

Box 7 Structural trends in euro money markets

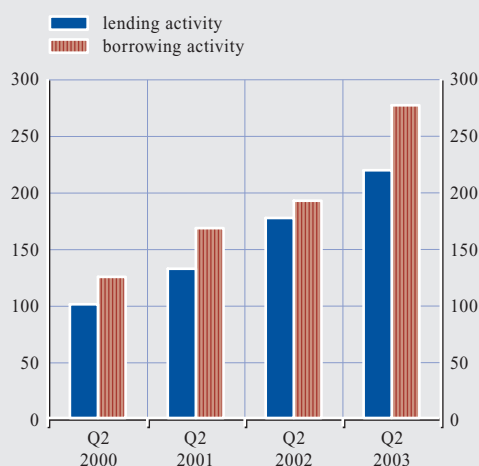
A recent study of the euro money markets undertaken by the ECB¹, based on data for the second quarter of 2003, sheds some light on structural developments in different segments of these markets. This Box reports on the main findings of this study and particularly highlights two important trends that were identified. First, the relative importance of unsecured deposit markets continued to decline, which benefited secured products. This might reflect a growing preference on the part of market participants for limiting credit risk exposures. Second, euro money market derivatives continued to grow in importance. Improving depth and liquidity in these markets can contribute to financial stability by facilitating the transfer and broader dispersion of interest rate risks from those who would rather not bear them to those who are able and willing to do so.

Overall, turnover expanded in all segments of the money market in 2003 compared with 2002. Even in the unsecured deposit markets, volumes rose by 24% in 2003, as opposed to a decline of 18% in 2002. This meant that turnover was 5% higher than in 2000, when data were collected for the first time. In the secured repo markets, which overtook the deposit markets as the most actively traded money market segment in 2002, there was continued strong growth. A rise of 34% in 2003 brought the volumes traded to more than double the amounts traded in 2000 (see Chart B7.1). Turnover increased even more rapidly in the OTC derivatives markets: foreign exchange swaps rose by 57% in 2003, interest rate swaps (other than overnight index swaps) by 36%, while overnight index swaps more than doubled compared with 2002 (see Chart B7.2).

¹ See ECB (2004), "Euro Money Market Study 2003", 16 January. The study is based on data received from a sample of credit institutions, implying that results must be interpreted with caution, as they are not necessarily representative of the euro money market as a whole.

Chart B7.1 Secured cash borrowing and lending

(cash lending in 2000 = 100)

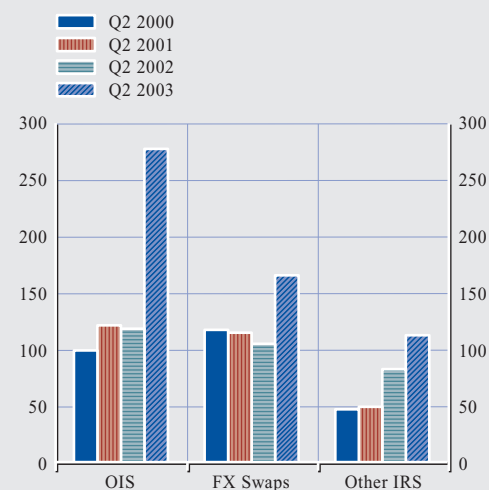


Source: ECB.

Note: The charts only provide turnover data on a relative basis. In Chart B7.1 the secured cash borrowing in Q2 2000 represents the 100 level, while Chart B7.2 depicts the Q2 2000 turnover in the overnight index swap (OIS) markets.

Chart B7.2 Activity in selected derivatives markets

(OIS turnover in 2000 = 100)



Source: ECB.

As in earlier years, the 2003 data confirm that activity in the euro money market tends to be highly concentrated in short maturities. In the unsecured deposit markets, for example, the share of overnight transactions in overall trading volume stood at around 70%, showing little change compared with the previous years (see Chart B7.3).² In the repo markets, the bulk of transactions took place in the segment between tom/next and one month, which accounted for 80% in 2003, up from 78% in 2002 (see Chart B7.4). Overnight maturity appears to be significantly less important in the repo markets than it is in the deposit markets. This is probably explained by technical difficulties linked to collateral settlement in this very short tenure. When the overnight maturity is excluded, the gain in importance of secured repo markets relative to the unsecured deposit markets is clear. In 2000 the respective shares were 35% for deposits and 65% for repos, while in 2003 they stood at 20% and 80% respectively. This development seems to mainly reflect banks' general aim of limiting their credit risk exposure, thereby contributing positively to financial stability.

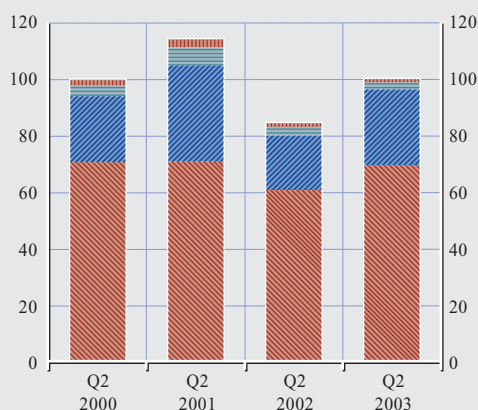
In money market derivatives there are also indications that turnover tends to be highly concentrated in the shortest maturities. In the overnight index swap (OIS) market, the share of transactions with maturities of up to one month increased from 39% in 2000 to 57% in 2003. In foreign exchange swaps this share was even higher (at 83% in 2003), although no discernible trend is apparent over recent years.

² It should be noted that data on the number of transactions are not weighted by maturity. Hence, these figures should not be seen as an indicator of the amounts outstanding of interbank lending. For instance, if the amounts outstanding of overnight and one-week deposits were, on average, identical in size, the number of transactions in the overnight maturity would need to be five times (i.e. five working days) higher than the number of transactions in the one-week maturity.

Chart B7.3 Unsecured cash lending by maturity

(2000 = 100)

- more than 1 year
- 3 months to 1 year (included)
- 1 month to 3 months (included)
- tom/next to 1 month (included)
- overnight



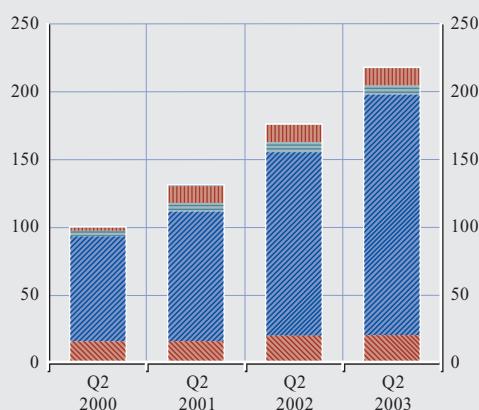
Source: ECB.

Note: The charts only provide turnover data on a relative basis. In both charts the overall lending amount in Q2 2000 represents the 100 level.

Chart B7.4 Maturity breakdown in secured lending

(2000 = 100)

- more than 1 year
- 3 months to 1 year (included)
- 1 month to 3 months (included)
- tom/next to 1 month (included)
- overnight



Source: ECB.

Market concentration can provide a good indication of the market's dependency on individual market participants and the risks for the market if a significant counterparty were to exit. Overall, as in 2002, the ECB Money Market Study for 2003 reveals that the euro money markets are generally still rather concentrated. In the deposit markets, this concentration is least pronounced, with the ten largest market participants accounting for "only" one-third of the overall market. The repo market, however, is significantly more concentrated with the ten most active banks accounting for around 54% of the overall repo turnover. Finally, the OTC derivatives markets are the most concentrated. Here, the share of the ten most active banks varies between 71% (overnight index swaps) and 84% (cross-currency swaps). This indicates that it cannot be excluded that a potential failure of one of the major market players could lead to severe frictions in the functioning of these markets.