EUROPEAN CENTRAL BANK

EUROSYSTEM

DG MARKET OPERATIONS

2 December 2020

ECB Money Market Contact Group (MMCG)

Tuesday, 1 December 2020, 13:00-17:00 CET

Webex conference

Summary of the discussion

1) Review of money market developments and expectations

René Brunner (Erste Group Bank) and David Tilson (Bank of Ireland) introduced the outlook for banks. Michael Schneider (DZ Bank) and Harry-David Gauvin (HSBC France) outlined expectations of possible recalibrations of targeted longer-term refinancing operations (TLTROs) following the December meeting of the Governing Council, and Jaap Kes (ING) presented the anticipated financial conditions at year-end.

NFCs' deposits at a record high, with subdued demand for new loans. MMCG members confirmed that the increase in the deposit base is exceeding loan growth. In spring 2020 non-financial corporations (NFCs) drew on standing credit lines and withdrew cash from money market funds to build precautionary deposit buffers and, as a result, corporate bank deposits reached an all-time high. With regard to assets, MMCG members cited weak loan demand and the low-yield environment as the main reasons for the lack of opportunities for investing the additional cash deposits held by banks. Since the summer, NFCs have been drawing funds first from capital markets and, second, accumulated deposits, leaving bank loans as third and last source of funding. MMCG members also reported fierce competition between banks to grant TLTRO-eligible loans, as meeting TLTRO III lending targets is now being viewed as challenging. Given that competition leads to a reduction in lending rates, corporates currently prefer to renegotiate better conditions for their outstanding loans rather than ask banks for new loans.

Profitability may come under pressure in 2021. After a relatively benign 2020 for banks' P&L accounts, rising corporate insolvencies and the need to meet intermediate MREL targets by the end of next year will test banks' profitability. Government guarantee schemes, TLTRO III funding and tiering allowances have supported banks' profitability in 2020, despite the negative impact of the continuing low interest rate policy and the increasing cost of excess liquidity generated by the asset purchase programmes. To support profitability, several initiatives are currently being explored with regard to banks' liabilities: (i) passing through negative rates to corporates, international customers and wealthy retail customers and/or (ii) charging fees to compensate for the impact of the zero lower bound for retail deposits.

Policy adjustment in December is expected to include a TLTRO III rate recalibration, which will also apply to outstanding amounts. The MMCG expects a decisive Governing Council package to be announced on 10 December 2020; in particular extending the pandemic emergency purchase programme (PEPP) and the TLTRO III programme. Market expectations indicate an increase in PEPP of around €500bn with an extension to end-2021. With regard to TLTRO III, MMCG members believe that extending the discount rate for at least another year would be instrumental in banks maintaining excess liquidity holdings and continuing to service loan demand. Otherwise, large early repayments of TLTRO III could materialise in September 2021. According to MMCG members, the loan market is becoming increasingly leveraged, and in countries with deteriorating underwriting standards some banks are increasing their risk appetite to meet the required TLTRO lending benchmark, thereby facing potential loan loss provisions and an increase in NPLs. Such banks seem to be driven by a need to achieve the ECB target – this will enable them not only to receive the 50 basis point discount over the one–year period running from June 2020 to June 2021, but also to avoid the negative carry of 50 basis points during the three-month period from June 2021 to September 2021. There would be a return to the main refinancing operations (MRO) rate in TLTRO III from June 2021 to September 2021 if the lending benchmark could not be met, as banks can only make repayments from September 2021. This, according to MMCG members, would be an unintended consequence of the former TLTRO III modifications. Other possible options for changes to the TLTRO that MMCG members put forward included: (i) adding new quarterly operations; (ii) setting a similar or less demanding lending benchmark given insufficient loan demand; (iii) increasing the borrowing allowance; (iv) extending the maturity to four years; and (v) prolonging temporary collateral eligibility measures without a further easing of collateral.

Deposit facility rate (DFR) cuts neither expected nor desired, while increasing the tiering multiplier to 8-10 is highly desirable. According to MMCG members, DFR cuts would translate directly into a decrease in the €STR and EURIBOR, with a negative impact on the return on mortgages. On the other hand, an increase in the tiering allowance would provide relief for banks by alleviating the compression of net interest margin.

MMCG confirms that collateral availability is sufficient and supports the further harmonisation of additional credit claim (ACC) frameworks. Collateral availability remains an important driver of TLTRO participation. A number of MMCG members reiterated their previous call for (i) greater transparency regarding the different ACC frameworks in place across jurisdictions and for (ii) a level playing field regarding ACC use. MMCG members are of the view that the eligibility of ACCs in all jurisdictions has helped to free up space on banks' balance sheets although they stressed that national schemes should ensure that ACCs can be used efficiently as collateral in TLTROs. Following Brexit, a number of syndicated loans with lead arranger based in London will no longer be eligible for the ECB collateral pool.

Despite the calm observed in the money markets so far, MMCG members believe that tensions could still materialise, given that the market situation is dynamic. Prices in the cross-currency market for US dollars covering year-end are significantly lower than in previous years. The low pre-funding costs seen so far can be explained by the flattening of the US dollar yield curve and the better-than-expected scores for US global systemically important banks, which are helping to boost US dollar supply. The MMCG had mixed views on the demand for dollars from European customers. Some members claimed that US dollar structural deficits are now weaker, as more corporates are pricing their exports in euro, while other members felt that US dollar demand is still as high as it was in previous years. The US dollar funding market is also reported to be fragmented, as broker-dealers have large US dollar funding needs and there are large costs deriving from the volatility triggered by the concentration of excess liquidity in a few players. With regard to the secured segment, repo rates for non-general government collateral show a downward trend for both core and peripheral countries, driven by abundant excess liquidity. MMCG members believe that the securities lending facilities of Eurosystem NCBs are important to mitigate the downward repo pressures over the year-end and that the non-price terms of these facilities (e.g. collateral, limits) should be adjusted flexibly should this be required at this time. The ECB's role as coordinator would be important in this regard.

2) Adjustments to the Eurosystem publication of liquidity management data

Nikolaus Solonar (ECB) reported on three technical changes to the publication of liquidity management data on the ECB's website and on wire services.

Effective 14 December 2020, daily data will be available at 11:30, the autonomous factor forecast will only be released on Mondays, and the publication of the MRO benchmark amount will be suspended. The rationale for the changes is to provide operational relief to Eurosystem liquidity management staff given the growing number of operations conducted due to the coronavirus (COVID-19) crisis. MMCG members confirmed that the envisaged changes will not have any material impact, given the current context of a large liquidity surplus.

3) Update on TARGET Instant Payment Settlement (TIPS)

Fabrizio Dinacci (ECB) provided an update on the evolution of the pan-European reachability strategy for instant payments and its impact on banks' liquidity management. Andreas Biewald (Commerzbank) elaborated on the advantages of transitioning from the automated clearing houses (ACHs) to TIPS to allow for the instantaneous settlement of payments in central bank money.

TIPS will bring a paradigm shift. On 24 June 2020 the Governing Council decided to support the full deployment of instant payments across the Eurosystem. This decision will allow banks to decide whether they wish to use TIPS or ACHs for payment settlement, although banks will need to be reachable via TIPS if another institution wishes to settle directly using TIPS. The decision will come into force in November 2021, when all banks will be required to adhere to the reachability criterion. MMCG members agreed that banks will need to carry out preparatory work as TIPS could become the "new normal". The change is expected to have a significant impact on liquidity management as settlements will be possible 24/7, which will require sufficient cash buffers – these are less expensive in the case of TIPS. Banks will need to develop artificial intelligence technologies to manage instantaneous payments in order to address liquidity needs. In the long run, the change may result in the creation of ultra-short tenors in the unsecured segment.

4) Green finance

Ileana Pietraru (Société Générale) and Harald Endres (Deutsche Kreditbank, Bayerische Landesbank group) introduced the Environmental Social Governance (ESG) mandate and explained how responsible investment could help to shape the money market in the future.

An issue which is fashionable but not yet sufficiently mature for money markets. MMCG members agreed it is important and urgent to develop ESG commercial paper market, although they also insisted that credibility should be enhanced through the implementation of strict ratings and controls. Recent years have seen the increasing popularity of green bond issuance, often at yields which are lower than those for their conventional counterparts. This green trend is spearheaded by the European corporates that are dominating issuance, although the trend is global. Progress in incorporating green aspects into money markets has, however, been slow, as the short-term nature of these markets makes it more difficult to issue paper that supports green projects. Attempts with commercial paper have had limited success, as investors have been unwilling to pay a premium for the "green label". The repo market has seen a new GC green repo basket but transaction volumes are still low. The MMCG concluded that despite the ESG's growing popularity money markets are still insufficiently mature to fully incorporate its mandate. The prevailing view was that the movement will gain momentum in the future, but efforts still need to be made to establish verifiable and consistent standards and ratings. In the longer run, it is possible that markets will accept green finance as the "new normal" and start charging punitive rates for conventional issuances.

5) Other items

The next meeting is scheduled for 16 March 2021.

List of participants

Money Market Contact Group meeting

Participant's organisation	Name of participant
Bank of Ireland	Mr David Tilson
Barclays Bank	Mr Bineet Shah
Bayerische Landesbank group	Mr Harald Endres
BBVA	Mr Fernando Soriano
Belfius Bank & Insurance	Mr Werner Driscart
BNP Paribas	Mr Patrick Chauvet
BPCE/Natixis	Mr Olivier Hubert
Caixabank	Mr Xavier Combis Comas
Caixa Geral de Depósitos	Mr António Paiva
Commerzbank	Mr Andreas Biewald
Coöperatieve Rabobank U.A.	Mr Frank Beset
Deutsche Bank	Mr Jürgen Sklarczyk
DZ Bank	Mr Michael Schneider
Erste Group Bank	Mr René Brunner
HSBC Continental Europe	Mr Harry Gauvin
ING	Mr Jaap Kes
Intesa Sanpaolo	Ms Maria Cristina Lege
LBBW	Mr Jan Misch
Nordea	Ms Jaana Sulin
Société Générale	Ms Ileana Pietraru
UniCredit Bank	Mr Harald Bänsch
European Central Bank	Ms Imène Rahmouni-Rousseau (Chair)
European Central Bank	Mr Helmut Wacket
European Central Bank	Mr Julija Jakovicka
European Central Bank	Ms Maria Encio (Secretary)