EUROPEAN CENTRAL BANK

EUROSYSTEM

Money Market Contact Group 7 March 2012

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Teleconference held on Thursday, 1 March 2012 at 10:30

The ad-hoc teleconference was launched in order to receive banks' feedback on the Eurosystem second 3-year longer-term refinancing operation (LTRO) conducted on 29 February and its impact on the market.

The second 3-year LTRO was generally welcomed by market participants and was expected to extend the positive market impact of the first 3-year tender.

With regard to funding markets, members noted that already the first 3-year operation, conducted on 22 December, had helped to re-establish the yield curve in the capital market and facilitated banks' issuance since the start of the year, also in Italy and Spain. The, broadly expected, high demand at the second 3-year LTRO on 29 February further eased concerns over bank funding for euro area banks as they could, on aggregate, pre-fund their upcoming debt maturities until 2013. Thus pressures for forced deleveraging have eased and some MMCG members mentioned that part of the funds borrowed at the second 3-year LTRO will be used for the extension of credit to the real economy. A larger number of participating (reportedly smaller) banks was also seen as a confirmation of this statement. The crucial question at the moment is how quickly funds obtained in the 3-year operation will flow to the different asset classes, direct loans, bond portfolios, repayments and acquisitions.

With regard to the Chairman's question whether the Eurosystem should be seen as substituting market lending or rather complementary to it, members mentioned that there was no crowding out effect due to the Eurosystem operations. On the contrary, these were seen as facilitating banks' issuance and euro area banks intend to continue issuing in the market in order to maintain their access to all funding channels, even at a higher cost compared to Eurosystem operations.

Improved conditions and more active issuance have also been reported in US dollars, stemming mostly from supranational but also from corporate issuers, which in turn facilitated better liquidity in the FX swap market.

In the unsecured money market, the decline at the shorter end of the Euribor curve is expected to extend into longer maturities, with the 6-month Euribor rate seen declining below 1%, encouraging more investor activity. Several MMCG members reported signs of improvement in the unsecured (non-interbank) market, as reflected in the improvement of investors' flows (also from the US), restoring of credit lines and the extension of maturities. Reportedly, Swiss investors have also become more willing to offer unsecured money to the euro area banks.

Meanwhile, no major changes are expected at the shortest, unsecured market maturities. EONIA volumes are expected to stabilise at around EUR 30 bn. The recent increase in EONIA volumes to around EUR 40 bn prior to the second 3-year LTRO was merely viewed as a temporary phenomenon, possibly reflecting mobilisation of collateral ahead of the 3-year operation.

In general, members stressed that no major improvement is expected in the unsecured interbank activity due to the following factors. (i) Activity in the interbank market has been progressively shifting from the unsecured into the secured segment already prior to the crisis and has become virtually non-existent in longer maturities. Furthermore, (ii) the still elevated level of risk aversion and (iii) the regulatory environment (Basel III) are also seen as other two major impediments for the interbank activity in the unsecured money market segment.

In the secured money market, members pointed out that, following the allotment of the second 3-year LTRO, the Italian and Spanish repo rates declined below the Eurex GC repo rates reflecting strong demand for Spanish and Italian collateral, which made it increasingly difficult to cover short positions in these markets. Although most members expected the phenomenon to be of a temporary nature, it was noted that a shortage of collateral in those markets could possibly increase the risk of fails as their cost was low due to the low interest rate environment.

With regard to monetary policy expectations, following the allotment of the 3-year LTRO, market analysts revised their ECB rate cut expectations with no change expected for the entire 2012. However, banks seemed to be split with regard to their expectations of another 3-year operation.