EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

10 December 2024

ECB Money Market Contact Group (MMCG)

Wednesday, 4 December 2024, 14:00-16:30 CET, Frankfurt, online meeting

Summary of the discussion[1]

MMCG members discussed the drivers behind the recent upward pressure on repo market rates. The abundant availability of collateral due to the increase in net sovereign issuance and ongoing quantitative tightening was seen as a main driver. At the same time, while members considered the overall level of excess liquidity to be ample, several intermediation bottlenecks were identified that were making it more costly for liquidity to find its way to where it was demanded. Market makers' intermediation capacity was becoming scarcer as the net issuance of euro government bonds (EGB) increased, and this situation was becoming more acute on balance sheet reporting dates. Moreover, owing to regulatory requirements, bank internal governance and risk management practices, bank market-making activity had to be funded autonomously in the repo market without the ability to tap banks' own treasury holdings of excess liquidity, even if these holdings were ample. It was also highlighted that the repo trading landscape in Europe remains segmented across different platforms and central clearing counterparties. In addition, while the central clearing of repo transactions, including through the sponsored membership model, affords netting benefits that can help to alleviate balance sheet utilisation costs, not all market participants have access to it. Despite all of this, participants underlined that the repo market continued to function smoothly.

The September 2024 quarter-end episode, with an upward spike in repo rates above the deposit facility rate (DFR), marked a turning point and was a wake-up call for participants in repo markets. It prompted market participants to prefund their year-end positions earlier than usual and to plan their balance sheet capacity accordingly. Upward pressure in repo markets is still expected at the end of the year, reflecting banks' balance sheet optimisation strategies related to their leverage ratios and global systemically important bank/other systemically important institution (G-SIB/O-SII) scores. Nevertheless, many participants expect rates to de-escalate from the current pricing at the turn of the year. Should the spread between repo rates and the DFR keep widening for a prolonged period, beyond temporary reporting-date effects, some banks' treasuries may be more willing to channel excess reserves to the repo market, alleviating the upward rate pressure. The EUR/USD FX swap market pricing is expected to remain benign over year-end. Take-up in the standard refinancing operations is expected to remain limited at this stage. For the main refinancing operations (MROs) to play a central role in meeting banks' liquidity needs, members stressed that it is important for the market as well as supervisors and other stakeholders to perceive central bank funding as being "business as usual".

[1] The views expressed in this summary are those of the MMCG members and do not necessarily reflect the views of the ECB.

The group also discussed banks' choice of high-quality liquid asset (HQLA) buffer composition as they seek to achieve a balance between prudent liquidity management and maximising risk-adjusted returns. Together with declining excess liquidity and the return to positive rates, the share of reserves in HQLA portfolios had declined. Some banks had moved to purchasing outright sovereign bonds and high-quality covered bonds to boost the returns from their liquid buffers. However, banks' risk appetite for HQL securities varies across and within countries and may be limited by prudential risk limits. Members highlighted that there are limits to the amount of sovereign bonds that banks can acquire, so there will be a need for greater participation by other investors in EGB markets, including hedge funds or sovereign wealth funds. While some members mentioned that their institutions did not set a fixed target for the share of reserves in their HQLA buffer, credit risk and concentration limits in fact restrict the scope for the share of non-reserve assets to increase significantly.

Views were mixed among members as to how demand for reserves is expected to unfold in the future. At the time of the discussion, demand for reserves in HQLA was being boosted by the fact that few low-risk assets were yielding more attractive returns than the DFR. Assuming further cuts in policy rates and a reversal in the yield curve inversion, some members expect a further reallocation of HQLA towards securities. Other members, however, stressed the safety and liquidity features of reserves, not least in view of the supervisory liquidity management guidelines. Looking further ahead, the wider adoption of instant payments and an eventual shift to T+1 bond settlement were expected to boost reserve demand further. However, some members highlighted that the collateral posted with the Eurosystem, including non-HQLA collateral, can be quickly mobilised to meet liquidity needs, including on an intraday basis, thus alleviating the ex ante demand for reserves.

Participant’s organisation	Name of participant	
Amundi Asset Management	Mr Patrick Siméon	
Banco Santander	Mr Luis Barrigon Rodriguez	
Barclays	Mr Isaac Davies	
Belfius Bank	Mr Werner Driscart	
BNP Paribas	Mr Sébastien Figué	
BPCE/Natixis	Mr Olivier Hubert	
CaixaBank	Mr Xavier Combis	
Commerzbank	Mr Andreas Biewald	
Coöperatieve Rabobank	Mr Eric Scotto di Rinaldi	
Crédit Agricole/CACIB-CASA	Mr Pierre Le Veziel	
Deutsche Bank	Mr Jürgen Sklarczyk	
DZ Bank	Mr Oliver Deutscher	
Erste Bank	Mr René Brunner	
Eurex Clearing	Mr Frank Odendall	
Eurobank	Mr Dimitris Psichogios	
HSBC Continental Europe	Mr Pierre Bouvy	
ING Bank	Mr Leif Domeyer	
Intesa Sanpaolo	Ms Maria Cristina Lege	
Société Générale	Ms Ileana Pietraru	
Unicredit	Mr Michele Montani	
European Central Bank	Mr Thomas Vlassopoulos	Chairperson
European Central Bank	Ms Marta Skrzypińska	Secretary
European Central Bank	Mr Helmut Wacket	
European Central Bank	Mr Vladimir Tsonchev	
European Central Bank	Mr Raúl Novelle Araujo	
European Central Bank	Ms Francesca Bozza	