

Recent developments in the euro money market

Money Market Contact Group
Frankfurt, 18 September 2012

ECB developments and announcements I

5 July 2012

- *The ECB reduced by 25 basis points the interest rate on the main refinancing operations to 0.75%, on the marginal lending facility to 1.50% and on the deposit facility to 0.00%, with effect from 11 July 2012.*
- *Further to its decision of 8 December 2011 to allow the NCBs, as a temporary solution, to accept as collateral **additional performing credit claims (ACC)** that satisfy specific eligibility criteria, on 5 July 2012 the Governing Council approved the framework for ACC proposed by the Bank of Greece, as well as the extensions of the ACC frameworks proposed by the Central Bank of Cyprus, the Banco de Portugal and the Banca d'Italia.*

20 July 2012

- *The ECB suspended **the collateral eligibility of bonds issued or guaranteed by the Greek government** and will assess their potential eligibility following the conclusion of the currently ongoing review, by the European Commission in liaison with the ECB and the IMF, of the progress made by Greece under the second adjustment programme.*

ECB developments and announcements II

26 July 2012

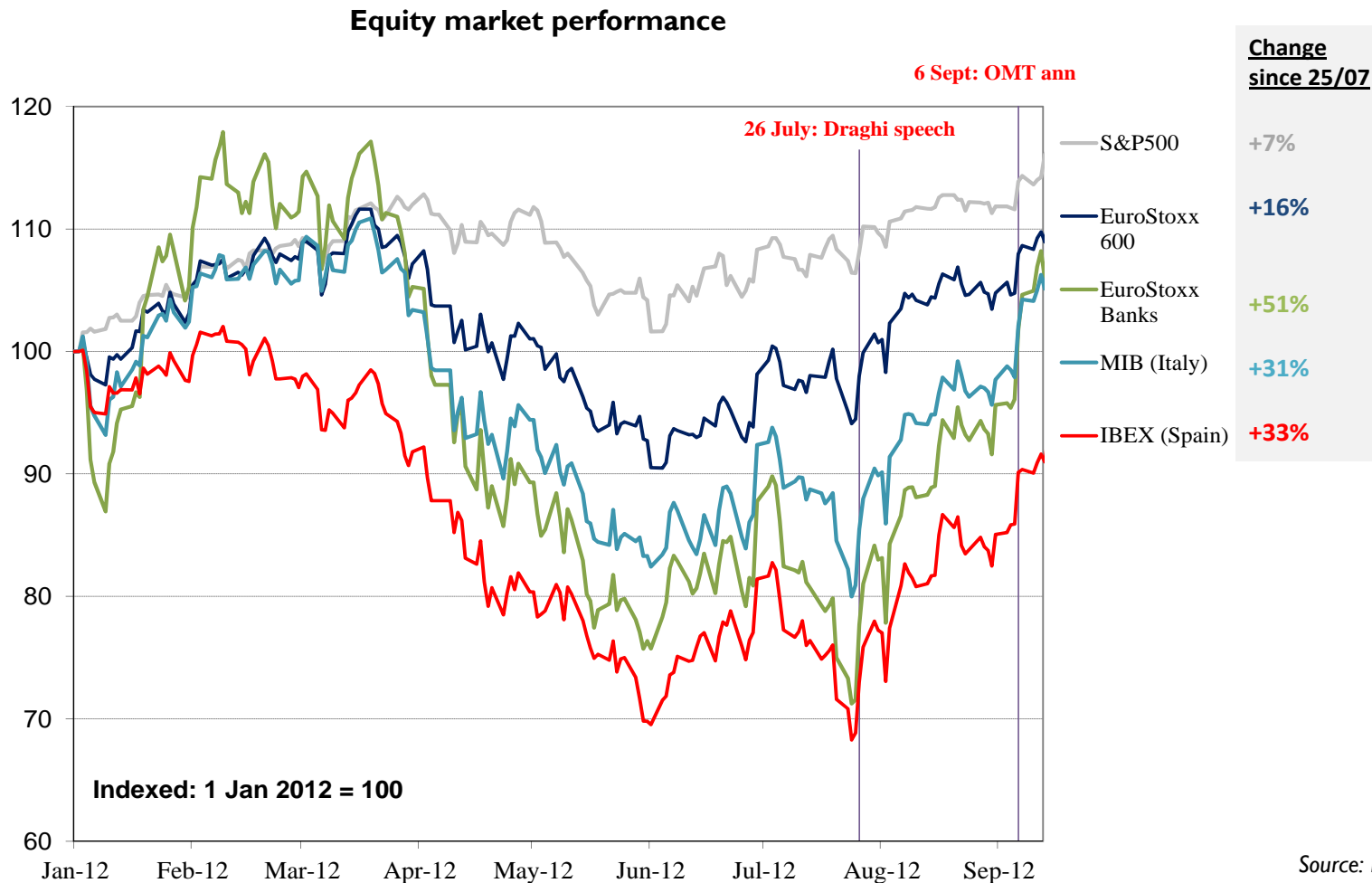
- *ECB President Draghi's speech in London on "irreversibility of the euro"*

6 September 2012

- *The ECB announced modalities for the Eurosystem's outright transactions in secondary sovereign bond markets, **Outright Monetary Transactions (OMTs)**, that aim at safeguarding an appropriate monetary policy transmission and the singleness of the monetary policy.*
- *The ECB adopted **two measures to preserve collateral availability**: (a) suspended the application of the minimum credit rating threshold for marketable debt instruments issued or guaranteed by the central government, and credit claims granted to or guaranteed by the central government, of countries that are eligible for OMT or are under an EU-IMF programme and comply with the attached conditionality as assessed by the Governing Council and (b) making eligible marketable debt instruments denominated in the USD, GBP and JPY, and issued and held in the euro area.*

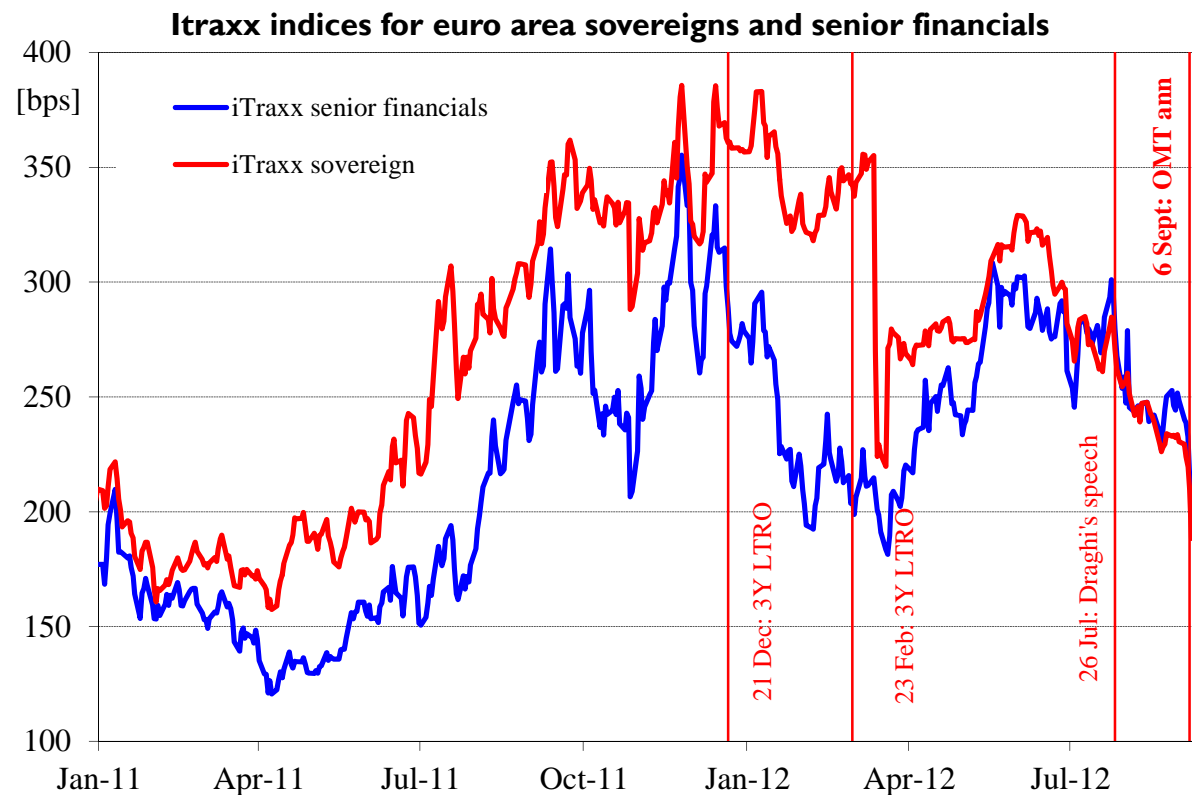
Financial market background I

- Strong recovery of risk sentiment with an outperformance of Italian and Spanish, on a national level, and banking shares, on a sector level



Financial market background II

- Perceived credit risk of senior financials decreased in line with a decline in sovereign risk premia

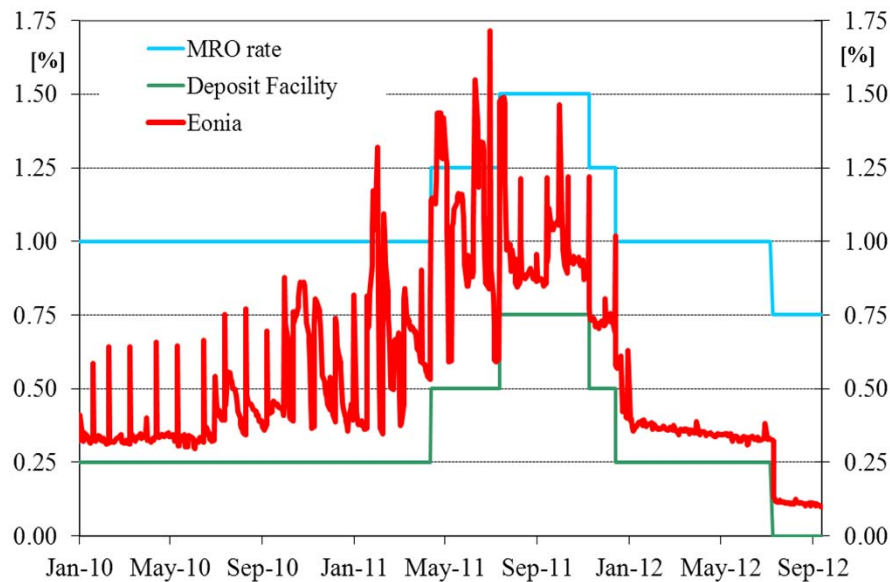


Source: Bloomberg

Unsecured money market I

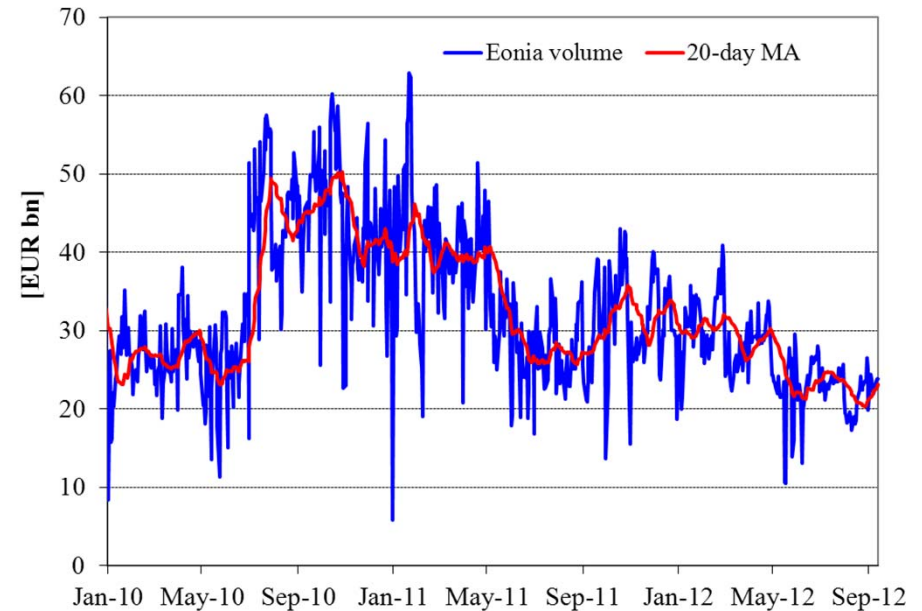
- Decline in unsecured rates across maturities
- **EONIA** lending volumes little impacted. **Dekabank** added to the panel.
- Strong investors' interest in banks' **CD/CP** in search for a positive yield

EONIA rate



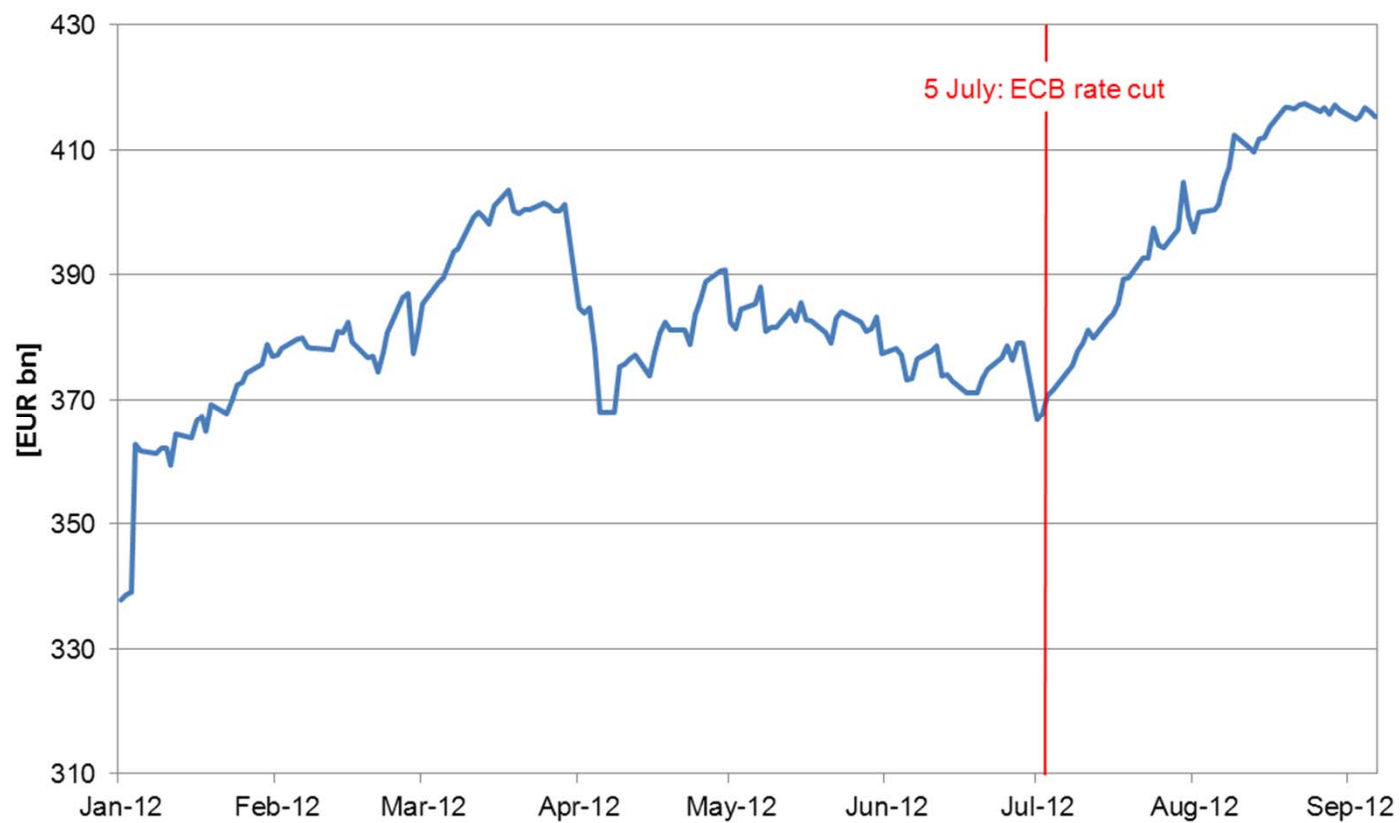
Source: ECB

EONIA volumes



Unsecured money market III

STEP outstanding volumes (all maturities)

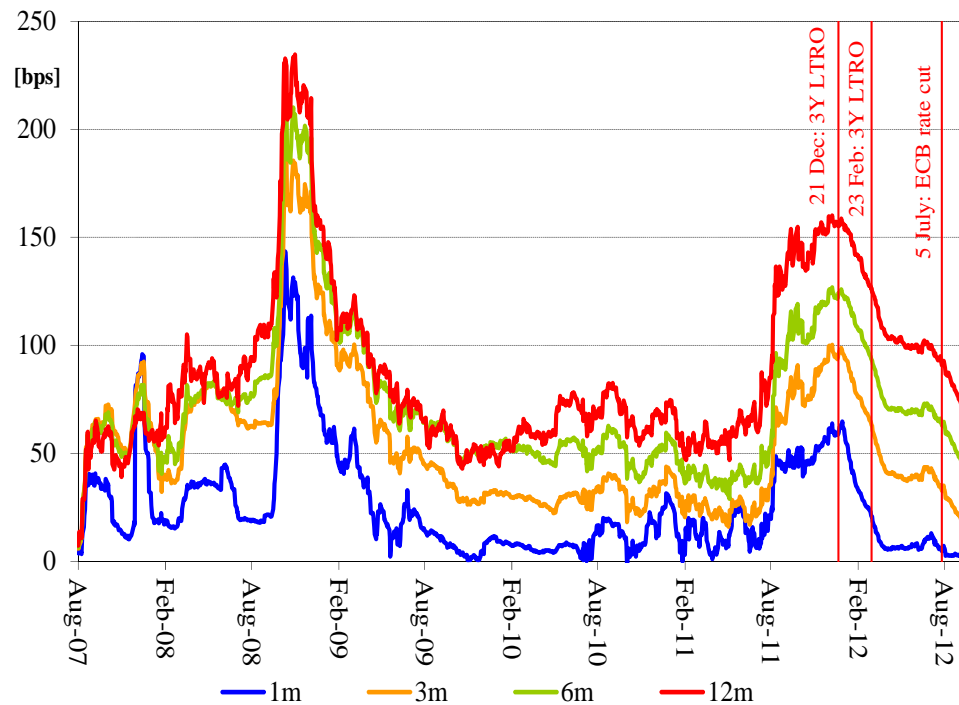


Source: ECB

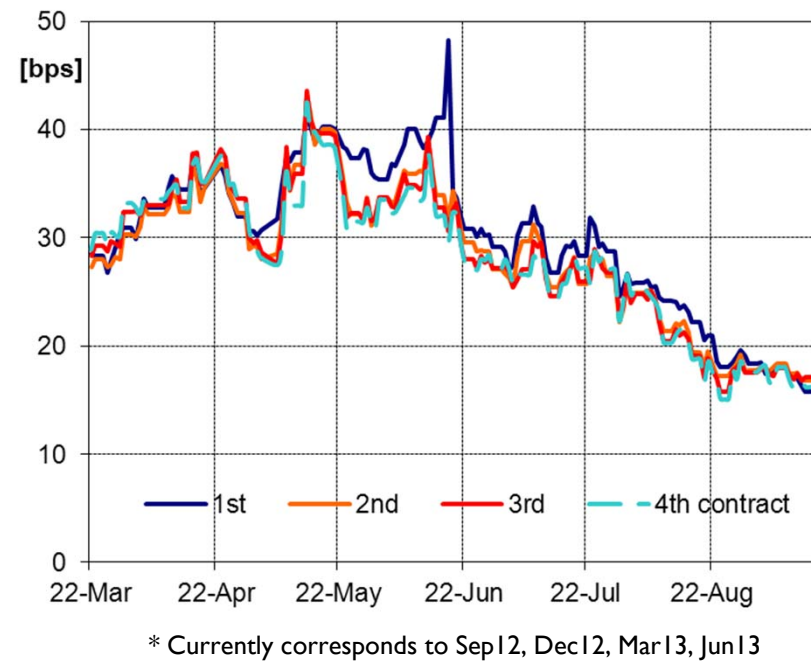
Unsecured money market III

- A continuous decline in the Euribor - OIS spreads reflecting abundant liquidity conditions, market expectations of the ECB's accommodative stance and a declining credit risk premium

Current Euribor-OIS spreads



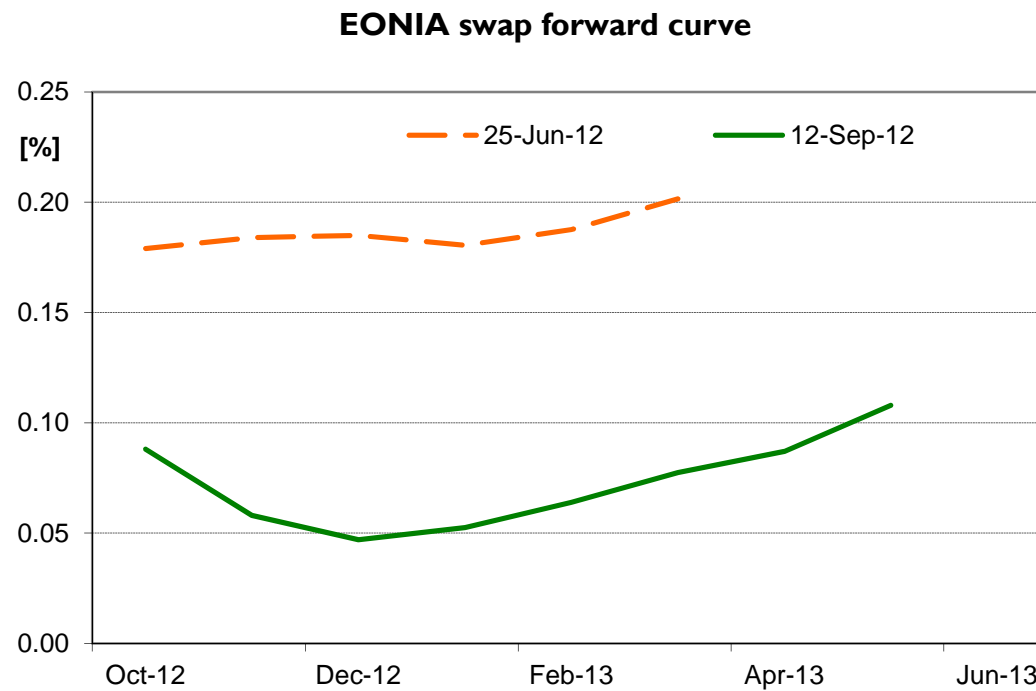
3-month forward spreads*



Source: Bloomberg

Market expectations of the ECB policy rates

- **EONIA swap forward curve prices in a slight chance of a cut in the deposit facility rate by end-2012**
- **Reuters' poll (10 September): 21 out of 26 traders see no cut in the deposit facility rate this year**

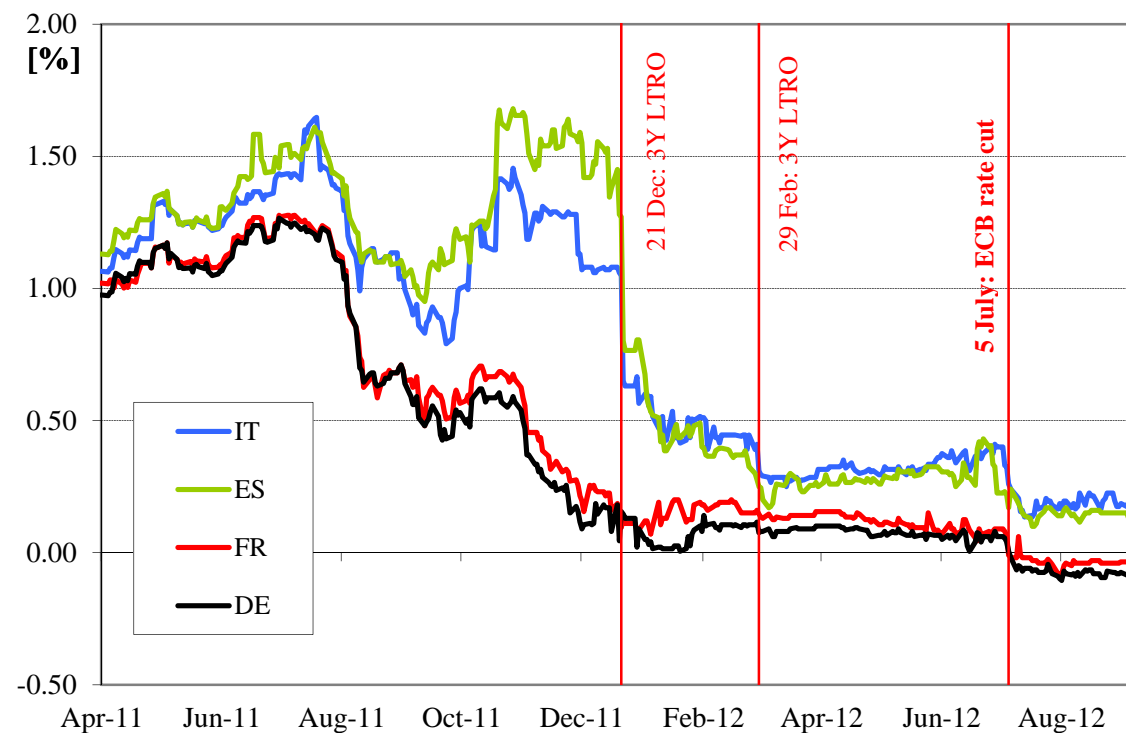


Source: Bloomberg

Repo market rates

- **Negative/zero rates in German and French repo**
- **Spanish and Italian repo rates declined but the spread to Germany broadly stable**

3-month repo rates for different types of collateral

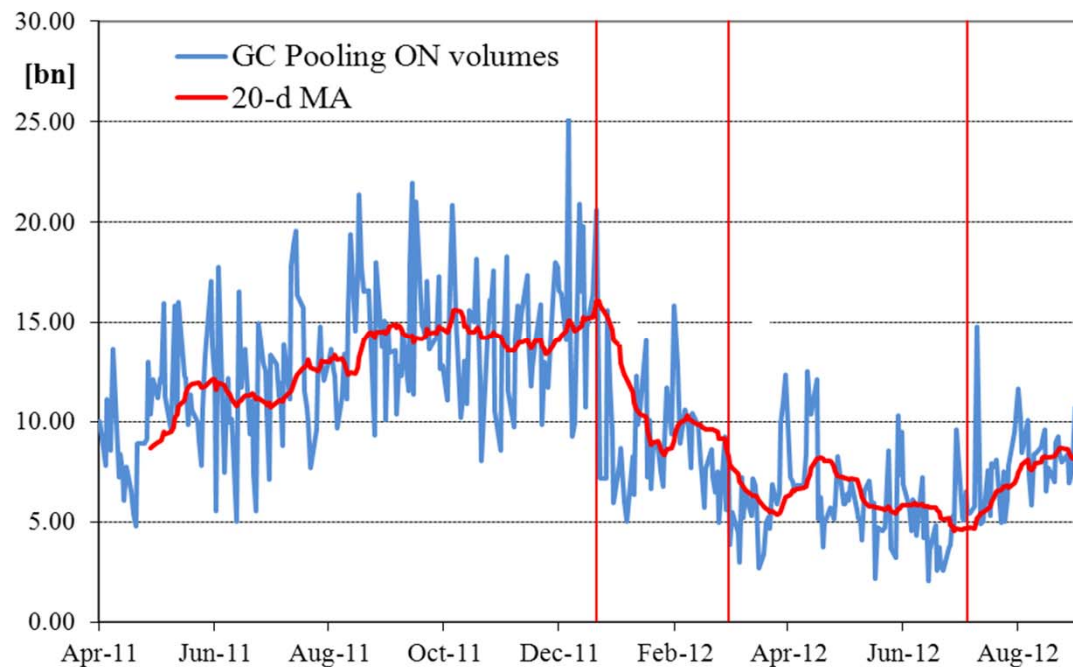


Source: Bloomberg

Repo market volumes

- A decline in “core” countries repo volumes due to negative/zero rates reflecting investors search for yield
- Little impact on short-term repo volumes (O/N GC pooling)

GC pooling O/N trading volumes

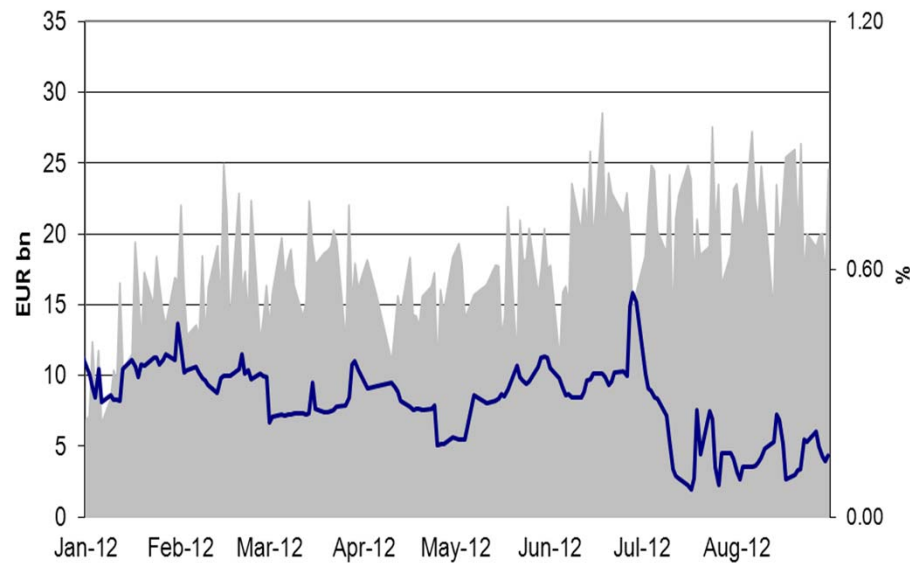


Source: Bloomberg

Repo market volumes – Spain and Italy

- **Spanish repo market: stable “domestic” trading volumes, declining international activity**
- **Italian repo: stable trading volumes**
- **Major risk factor: CCP haircut and limit actions**

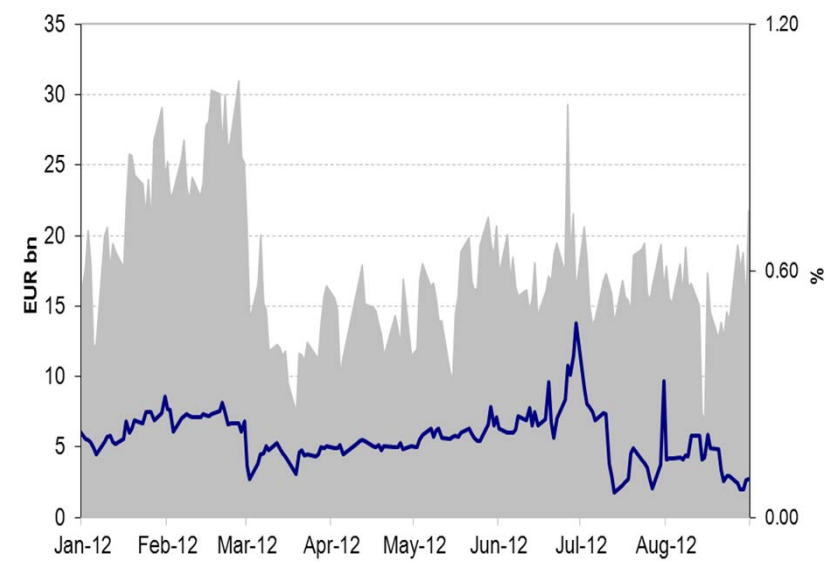
Italian repo market



Volume Average Rate (rhs)

Source: MTS

Spanish repo market (settled via Iberclear)



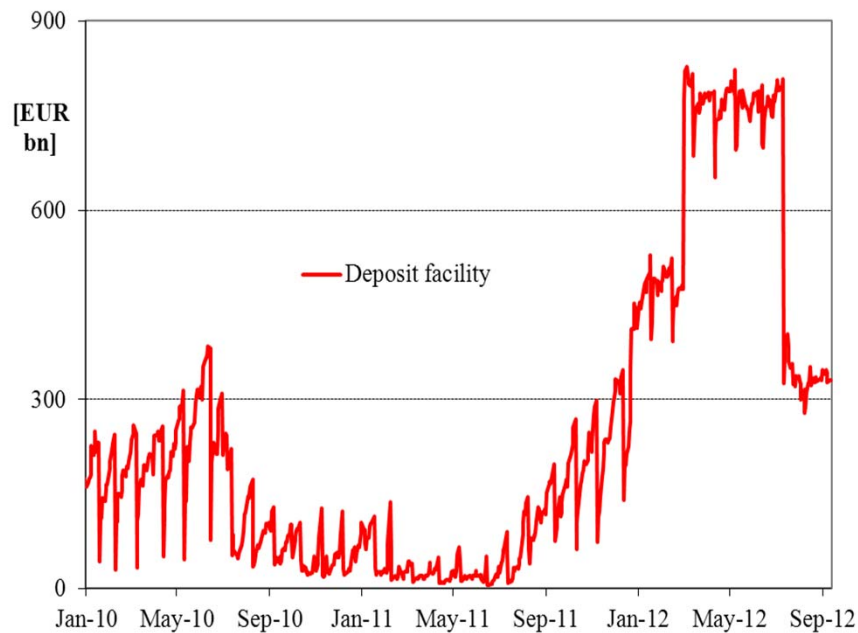
Volume Average Rate (rhs)

Source: Banco de España

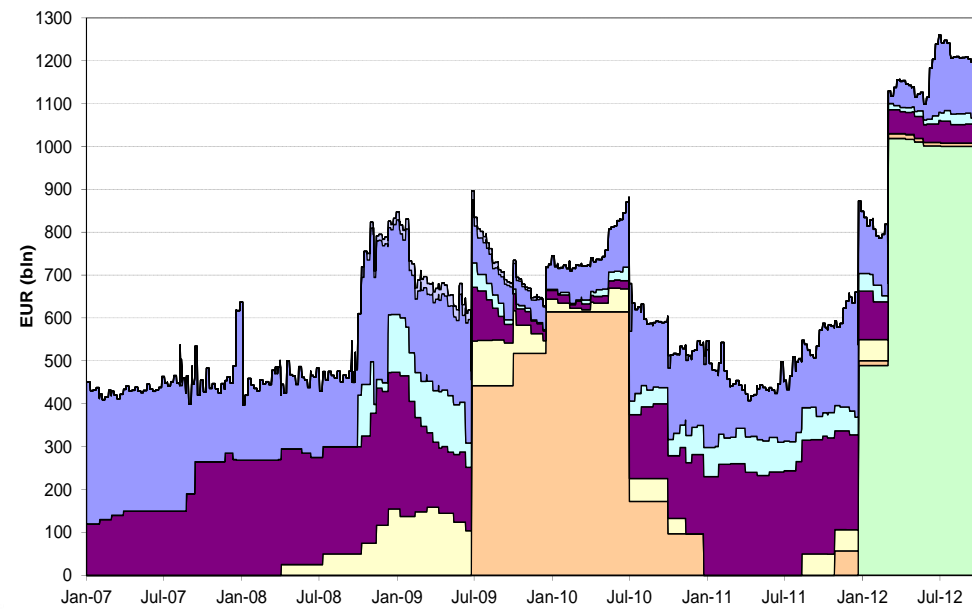
Use of the ECB's standing facilities and operations

- A structural shift from deposit facility into excess reserves
- Limited changes in the recourse to the ECB operations

ECB deposit facility



Maturity breakdown of the ECB's liquidity provision



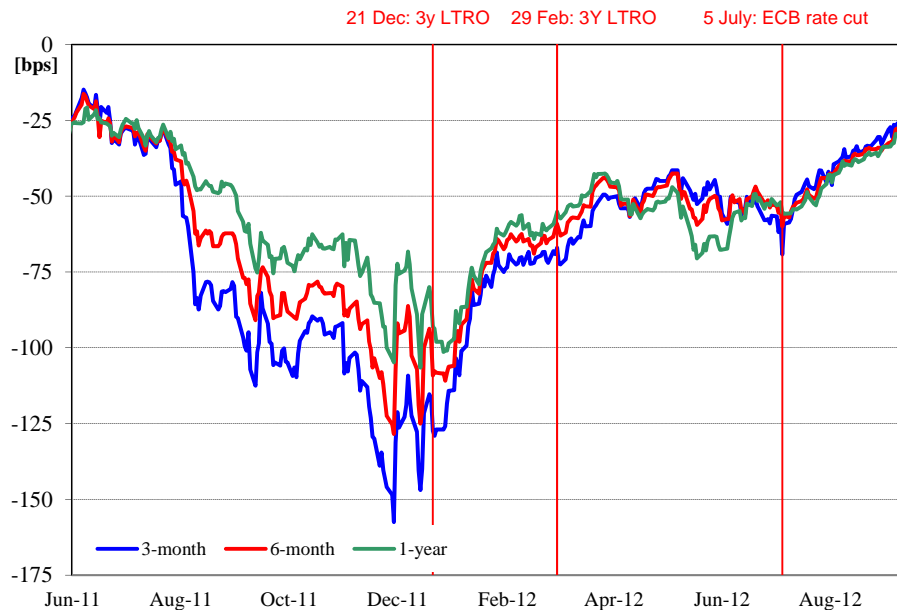
□ 36M LTRO □ 12M LTRO □ 6M LTRO ■ 3M LTRO □ 1M SLTRO □ MRO ■ FTO Providing □ FX Swap

Source: ECB

USD funding situation and ECB USD operations

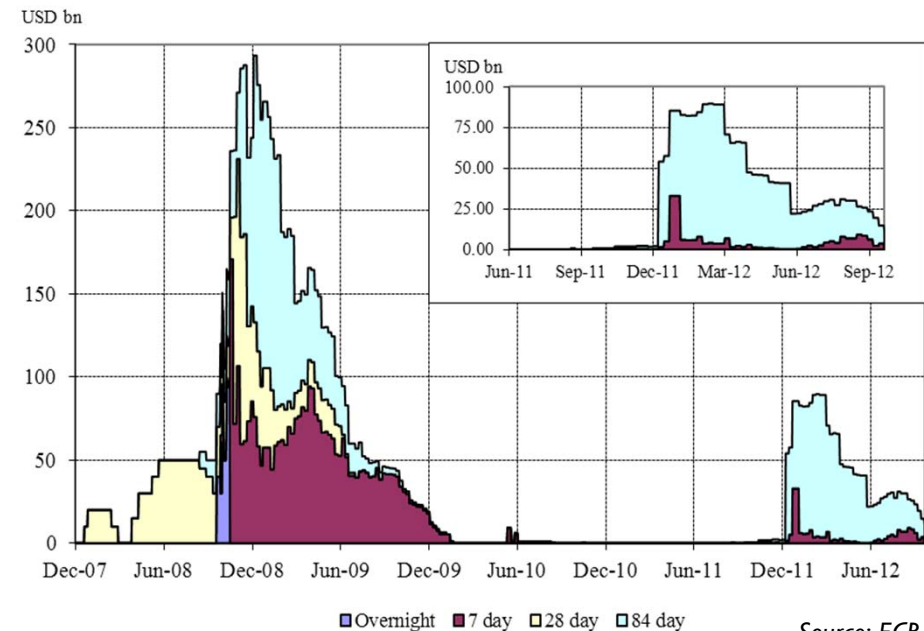
- Further easing of USD funding conditions in the FX swap market
- Declining recourse to the ECB USD facilities

EUR/USD FX basis swap



Source: Bloomberg

ECB USD operations

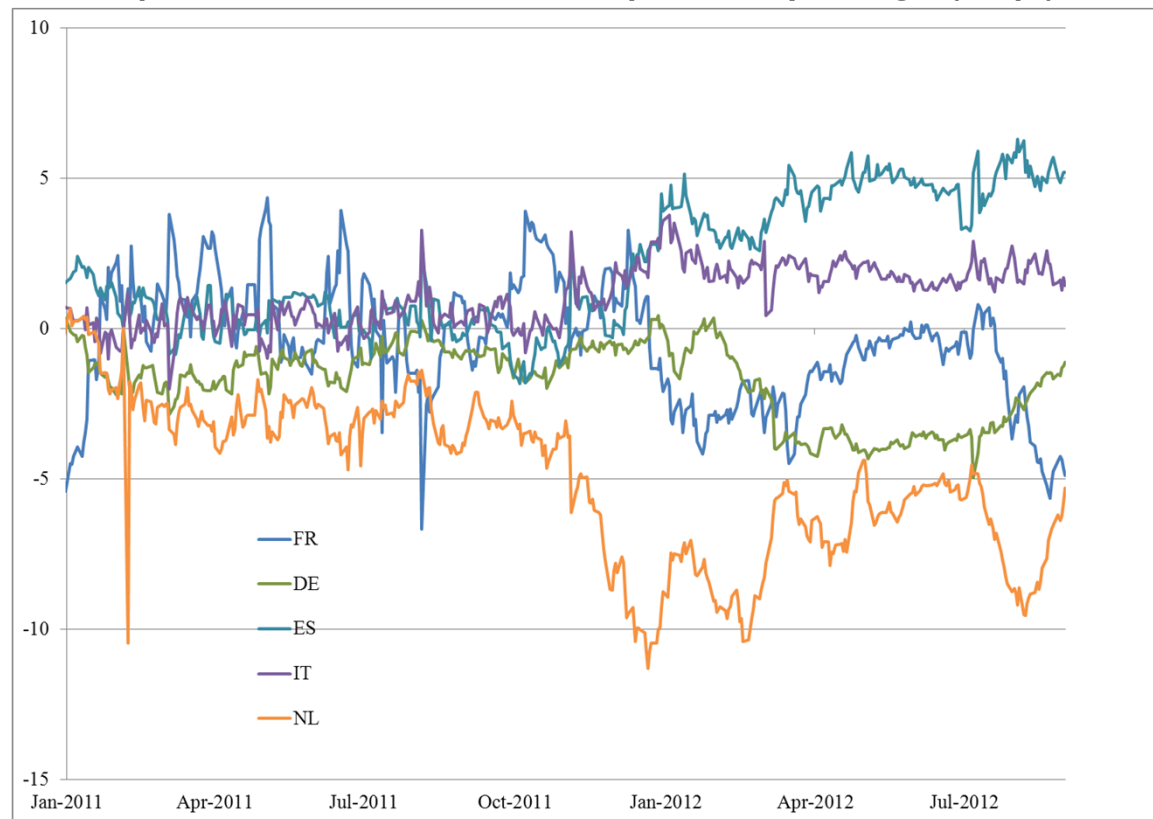


Source: ECB

Signs of market segmentation I

- Dispersion of Euribor contributions based on the country of origin
- Dispersion of remuneration in retail deposits
- “Home bias” in the money market activity and collateral use

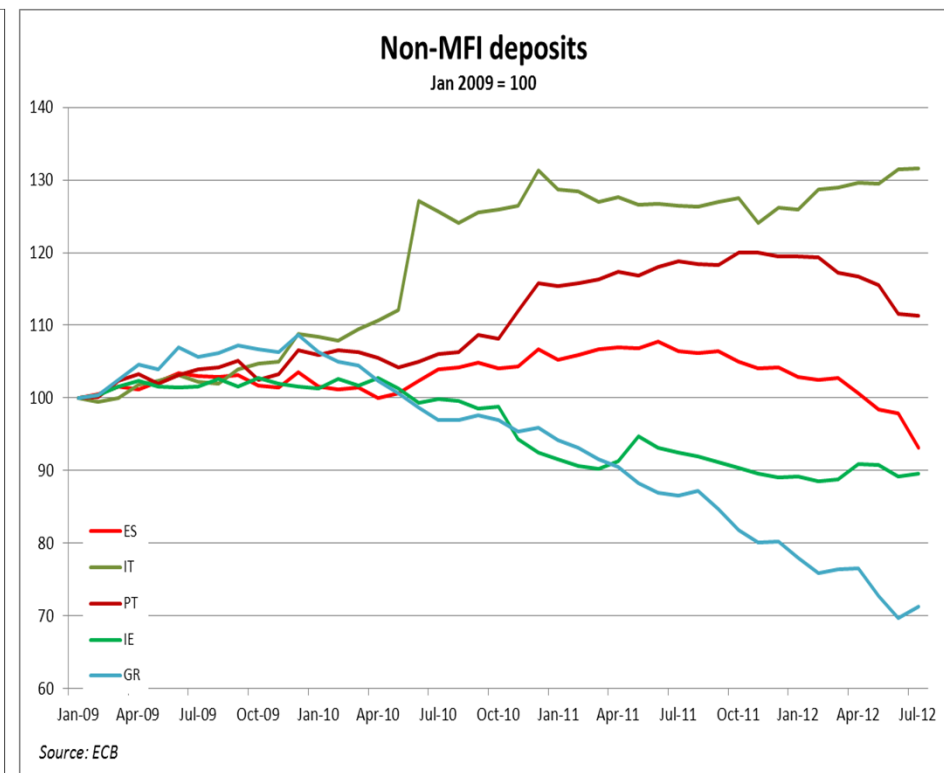
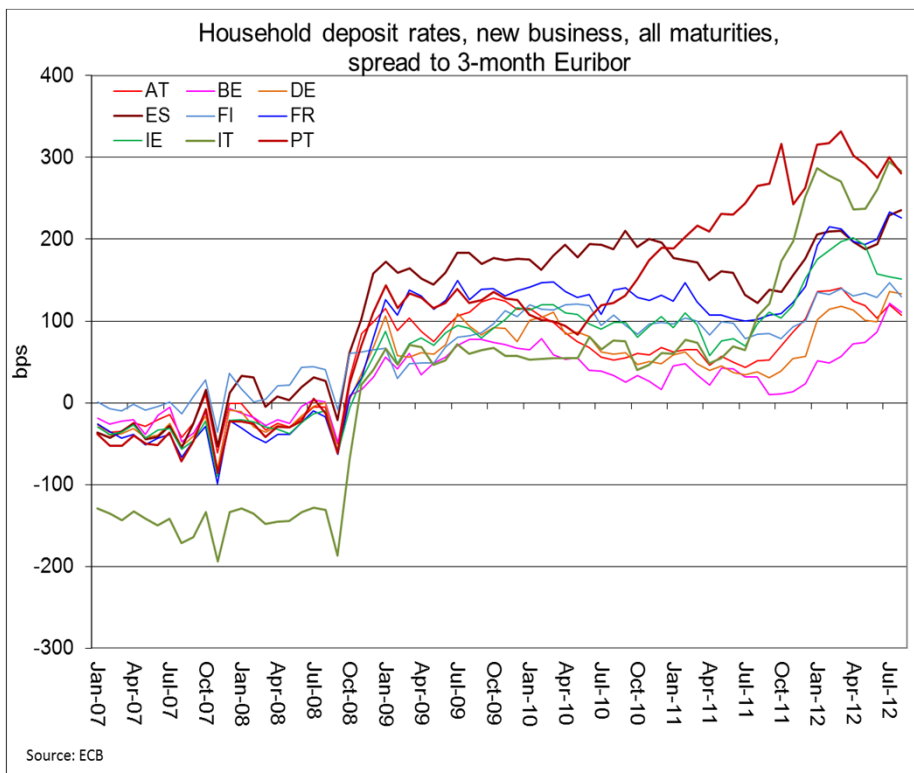
Dispersion of Euribor contributions per country of origin (in bps)



Source: Bloomberg, ECB calculations

Signs of market segmentation II

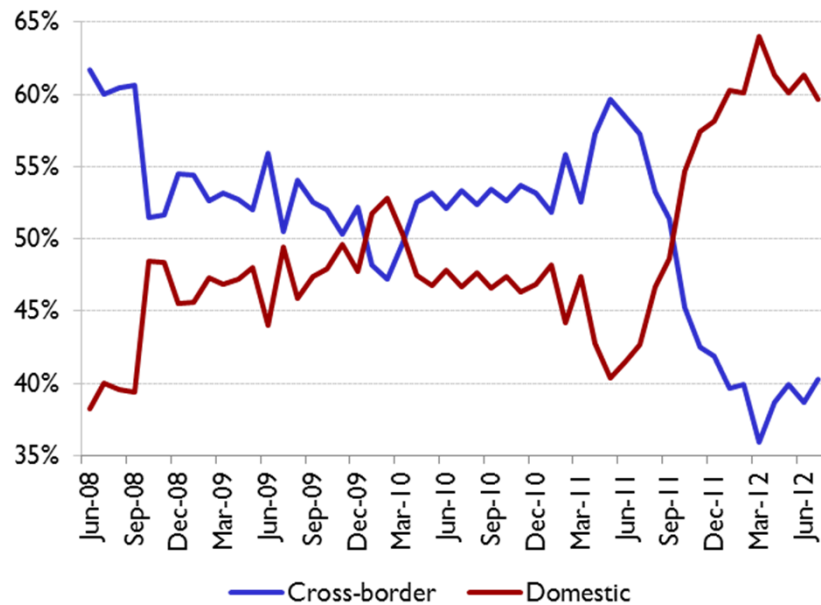
- Increasing dispersion of retail deposit rates
- Larger outflows in Greece
- No outflow in Spain if retail IOUs (“pagares”) are included



Signs of market segmentation III

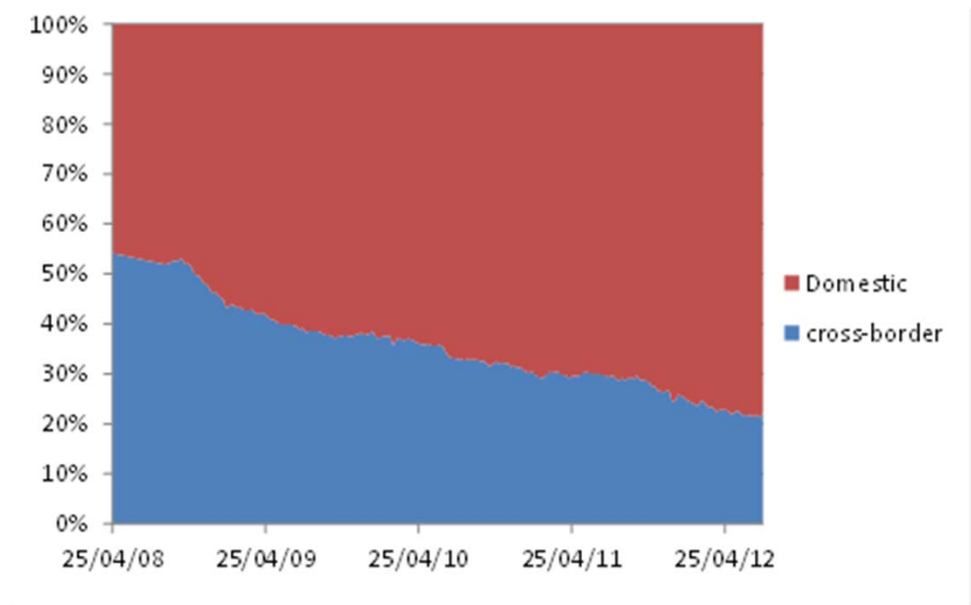
- **Persisting “home bias” in the market lending activity and collateral usage**

**Share of cross-border O/N loans
(TARGET2 money market transactions)**



Source: TARGET2

**Domestic and cross-border use of collateral in
Eurosystem monetary policy operations**



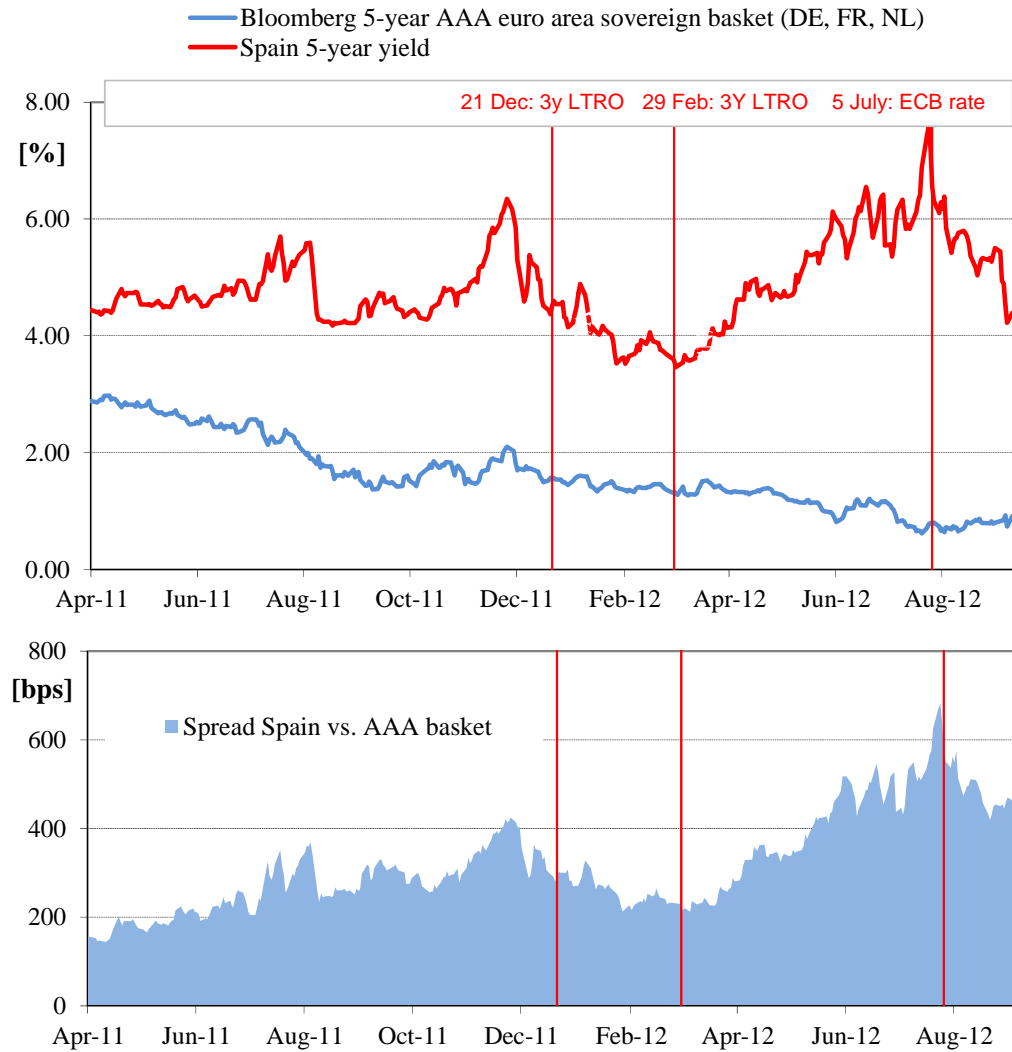
Source: ECB

Potential issues for discussion

1. *MMCG assessment of the functioning of the euro money market:*
 - (a) *MMCG feedback on their **experience with zero and negative interest rates** in the euro money market*
 - (b) *Situation with regard to **haircuts and limits in the government bond repo market***
 - (c) *Evolution of credit limits among banks over the past three months*
2. ***Impact of the recent announcements by the ECB** (outright monetary transactions and collateral measures) on the euro money market (unsecured, secured)*

Background slide: Repo market

Spread Spanish yield vs. AAA basket



Source: Bloomberg