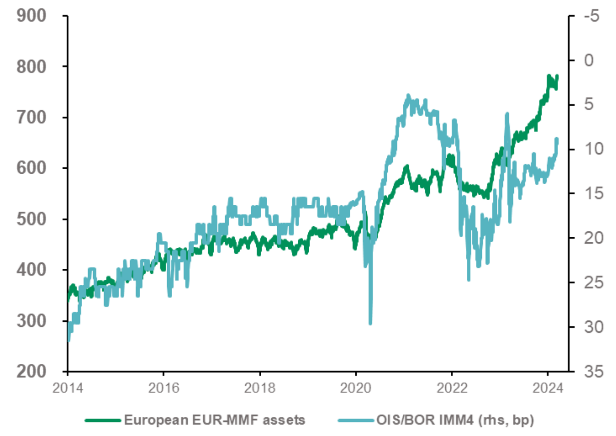
Capital Markets: Banks facing RM, OI

- Spreads tightened
- Domestic consolidation

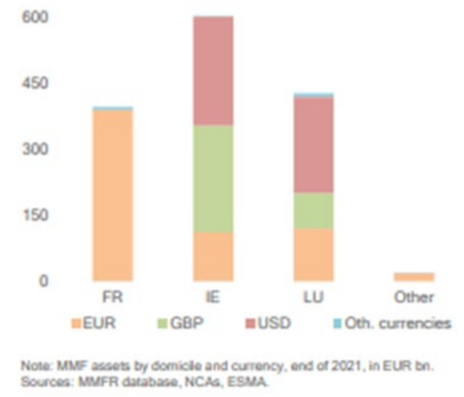
Other

Distortions may come from national initiatives, Livret A, Fiscal treatment of bills…

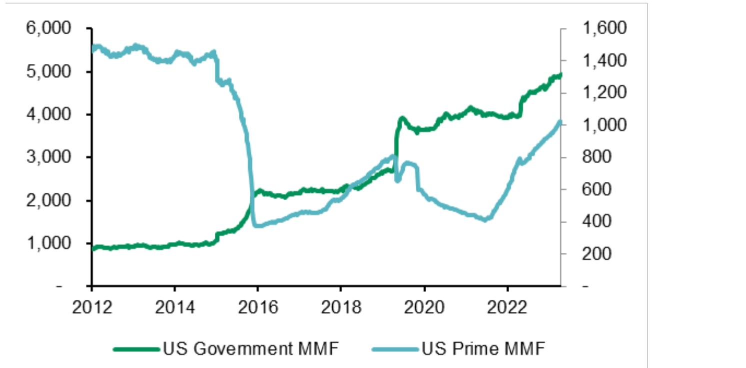
European EUR MMFs up EUR ~180bn since end of 2021



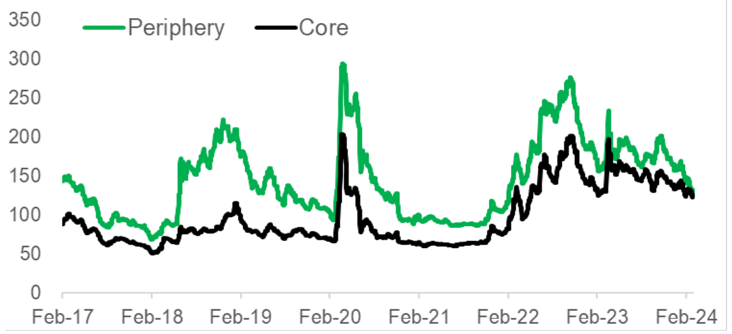
French EUR MMF ~60% of European EUR total (~780bn vs ~600bn end of 21)



US MMFs: Govt up USD845bn, Prime up USD590bn since March 2022



Senior Preferred Spreads - Core vs Periphery



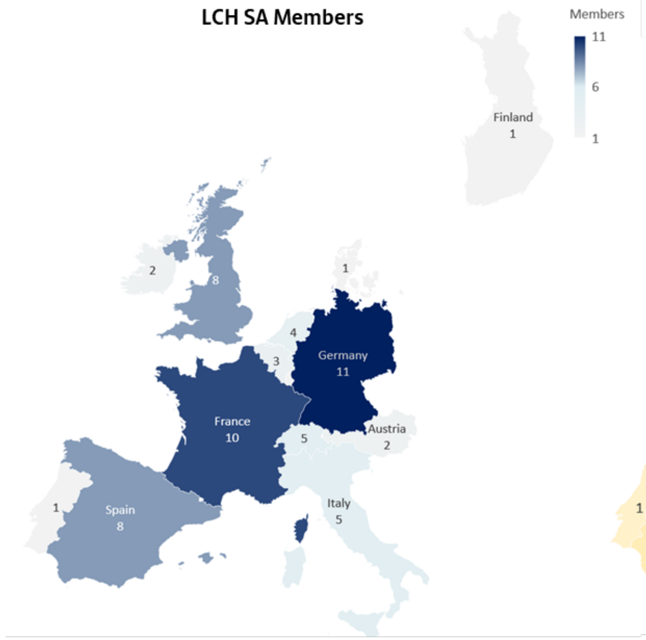
Secured - CCPs

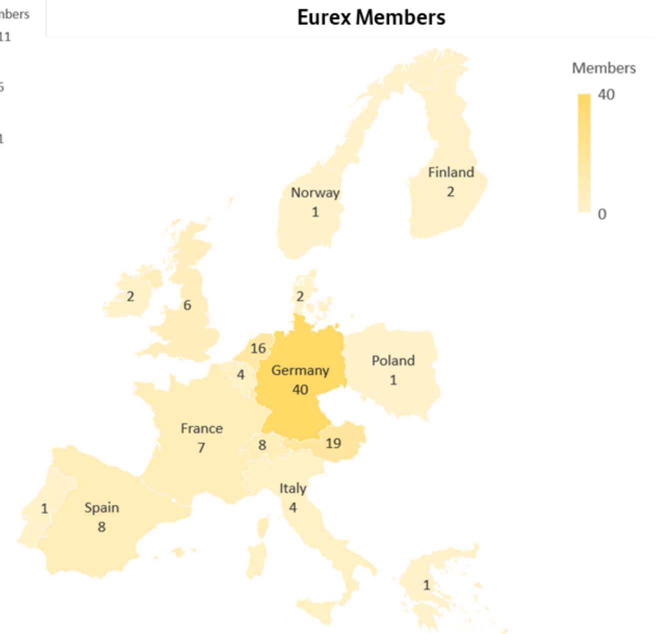
CCP Membership

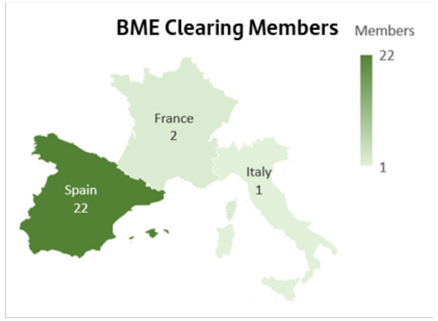
- Big banks present both in LCH and Eurex
- Smaller banks more present in domestic ones
- Some official institutions (OI) active

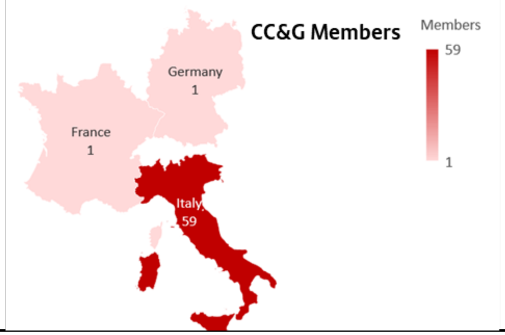
	LCH	Eurex
OI	2	15
Real Money	1	8
Non European	34	21

European commercial and investment banks memberships









Volumes

- According to ICMA survey, around 50% of Euro trades are cleared
- Europe smaller and more dominated by banks than US
- Buy side footprint small so far but clearly growing
- Mandatory clearing in UST Repo from Jun26

Europe (EUR trillion)	
Total daily outstanding	5,63
Non CCP cleared (% of total)	3,54 (63%)
CCP cleared (% of total)	2,09 (37%)
EUR denominated	3,42
EUR CCP cleared	1,85 (54%)
EUR D2C cleared	0,02 (<1%)

CCP Cleared
EUR 54% vs USD 32%

D2C Cleared
EUR 1% vs USD 25%

US (USD trillion)	
Total daily outstanding	8,52
Non CCP cleared (% of total)	5,43 (68%)
Bilateral	2,89
Tri-party	2,54
CCP cleared (% of total)	3,09 (32%)
D2C cleared	0,77 (25%)

Maturities

- Mostly Govies/SSA

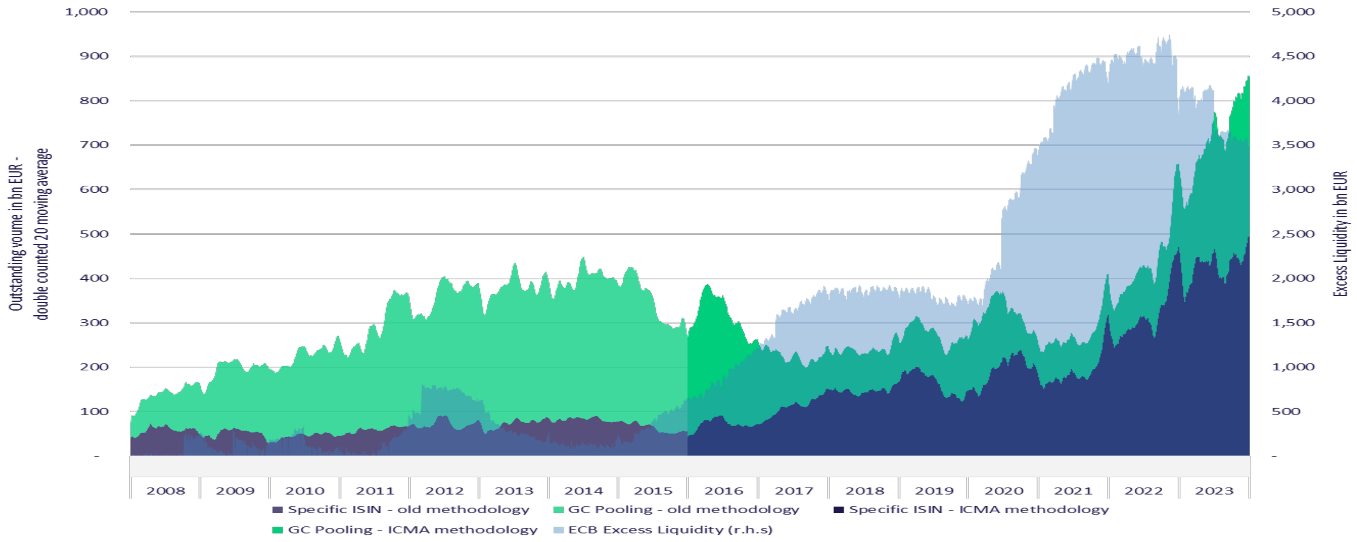
	GC Pooling Eurex	Specials & GC Eurex	Specials & GC LCH
Avg Tenor	4.3 days	6.3 days	2.3 days

Sources: BNP, Santander, ECB, EBA, ICMA, FICC, Eurex, LCH, BME Clearing & Euronext

Secured - CCPs

Repo spreads not indicating any fragmentation

GC Pooling liquidity during major crises: Volumes are inversely correlated with ECB excess liquidity



Benefits

- Liquidity – CCPs gives members access to a wide pool of market participants and liquidity with lower legal burden
- Operational efficiency and transparency – Streamlined settlement infrastructure
- Counterparty risk mitigation
- Regulatory capital cost relief for commercial banks – Balance Sheet netting as long as two-way

Challenges

- Wrong Way Risk – Potential concentration limits and HCs increase (e.g sovereign crisis) – Market structure still dependant on CCP Margins
- Systemic risk in CCPs – One way only participants may add risk to system. CCP not meant to become emergency liquidity venue
- Could mandatory HC be as/more efficient than CCP mandatory clearing?
- Costs – Risk management capabilities now more sophisticated?
- Limitations – Not all ISINs can be cleared, not all products covered

Sources: BNP, Santander, ECB, EBA, ICMA, FICC, Eurex, LCH, BME Clearing & Euronext

Secured – Other

Bilateral Market

Two tier market with client business more directed to tier 1 banks, developing with smaller banks

- **Still biased towards north countries / biggest banks?**
- **MMFs small in Europe, big in US**

WWR still a potential topic in times of stress

- **Market has proven its ability to adapt there, and bilat can develop when CCPs widen margins: fragmentation is still possible**

LT repo is mainly a bilateral market (only small interbank activity up to 3Y is cleared, mainly govies)

- **Long term repo more competitive and not only limited to tier 1 banks**
- **Forward bond market (derivative) is purely bilat and create 2 way interests in LT repo**
- **Retained Covered market (Only short term trades in gc pooling)**
  - **Market was very active last year, and has slowed down this year**
- **Excess cash not evenly distributed, even smaller / periph banks may have excess liquidity to deploy LT**

Infrastructure: more a question for large very short-term flows

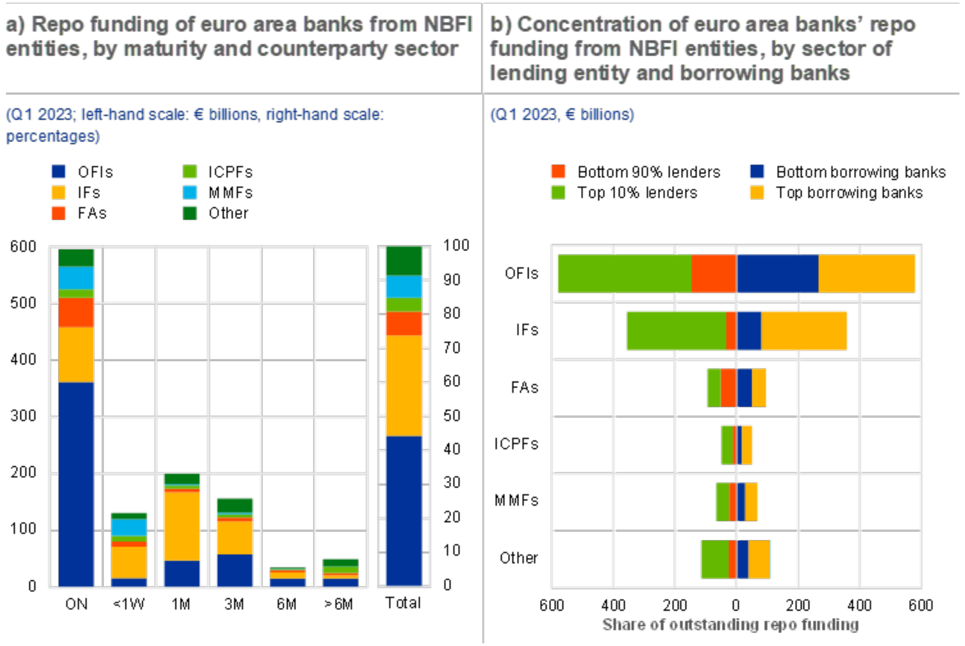
T2S already an improvement, although only 1% of settlement using bridges. Far from operating as in one single CSD

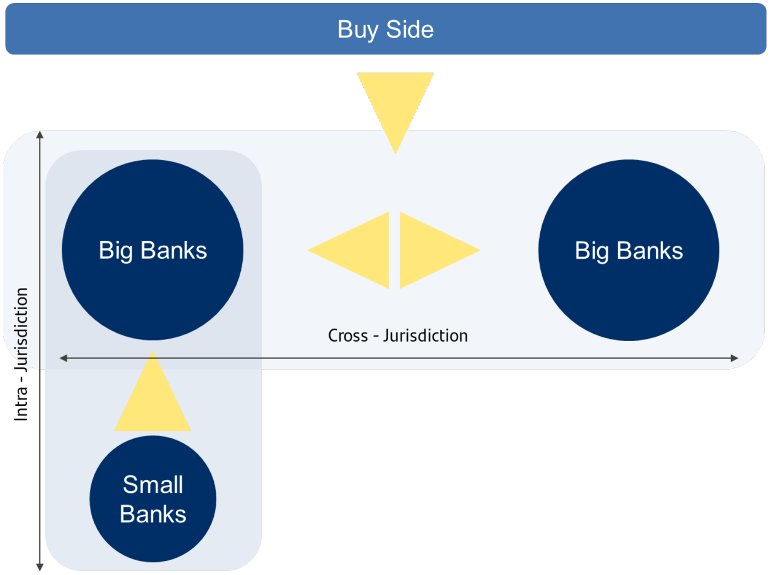
ECMS another improvement for central bank money

Collateral to remain fragmented in siloed collateral pools, multiple CSDs with different cut-offs for interbank

Regulatory treatment the main risk

Still a risk of asymmetrical treatment – LCR Open trades, NSFR





Central bank operations

Fragmentation risks may become more relevant as excess liquidity reduces, but sentiment is that risks have reduced

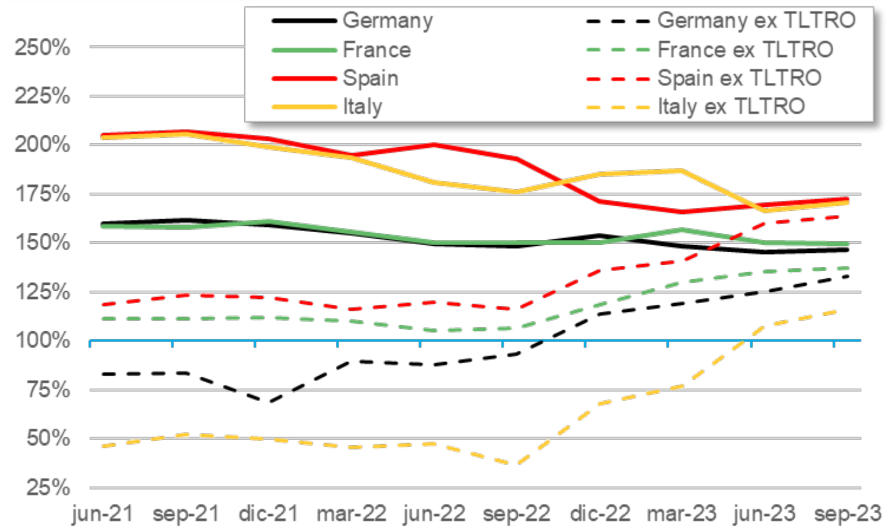
- No sign of tension so far on regulatory ratios after TLTRO reduction
- No signs of fragmentation in the funding market
- Banks had time to find alternative solutions in a context of excess liquidity
  - Change took place over the course of a year
  - TPI
  - X-CCY Swap lines
  - Gradual reduction of excess liquidity

WHAT IS NEXT FROM ECB?

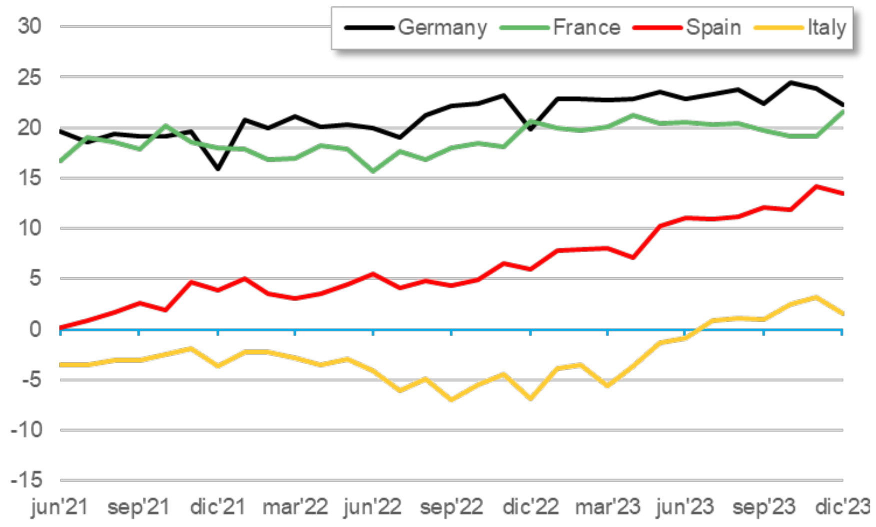
- Collateral framework - Level playing field among European banks?
- Demand driven component needed to prevent fragmentation?
  - How to avoid stigma on ECB operations?
  - How to avoid intermediating the market?
- Key aspects to balance against market:
  - Collateral – Tiering collateral baskets?
  - Term – Need for regular long-term operations?
  - Price

Lender of first resort ⟷ Stigma

LCR in selected geographies



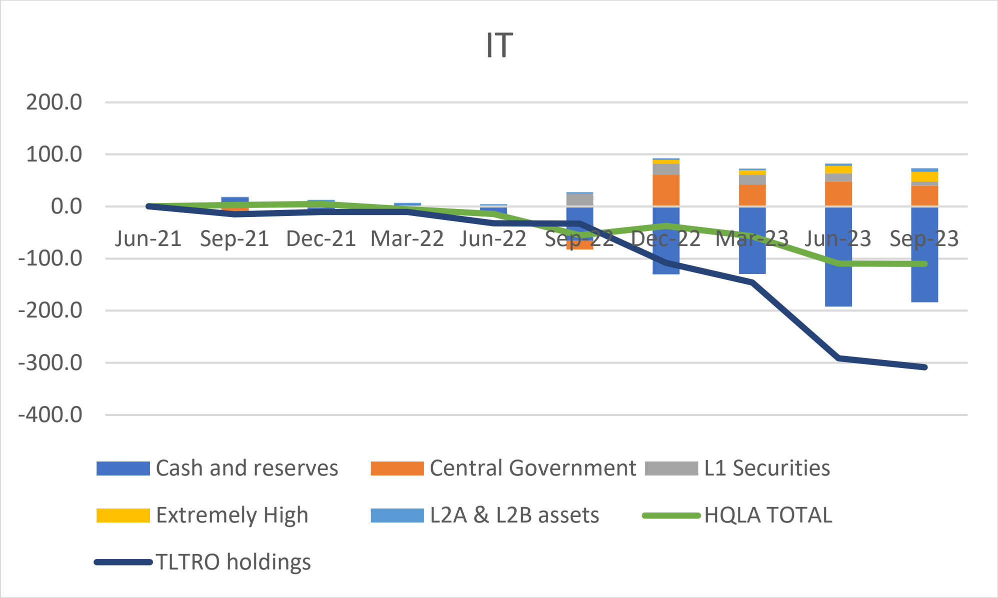
Excess Liquidity minus TLTRO (as a multiple of MRR)

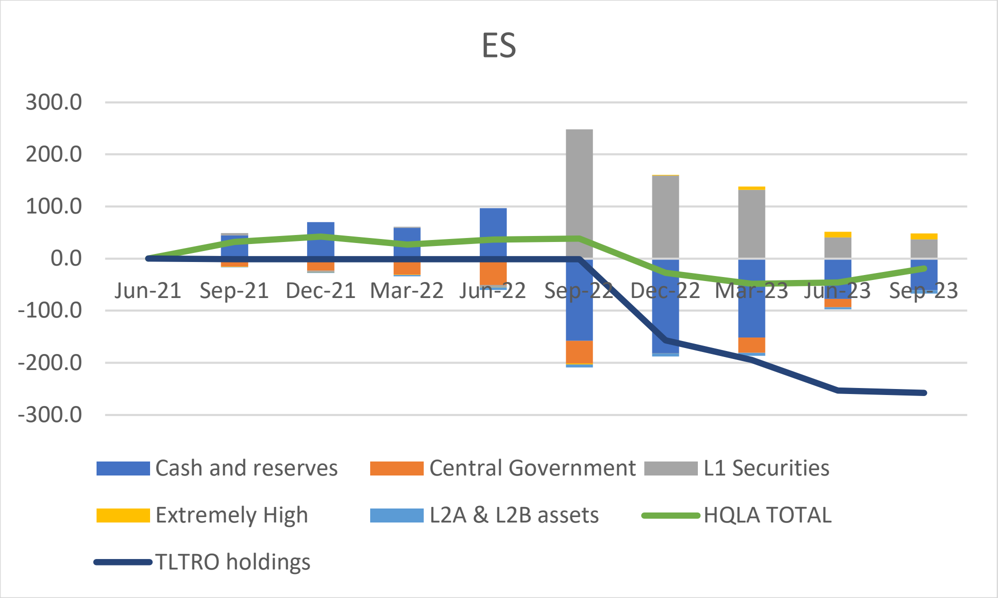


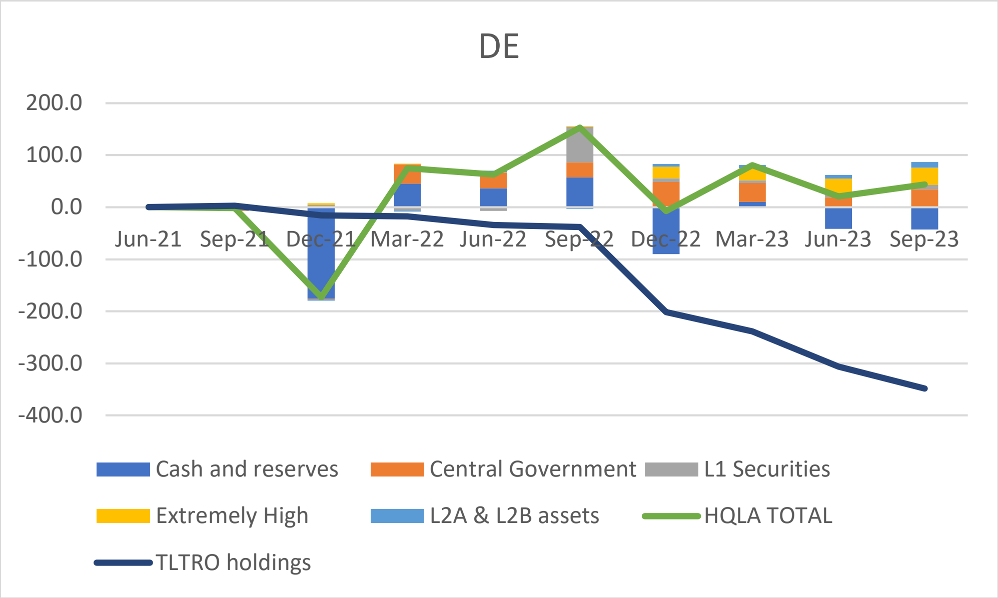
ANNEX

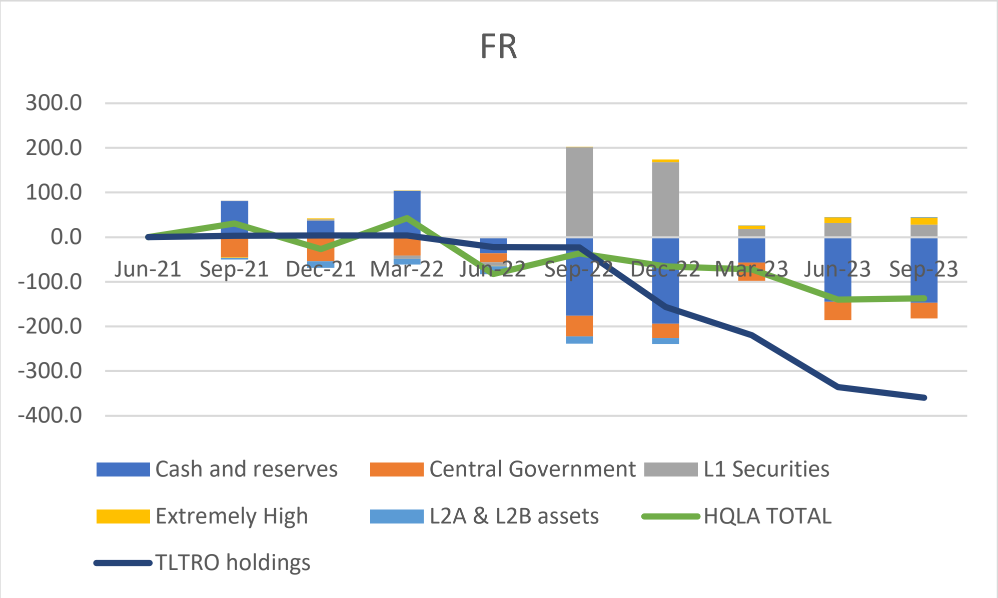
TLTROs – impact in HQLA?

Cumulative changes since June 2021 (quarterly figures, €bn)









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