EMMEC Meeting - Summary

Meeting title	EMMEC meeting
Date and time	16 December 19.00 – 17 December 2024 16.30
Location	Hybrid: • Rabobank HQ, Croeselaan 18, 3521 CB Utrecht, The Netherlands • Conference call (Teams)
Attendees	EMMEC Members - physical F. PAILLOUX -Chair- (Société Générale) – ACI France P. LE VEZIEL (Credit Agricole SA & Crédit Agricole CIB) – ACI France R. BRUNNER (Erste Group Bank AG) - TMA Austria H. WESTERMANN (Commerzbank) - AEFMA Germany F. SPAHN (DZ Bank) - AEFMA Germany P. BYRNE (Bank of Ireland) M.C. LEGE (Intesa SanPaolo SpA) - Assiom Forex Italy S. CIMINO (UniCredit) - Assiom Forex Italy J. PIASKO (Julius Baer) F. BESET (Rabobank) J. LARDINOIS (Belfius Bank) - ACI Belgium C. HUSS (Union Bancaire Privée) - LFMA Luxembourg G. SANCHEZ DE ROJAS (Banco Santander SA) - ACI Spain EMMEC Members - online L. BRANDTNER (Raiffeisenlandesbank Oberösterreich) - TMA Austria C. CAGNAZZI (Banca Popolare di Sondrio) - Assiom Forex Italy C. ORIGER (BCEE - Banque et Caisse d'Épargne de l'Etat) - LFMA Luxembourg M. POLFER (BCEE - Banque et Caisse d'Épargne de l'Etat) - LFMA Luxembourg J. M. TASSARA (Cecabank) - ACI Spain T. KOEFOED (Danske Bank) - ACI Denmark B. LAIN SAN MARTIN (Cecabank) - ACI Spain O. HUBERT (Natixis) – ACI France V. CAILLON (Société Générale) – ACI France Guest speakers A. RANALDO - University of Basel J. LARDINOIS - Belfius A. BIEWALD - Commerzbank A. PETIMEZAS - AFS group G. LE BLANC - AFS group

	Observers F. HEBEISEN - ACI France K. M. LARSEN - ACI FMA B. VAN DER VEEKEN - Volksbank J. JACKOVICKA – ECB H. WACKET - ECB P. NICOLOSO - ECB **EMMEC Secretariat** R. CAPPARELLI – EMMI B. DENECKER - EMMI
Agenda items	**Speaking points**
Introduction	EMMEC members were reminded of competition law, confidentiality and conflicts of interest.
Item 1	**Members' roundtable:** • PMI Data and Euro Area Outlook: Positive PMI data were noted in the euro area; however, uncertainty stemming from the U.S. political situation, following Trump's victory, may prompt the ECB to consider further rate cuts in 2025. Additionally, political developments in Germany and France could influence growth in the euro area. Members discussed the terminal rate of 1.75%, acknowledging that it could be revised downward if economic conditions deteriorate. Regarding the repo market, several members saw trading in preparation for the year-end turn quite early in the quarter, with spikes of 250 basis points for Italian collateral in Oct. With the TLTRO reimbursement, some Italian government bonds (BTPs) are expected to re-enter the market at lower rates. Trading activity in the repo market is anticipated to continue declining going into the year end, with yields potentially decreasing further. Overall expectations are that the activity for the last weeks of the year will be relatively calm. • Foreign Exchange (FX) Market: The FX market remains relatively calm, with sufficient access to U.S. dollars across institutions. While Trump's election as U.S. president was seen as impactful (threat of tariffs, geopolitics, …), the discussion highlighted Europe's limited capacity to respond effectively to the latest development. • ECB and Growth Estimates: Members expressed skepticism regarding the ECB's growth projections, suggesting they may be overly optimistic. It was noted that the ECB's practice of publishing key economic data quarterly leads the market to anticipate a more accommodative policy stance due to a lack of confidence in the current economic outlook, as market participants expect revisions within the next three months. • Unsecured Market Liquidity: Liquidity in the short term is ample, but spreads are widening across institutions in Europe. There is robust

demand for unsecured long-term instruments, though liquidity appears unevenly distributed within the eurozone. For example, the German government has had to raise yields on T-bills compared to earlier in the year. This increase in yields, surpassing €STR, is seen as a normalization process, likely tied to the ECB ceasing its reinvestment programs. Accessibility to liquidity remains a key issue.

- Sovereign Debt Risk and Market Stability: Members highlighted that while geopolitical tensions are evident, financial markets remain stable with no significant signs of stress. However, Significant sovereign debt risk was noted, with a mention of South Korea as an interesting example of a challenging episode. The monetary environment is perceived to be less stable and increasingly volatile, driven by divergent central bank actions worldwide.

- Economic Challenges and ECB Policy: Members discussed the ongoing economic struggles, marked by rising bankruptcies. They suggested that the ECB might need to lower rates further than the market currently expects, reflecting a shift in focus from combating inflation to addressing economic growth.

  The possibility of an ECB rate cut of 50 bps was deemed unlikely but noted as a topic of discussion in the last Governing Council meeting. Members emphasized that the economic challenges in Germany, stem more from structural issues and poor economic decisions than from high funding conditions, which remain relatively moderate.

- Divergent Views Within the ECB: It was observed that the ECB's Executive Board seems divided into two groups: one advocating a more dovish stance and the other favouring a more cautious approach.

- Fiscal and Monetary Policy Interactions: The interplay between fiscal and monetary policy was identified as a critical factor. Members noted the ECB’s consistent call for quicker action from the European Commission. While Germany and France are currently struggling, their GDP levels do not justify labelling them the "sick men of Europe."

- EBA Stress Tests: The recent stress tests announced by the EBA were mentioned as having potential implications for banks' balance sheets.

- Low MRO Take-Up: The take-up of Main Refinancing Operations (MROs) remains minimal, with only a few participants requesting small amounts of liquidity, primarily to test systems. Until the ECB establishes longer-term refinancing operations, significant ECB credit operations are not expected. It was noted that participating to MRO shows up in the financial statements and a participation, for a small gain, might come back to haunt the bank if in a later stage when there’s turmoil. Members express reluctance to participate in MRO due to the general stigma that remains despite the reduction of the spread to 15 bps over DFR, the stigma is mainly related to the great attention of analysts and investors on the recourse in MRO by banks. Furthermore the limited liquidity needs (LCR level and excess reserves remain ample) and in some cases also the lengthy

	internal approval process to access this credit operation, reduce the appetite for MRO-3mLTRO. • Debt Challenges in Germany: Members discussed Germany's difficulties in raising additional debt due to the need for political consensus, which remains challenging. The broader question of whether Germany and Europe are overly regulated was also raised. • French and Greek Bond Spread Dynamics: The Greek government bonds yield being above the French one was perceived to be driven by market positioning rather than fundamentals.
Item 2	Hunting for Dollars - Connection between repo markets and FX swaps by **Angelo Ranaldo**, Chair of Finance and Financial Economics, Faculty of Business and Economics. • Overview of US Funding Market Resilience: Professor Ranaldo provided an overview of the resilience of the US funding market, explaining the concept of Covered Interest Parity (CIP). He described how exposure to the US dollar is typically hedged through forward contracts, ensuring that synthetic dollar costs align with wholesale funding costs. However, he noted that the CIP basis between the USD and Yen, which theoretically should be zero, is generally positive and exhibits seasonality, with spikes at quarter-ends. By comparing positions of one week (1W) and one month (1M), he demonstrated market frictions that result in differences in the CIP basis. • Functioning of US Dollar Funding: Professor Ranaldo highlighted the peer-to-peer and over-the-counter nature of the US dollar funding market, which complicates the identification of specific patterns due to the unavailability of easily accessible data. He emphasized that regulatory requirements significantly impact the market, particularly at quarter-ends, leading to higher costs in the repo market. This incentivizes a shift from repo markets to FX markets, where synthetic funding becomes more appealing. • Market Frictions Across Currencies: In response to a question, Professor Ranaldo clarified that the issue lies primarily on the US side and is observed not only with the Yen but also with other currencies. • Key Players in US Dollar Funding: US banks were identified as the largest players in the market, predominantly acting as lenders of dollars. Conversely, most customers, including non-bank entities, are net borrowers of dollars. • Shifts in Dollar Borrowing Patterns: Professor Ranaldo presented evidence of a systematic decline in US dollar repo borrowing by Eurozone banks. In contrast, no comparable trend was observed in their euro-denominated borrowing. However, Eurozone institutions have notably increased their net synthetic dollar borrowing in FX markets, indicating a clear substitution from wholesale market borrowing to synthetic dollar funding in the FX market. • Regulatory Impact on Balance Sheets: A comparison of repo and FX treatments on bank balance sheets illustrated their regulatory implications. In repos, bonds remain on the balance sheet, which adversely impacts the leverage ratio. In contrast, FX positions are

recorded with minimal balance sheet and leverage ratio impact (only around 1%).

- Reporting Requirements and Window Dressing: Professor Ranaldo highlighted variations in reporting practices across jurisdictions. In the Eurozone, banks report balance sheet snapshots at quarter-end, incentivizing "window dressing" to optimize their regulatory positions. Conversely, in the UK and US, daily average reporting requirements reduce such incentives. A difference-in-difference analysis comparing Eurozone and UK banks showed distinct patterns of substitution from repo to FX synthetic funding.
- Quarter-End Dollar Funding Costs: The hunt for dollars at quarter-end impacts pricing, with the CIP basis typically around 30 basis points but rising two- to threefold during this period. While Japanese G-SIB banks tend to pay slightly higher costs, Eurozone G-SIBs effectively manage regulatory optimizations. Customers and non-bank financial institutions bear the bulk of increased costs during these periods.
- Interconnectedness of Money Market Segments: Professor Ranaldo emphasized that the money market should not be viewed in isolation. His findings highlighted strong interconnections among market segments, where developments in one area can have significant spillover effects on others.
- One member mentioned that EU banks typically rely on retail EUR funding (their natural funding source) to support EUR assets like mortgages. In contrast, they hold predominantly short-term wholesale USD assets. This highlights a key difference: US banks provide USD to their clients as a service rather than for profit and loss. Effective asset-liability management (ALM) would require matching assets and liabilities in both currency and tenor. However, this alignment is currently lacking, forcing EU banks to source USD in the most cost-efficient way—accounting for balance sheet costs, particularly noticeable at quarter-ends.
- Additional Regulatory Costs: Some members noted that regulatory costs associated with contributions to the Single Resolution Fund (SRF) could represent an additional burden, particularly since these costs are linked to quarter-end reporting.
- Shift in Reporting Practices: In response to a question, Professor Ranaldo observed that the industry appears to be transitioning from snapshot-based reporting to day-to-day reporting, which may impact banks' regulatory behavior.
- Reduction in CIP Basis: Members expressed surprise at the reduction in the CIP basis in recent years, despite the ECB's large balance sheet during that period. Professor Ranaldo attributed this trend to changes in the regulatory framework, the availability of collateral, and the role of arbitrageurs, all of which contribute to narrowing the gap. He further explained that additional constraints, such as US money market funds (MMFs) being unable to lend dollars directly to Eurozone hedge funds due to legal restrictions, also play a role. Instead, such transactions must be intermediated through US banks, which can impact the overall market dynamics.

	• Members signalled that US banks do not participate that much to the FX swap market as the onshore USD cannot go out due to stress tests in the US. Additionally it was pointed out that proprietary trading restrictions also impose restrictions for participating.
Item 3	Instant Payments and Intraday Liquidity Management by **Julie Lardinois** Head of Money Market & Repo | Financial Markets, Belfius Bank & **Andreas Biewald** Managing Director, Treasury Department, Commerzbank. • Overview of Instant Payment Regulation: Mrs. Lardinois provided an update on the status of the instant payment (IP) regulation, outlining the key dates and emphasizing the significant operational adaptations required to meet the new dynamics. The Target Instant Payment Settlement (TIPS) is a market infrastructure service launched by the Eurosystem in 2018. It enables 24/7 real-time settlement of instant payments in central bank money. Other instant payment systems do exist (STEP1, RT1), operating on a national and/or european level which leads to a fragmented payments landscape. Instant payments offer significant benefits to businesses and clients who might change their payment behavior in the future such as paying the salaries on the 1st of the month which is a Sunday or paying of provider after 6PM. • Main Challenges: Mrs. Lardinois identified several challenges associated with instant payments, among others: Technology and Interoperability: The need for real-time fraud detection systems, compliance with anti-money laundering regulations, and adherence to GDPR requirements. Liquidity Management: Banks require robust tools for liquidity forecasting (very difficult to put in place due to the absence of historical data) and management to support continuous operations. This includes adapting systems and ensuring 24/7 staff availability. Even if these points would be covered, the absence of an intraday market and the closing time of European settlement platforms (which is not expected to change in the near future), will leave some relevant residual liquidity risk with the banks. Communication: Effective communication strategies are crucial to prevent panic and mitigate risks of bank runs. • Opportunities: Mrs. Lardinois highlighted that instant payments can reduce credit risk by settling open transactions more efficiently. • Impact on Market Liquidity: From a treasury perspective, we will need higher liquidity reserves currently remunerated at 0% in order for the bank to meet the IP demands at all times. This could affect the bank's ability to invest in HQLA assets or the collateral market as a whole in case of usage of collateralized lines.

Higher liquidity needs might have consequences on the interbank market and it could become more expensive to build liquidity buffers once the excess cash is less than it is actually the case.

- Digital Bank Run Risks: The case of Silicon Valley Bank (SVB) was discussed as an example of a digital bank run, which could exacerbate liquidity outflows in the era of instant payments. Communication with clients during crises is essential to manage panic effectively. Furthermore, with instant payments, accessibility to additional funds may be restricted during certain hours, adding complexity to liquidity planning. Also noteworthy is the fact that in a world without instant payments, the repo market could function as a liquidity backstop. In this case cash will be instant whereas repo will be limited to market hours and will need the usual settlement delays.
- Mrs. Lardinois noted some mitigants such as robust liquidity management and buffers, continuous monitoring of outflows with alerts detecting unusual trends and some potential future mitigants like an effective communication with authorities, some regulatory measures and also an access to the central bank facilities after market hours.
- Workshop on Instant Payments: Mr. Biewald presented a workshop focused on instant payment regulation and its implications for liquidity management. He shared survey results showing that instant payments are perceived as having a significant impact across the industry.
- Legal Background and New Requirements: Mr. Biewald provided an overview of the legal framework for instant payments, including specific references to TIPS (TARGET Instant Payment Settlement). He detailed the new provisions introduced by the regulation, covering transaction volumes, customer limits, and decision-making behaviour.
- Implementation Considerations: Mr. Biewald emphasized the importance of implementation strategies, such as whether the default setting for instant payment transfers should be switched on or off, as this could influence the underlying instant payment volumes.
- Minimum Reserve Requirements: He noted the potential for instant payments to erode funds earmarked for minimum reserve requirements on certain days, necessitating careful liquidity management.
- Remuneration of Dedicated Cash Accounts (DCA): Mr. Biewald also addressed the topic of DCA remuneration, highlighting its implications under the new regulatory environment.
- Imbalance in Value Dates between TARGET2 and TIPS: In response to a question from members, Mr. Biewald highlighted an imbalance in the value date alignment between TARGET2 and TIPS, which currently allows the Liquidity Coverage Ratio (LCR) to be calculated on each TARGET2 day. Starting in November next year, an automatic transfer mechanism from TARGET2 accounts to TIPS accounts will be

	introduced. However, this system will only operate during standard working hours. • Operational Risks with Instant Payments: Mr. Biewald discussed potential operational challenges, such as banks running short on their instant payment accounts on high-transaction days (e.g., Black Friday). Failures in processing instant payments could lead to significant reputational risks, as any system shutdowns would likely be immediately reported in the media. • Impact of Monetary Policy on TIPS Accounts: Mr. Biewald noted that the ECB's monetary policy decision to cease remunerating minimum reserve requirements has unintended consequences for TIPS accounts, potentially influencing banks' liquidity management strategies. • Fraud and Liquidity Risks: Members raised concerns about the increased risk of fraud associated with the Instant Payment regulation. Additionally, they noted that as banks allocate more funds to safeguard against liquidity outflows, the overall liquidity available within the banking system could decrease, potentially tightening financial conditions
Item 4	Money Markets year end considerations by **Arne Petimezas**, Director Research, AFS Amsterdam. • Rising Repo Rates: Mr. Petimezas began his presentation by highlighting the relative increase in repo rates. In 2022, repo rates were 8-9 basis points below the Deposit Facility Rate (DFR), but they are now nearly aligned with it. The rise in repo rates is attributed to an increase in collateral supply and a decrease in bank reserves. • System Liquidity and Reserve Dynamics: Mr. Petimezas explained that system liquidity is measured through bank reserves. Reserves are expected to decline due to limited MRO take-up and the ECB's Quantitative Tightening (QT) schedule. He noted the impact of autonomous factors on reserves that can partially offset the ECB's QT, mitigating the decline in reserves in 2024. • Collateral Availability and Marginal Lending Facility: Mr. Petimezas reviewed the collateral available in the system, emphasizing that the securities lending facility remains highly priced, keeping it unattractive for market participants. He showed a declining ratio of reserves to available collateral since its 2022 peak, correlating closely with the spread between the Repo GC pooling rate and the DFR. He presented a model that accurately predicts developments in the repo-DFR spread. • French Banks' Repo Borrowing Activity: Mr. Petimezas demonstrated that French banks have increased borrowing activity in the repo market. Members suggested that the size of the French banking system and precautionary buffer-building could explain this trend, particularly as repo rates remain below the DFR. Money Market Funds (MMFs) were noted as another factor, with increasing MMF participation in the repo market and the existing relationships

	between French banks and asset management players. It was agreed that this increase in borrowing activity is not primarily driven by liquidity needs. • Bank Reserve Ratios and TARGET2 Balances: Mr. Petimezas analyzed bank reserve ratios relative to total assets across jurisdictions, highlighting: Italian Banks: Improving reserve ratios due to declining TARGET2 liabilities since Meloni's election and low MRO take-up following TLTRO repayments. French Banks: Losing reserves, corresponding to an increase in TARGET2 liabilities. He pointed out that determining changes in TARGET2 balances is complex, with political situations providing only partial explanations. In the case of France, a current account deficit and insufficient financial account surplus leads to TARGET2 balances filling the gap. • Year-End Patterns in Eurosystem Account Balances: Mr. Petimezas presented patterns in banks' Eurosystem balances at year-end: German and Dutch banks tend to lose reserves, while banks in other countries borrow reserves. These shifts are more pronounced in a system with less excess liquidity, potentially signalling market fragmentation. • Fragmentation Risk: Members discussed the disparities in liquidity dynamics, emphasizing that reduced liquidity in the system may exacerbate signs of fragmentation across the Eurozone. The repo market is expected to remain stable unless disrupted by external events. While the ECB theoretically supports bank reserves through affordable MROs (15 bps spread and acceptance of lower-quality collateral), stigma may discourage banks from borrowing. Rising MRO/LTRO uptake in specific member states could drive higher money market rates locally, further deterring participation. The aggregate reserve level Is misleading; if banks continue to avoid MRO/LTRO, the ECB may need to halt QT early to ensure effective monetary policy transmission.
Item 5	EMMEC survey results by **Remo Capparelli**, Benchmark Officer, European Money Markets Institute. • Mr. Capparelli presented the survey results, and members discussed the potential suggestions proposed. The main conclusion was that the current state is considered satisfactory with minor improvements to be made.
AOB	• Helmut Wacket announced that this would be his final EMMEC meeting due to his upcoming retirement. Julija Jakovicka also announced her departure from EMMEC as her role at the ECB is changing. A new ECB representative will be announced in 2025. • The members confirmed the dates and potential locations for the 2025 meetings.

	• It was agreed to include a dedicated section in the agenda to discuss future agenda items. The secretariat will gather suggestions for potential topics and presenters for the next meeting and will request additional comments or updates following the meetings.