EMMEC Meeting - Summary

Meeting title	EMMEC meeting
Date and time	26 June 18.30 – 27 June 2024 16.30 CET
Location	Commerzbank AG offices: Kaiserstraße 16, 60311 Frankfurt am Main, Germany
Attendees	EMMEC Members F. PAILLOUX -Chair- (Société Générale) for ACI France – physical P. LE VEZIEL (Credit Agricole SA & Crédit Agricole CIB) for ACI France – physical L. BRANDTNER (Raiffeisenlandesbank Oberösterreich) for TMA Austria - virtual H. WESTERMANN (Commerzbank) for AEFMA Germany - physical F. SPAHN (DZ Bank) for AEFMA Germany - physical M.C. LEGE (Intesa SanPaolo SpA) for Assiom Forex Italy - virtual S. CIMINO (UniCredit) for Assiom Forex Italy - physical M. GALLI (Banco BPM) for Assiom Forex Italy - virtual C. HUSS (Union Bancaire Privée) for LFMA Luxembourg - virtual J. M. TASSARA (Cecabank) for ACI Spain - virtual L. BARRIGON (Banco Santander SA) for ACI Spain - virtual J. PIASKO (Julius Baer) for ACI Suisse - virtual M. PESONEN (Nordea) - virtual C. WICHMANN (Danske Bank) for ACI Denmark – virtual O. HUBERT (Nataxis) for ACI France – virtual K. WINDING LARSEN for ACI FMA – virtual J. LARDINOIS (Belfius) for ACI Belgium – virtual T. KOEFOED (Danske Bank) for ACI Danmark – virtual Guest speakers Christoph RIEGER (Commerzbank) Benoît NGUYEN (ECB Europa) Yves BLAVET (Socgen) Andrew COSSOR (DZ Bank) Observers F. HEBEISEN - ACI France J. JACKOVICKA – ECB O. VERGOTE – ECB R. CAPPARELLI – EMMI G. DILLEN – EMMI B. DENECKER - EMMI

	EMMEC Secretariat R. CAPPARELLI – EMMI G. DILLEN - EMMI
Agenda items	**Speaking points**
Introduction	EMMEC members were reminded of competition law, confidentiality and conflicts of interest.
Item 1	Members' roundtable: speaking points • Implications of FED Stance on ECB Decisions: Members examined how the Federal Reserve's monetary policy stance could influence the European Central Bank's (ECB) decisions. Additionally, the political environment, especially in France, was considered a factor. Some members anticipate only one more interest rate cut from the ECB this year, while others foresee two cuts, possibly in September and December. The ECB's efforts to meet its medium-term projections were acknowledged, though concerns were raised about the persistent service inflation. • Current State of Liquidity in Europe: The liquidity situation in Europe is perceived to be robust, supported by excess liquidity and strong Liquidity Coverage Ratio (LCR) figures. The quarter-end effect in the repo market is not a concern, with high volumes noted in MTS. No specific issues were identified across money market segments. However, a decline in demand for Net Stable Funding Ratio (NSFR) longer-term repos was observed in the last quarter, notably explained by the strong pre-funding of the LT programs in Q1 and a lightly decline of credits. • Post-European Elections Atmosphere: After the European elections, a cautious atmosphere led to some market tensions, not driven by fundamentals. President Macron's actions were generally viewed as strategic by most participants. the outcome of the election is highly uncertain • Impact of US Elections: The upcoming US elections will be closely monitored, with potential implications for market conditions. Members discussed the effects of inflation reduction and low energy prices in the US. • Interest Rate Pass-Through: The pass-through of the higher interest rate environment on banks' funding costs is incomplete, due to extensive long-term precautionary funding secured when rates were lower. • Primary Market Issuance: Members reviewed significant issuance activity in the primary markets by banks, such as retained covered bonds, to maintain high NSFR ratios affected by the reduction of TLTRO. They also discussed an ICMA briefing note on changes to the EU's NSFR Required Stable Funding factor for short-term reverse repo and have confirmed that European players worries were properly addressed toward regulators: https://www.icmagroup.org/assets/ICMA-ERCC_BN_NSFR-and-reverse-repo_May-2024_Final.pdf • Decreasing Demand for NSFR: The demand for NSFR has decreased, with banks globally managing NSFR as part of medium to long-term funding plans,

	and using short-term activities for residual adjustments. These plans are typically prepared three years in advance and presented to the ECB Joint Supervisory Team (JST). Most banks completed a significant portion of their Long Term funding plans early in the year and are currently satisfied, avoiding further increases in the ratio. It was noted that with Short Term interest rates at 4%, the demand for mortgages and credits has decreased, making a high NSFR potentially costly. Differences in appetite for ECB structural operations between large and small banks were also noted. • **Data Dependence and Market Surprise Potential**: The ECB's flexible, data-dependent approach allows it to surprise the market if necessary. • **Middle East Tensions**: Some members noted that market prices do not fully reflect the tensions and related risks in the Middle East. • **UK Money Markets Code:** Members mentioned that Bank of England published the UK Money Markets Code in June 2024. Money Markets Code: https://www.bankofengland.co.uk/markets/money-markets-committee-and-uk-money-markets-code/the-uk-money-markets-code Related notes: https://www.bankofengland.co.uk/markets/money-markets-committee-and-uk-money-markets-code/the-uk-money-markets-code-explanatory-notes
Item 2	**Presentation**: "ECB 3.0: Constructing a new floor!" by Christoph Rieger, Head of Rates & Credit Research, Commerzbank • Mr. Rieger delineated the evolution of excess liquidity in the euro area, identifying three stages: the scarce reserve system, the abundant reserve system, and the most recent ample reserve system. • Mr. Rieger explained the primary changes in the revised ECB operational framework and highlighted the relationship between excess liquidity and overnight spreads. Estimating the Floor Required Excess Liquidity (FREL) remains challenging. • Mr. Rieger presented an estimate of when the ECB balance sheet will cease shrinking, emphasizing that the main assumptions pertain to Short Term Operations. Once excess liquidity approaches FREL, the continued decline of the ECB bond portfolio (QE) will be offset by banks' liquidity needs and their participation in ECB open market operations. Persistent demand for short-term operations might prompt the ECB to launch structural operations. • Mr. Rieger noted that Italian banks have maintained stable excess liquidity levels (around EUR 75 billion) while repaying TLTRO funding, without causing rate disruptions. • The slight increase in the €STR-DFR spread over the past year is not viewed as indicative of tight liquidity or competitive bidding in the unsecured overnight rate. Additionally, liquidity is not seen as a factor in the widening spreads between repo General Collateral (GC) rates and repo rates with special collateral. • Mr. Rieger questioned Euribor's fitness for purpose, prompting a discussion on the potential benefits and costs of transitioning to a new benchmark. Members highlighted that adding new Euribor panels would enhance its

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robustness, though switching benchmarks would cause significant disruption to P&L and corporate clients. Euribor is considered the only reliable benchmark reflecting the average cost of funding for European banks, despite its uniqueness compared to other countries' benchmarks. Some members noted that similar rates are used in many Asian countries.
Mr. Rieger presented data on the French 30-year asset swap spread and 5-year Credit Default Swaps (CDS). Credit markets remain stable, with 5Y CDS at historically low levels since Draghi's "whatever it takes" statement, with confidence increasing further since the introduction of Next Generation EU . However, the increasing 30Y OAT ASW, currently at three-digit levels, is a concern attributed to supply and demand imbalances.

Discussion among members on the following points:

Attractiveness of the New Framework: Members discussed the attractiveness of the reduced corridor between the Main Refinancing Operations (MRO) and the Deposit Facility Rate (DFR) under the new operational framework effective from September. Some suggested that making MRO access more attractive could increase volumes, while others expressed concerns about the stigma and potential supervisory issues from the ECB JST.
Anticipated Features of ECB Structural Operations: Mr. Rieger outlined potential features of the ECB's structural operations under the new framework. Expected to be launched in 2027, these operations would be of 1-3 years in duration, without incentive structures, and allotted based on a market mechanism rather than fixed rate full allotment.
FREL Estimates: One member estimated that FREL would remain above EUR 1 trillion due to the current regulatory environment and banks’ preference for safety. The €STR is expected to maintain its current spread with the DFR even as FREL levels approach.
Differences Between €STR and Repo Rates: Mr. Rieger explained that the lower €STR compared to the GC German repo rate is due to the different nature of these markets. €STR transactions serve banks' clients and require remuneration, while the repo market involves banks and asset managers seeking funds.
OAT Asset Swap Spread Concerns: Members discussed the possibility of activating the Transmission Protection Instrument (TPI) in response to high OAT ASW levels. Mr. Rieger noted that current levels do not warrant ECB intervention, as there are no contagion effects and the bond market functions well, as evidenced by Italy's low yields.

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Presentation: "Safe Asset Scarcity and Monetary Policy Transmission" by Benoit Nguyen, Team Lead - Market Operations, European Central Bank

Mr. Nguyen presented a research paper in which he reviews the pass-through to money market rates of the ECB's interest rate hikes. Views expressed are his and his coauthors’ own and not official position of the ECB. He highlighted the lack of passthrough to repo rates in 2022, and perceptions of safe asset scarcity impeding monetary policy transmission from financial reporters and quotes from ECB board member.
An inverse relationship between the pass-through of money market rates and the scarcity of safe assets, measured by repo specialness premium, was

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	outlined. Mr. Nguyen showed specialness inherited from the purchase programmes correlated with a lack of passthrough around the first hikes. • He also explained that increased demand for specials in the repo market might be in part driven by hedge funds' short positions in cash products. • Finally he discussed the improvement of passthrough in 2023 that coincided with the reduction of the Eurosystem's footprint, and the increase of collateral availability, also driven by net government issuances. Discussion among members on the following points: • **Increase in AUM**: Members noted that Assets Under Management (AUM) for money market funds are increasing, with many of these funds entering the repo market. The observed imperfect pass-through over the past two years was attributed more to the circulation of collateral rather than an actual scarcity of safe assets. • **Provision of Bonds**: The activities of Debt Management Offices (DMO) have played a crucial role in supplying bonds to the market, thereby reducing the specialness of certain securities. • **Cancellation of Repo Market Actions**: Members mentioned a cancellation of the Banque de France's ordinary actions in the repo market, impacting market dynamics. • **Preference for Term Deposits**: It was noted that most corporates, particularly the largest ones, are more interested in term deposits rather than engaging in the repo market.
Item 4	**Presentation:** "Towards a Retail Central Bank Digital Euro" by Yves Blavet, Head of Public Affairs – Retail Banking & Digital, Société Générale • Mr. Blavet emphasized the ECB's interest in preserving the role of anchor of central bank money in the digital age by launching a retail digital euro, distinguishing it from wholesale banking initiatives. The ECB is unique among major central banks in explicitly aiming to launch digital retail money as soon as possible. • The digital euro project involves establishing a legal framework by the end of 2025, empowering the ECB to decide on its issuance. The potential launch window is between 2028 and 2030. • The ECB aims to avoid draining banks' balance sheets with the digital euro, positioning it not as a store of value. The digital euro must rely on European technology to preserve sovereignty in the payment system, countering the dominance of American companies like Visa and Mastercard. • A fully mobile-based digital euro could exclude more than thirty million European citizens from using this means of payment. For that motive, the ECB is considering card-based solutions as an additional alternative. • Initially, the impact on financial stability is expected to be limited. However, a successful digital euro could lead to a significant drain of funds from banks' balance sheets. Implementation costs for banks would be considerable, particularly for upgrading information systems.

	- The digital euro could lead to significant losses in payment revenues under the current legal framework. Additionally, there appears to be a lack of clear advantages for retailers in adopting the digital euro. Discussion among members on the following points: - Cost Estimates: Members inquired about the total costs for an average bank to implement the digital euro. Mr. Blavet estimated costs to exceed those of SEPA, with more than 100 million euros for a significant European bank. The ECB has invited many market participants to discuss the project, and national banking federations are actively lobbying to influence the legislation. - Digital Euro vs. Instant Payments: Members argued that the impact of the digital euro on the banking system differs from that of instant payments. While instant payments transfer money between banks, the digital euro allows money to move outside the banking system more easily and quickly than cash withdrawals. Unlike needing an ATM to withdraw cash, digital euro transactions can be done directly via mobile phones, posing a significant shift in fund mobility.
Item 5	**Presentation:** "The FX Market and (selected) recent central bank developments " by Andrew Cossor, Senior FX and Fixed Income Analyst, DZ Bank - Mr. Cossor provided an overview of key US economic data, including consumer confidence, GDP growth, unemployment, and inflation. He focused on wage developments, the workforce size, and the relationship between unemployment and current job vacancies. - Service inflation in the US is a primary concern, while energy and food prices no longer play a significant role. - Members asked whether inflation driven by the green transition should be taken into account. Mr. Cossor outlined that most Americans, generally speaking, they don't consider climate change as a problem that should concern them. Hence, this element is not currently included in the latest inflation expectations. The FED is expected to cut rates in the near future. - The Eurozone economy is projected to improve over time, with optimism for the rest of the year. However, The Euro area has structural demographic issues limiting economic growth, with Italy facing the most significant structural limitations. - The ECB is expected to cut rates once per quarter until the end of the year/first part of 2025. While ECB President Christine Lagarde is optimistic about wage growth, Mr. Cossor remains less confident. - Mr. Cossor presented data on French public finances, highlighting the political difficulty of reducing public debt while seeking re-election. France's reliance on foreign buyers of public debt poses potential risks if foreign investors disapprove of election outcomes. - In sum, based on the economic situation and the political uncertainties, the DZ BANK forecast on a three-six and twelve-month view is USD 1.08. - Mr. Cossor showed the economic outlook of the UK economy. Average wage growth rates in the UK are incompatible with achieving a 2% inflation rate in the long run. The pound is expected to trade sideways against both the dollar and the euro in the mid-1.20s and mid-0.80s respectively.

	Discussion among members on the following points: • **Green Transition and Inflation**: Members questioned whether inflation driven by the green transition should be considered. Mr. Cossor noted that most Americans do not view climate change as a pressing issue, so it is not factored into current inflation expectations. • **ECB Independence from FED**: Members asked about central bank actions in relation to the FED. Mr. Cossor suggested that the ECB has an opportunity to act independently of FED decisions. • **Exchange Rate in Monetary Policy**: The relevance of the exchange rate in European monetary policy was discussed. While it is less significant today, concerns could arise if the EUR/USD rate falls below parity. • **Political and Practical Considerations**: The process of dedollarization is not seen as widespread. Countries not using the dollar often do so for political reasons or lack of access. Mr. Cossor noted that if Donald Trump is re-elected, the Euro might gain more market share.
AOB	• It is discussed the possibility to move the September EMMEC meeting from Brussels to Luxemburg.