EMMEC Meeting - Summary

Meeting title	EMMEC meeting
Date and time	26 March 18.00 - 27 March 2024 16.30 CET
Location	UniCredit: Piazza Gae Aulenti, 3, 20124 Milano MI, Italy - Hosted by Assiom Forex Italy
Attendees	EMMEC Members F. PAILLOUX -Chair- (Société Générale) for ACI France – physical M.C. LEGE (Intesa SanPaolo SpA) for Assiom Forex Italy - virtual M. GALLI (Banco BPM) for Assiom Forex Italy - physical L. BRANDTNER (Raiffeisenlandesbank Oberösterreich) for TMA Austria - physical P. LE VEZIEL (Credit Agricole SA & Crédit Agricole CIB) for ACI France – physical P. BYRNE (Bank of Ireland) - physical J. M. TASSARA (Cecabank) for ACI Spain - virtual H. WESTERMANN (Commerzbank) for AEFMA Germany - physical F. SPAHN (DZ Bank) for AEFMA Germany - physical K. WINDING LARSEN for ACI FMA - virtual J. LARDINOIS (Belfius Bank) for ACI Belgium - virtual M. PESONEN (Nordea) - virtual C. WICHMANN (Danske Bank) for ACI Denmark - virtual S. CIMINO (UniCredit) for Assiom Forex Italy - physical C. CAGNAZZI (Banca Populare di Sondrio) for Assiom Forex Italy - physical C. HUSS (Union Bancaire Privée) for LFMA Luxembourg - virtual F. BESET (Rabobank) - physical J. PIASKO (Julius Baer) for ACI Suisse - physical Guest speakers L. CAZZULANI (UniCredit) - physical A. IACONO (MEF Ministero dell'Economia e delle Finanze) - physical N. BERTOLINI (Intesa San Paolo) - physical M. PLOOIJ (ECB) - virtual R. CAPPARELLI (EMMI) – physical F. NUNZIANTE CESARO (EMMI) - physical Observers F. HEBEISEN for ACI France - physical H. WACKET - ECB - physical P. NICOLOSO - ECB - physical J-L. SCHIRMANN - EMMI - virtual (15h00 - 16h00)

	EMMEC Secretariat G. DILLEN - EMMI R. CAPPARELLI – EMMI
Agenda items	**Speaking points**
Introduction	EMMEC members were reminded of competition law, confidentiality and conflicts of interest.
Item 1	Update on the latest market trends and developments on monetary policy and central banks - Presentation by Luca Cazzulani, Head of Strategy research, UniCredit Bank. Money market rates: key trends as balance sheet normalization goes on. • 2024 is anticipated to be characterized by sluggish growth in the eurozone, with China likely to continue facing challenges. Economic expansion is projected to be significantly lower compared to 2023. • The normalization of the yield curve is expected in both the US and Euro area. • Throughout 2023, there was a consistent upward surprise in growth, largely attributed to excess savings. However, real terms excess savings are expected to reach zero in 2024, leading to the anticipation of economic stagnation. • A recession is not expected to materialize; instead, a prolonged period of limited economic growth is foreseen. • There are two different scenarios regarding the future trajectory of the FED and ECB's monetary policy easing cycle, influenced by uncertainties surrounding inflation. In the Eurozone, the SMA survey aligns with market trades on OIS swaps. Long-term expectations suggest that the ECB deposit rate will stabilize around 2%. • Episodes of significant volatility are likely over, with markets adjusting well to the process of central bank balance sheet normalization. • The real reduction in the ECB's balance sheet is attributed to the repayment of Targeted Longer-Term Refinancing Operations (TLTRO). Simultaneously, the ECB is conducting a balance sheet runoff on the Asset Purchase Program (APP) and Pandemic Emergency Purchase Program (PEPP). Regarding collateral pledged at the ECB, a noticeable decline in government bond relative to swaps is observed. Currently, the ECB's balance sheet reduction is progressing on autopilot, but as rates approach neutrality, the decision on balance sheet reduction becomes more challenging. • Markets responded orderly to the repayment of the largest operation of TLTRO III.4 in June 2023. The presenter provided estimates of collateral pledged in the remaining TLTRO operations. Excess liquidity across various jurisdictions, including Italy, remains ample. Italian banks can repay remaining TLTROs and still maintain excess liquidity. The presenter illustrated a chart relating the

amount of TLTRO redemption to the decline in excess reserves per jurisdictions.

- Regarding expectations of balance sheet reduction in the coming months, the presenter provided estimates of future developments in excess liquidity. It was emphasized that such estimates entail numerous assumptions due to various influencing factors. Based on historical analysis, banks require around 500 billion in excess liquidity to operate efficiently.
- The DFR-€STR spread is slightly tighter compared to similar levels of excess liquidity in the past. There is no anticipation for the €STR to react to the decline in excess liquidity. However, the large concentration of excess liquidity in core countries may eventually influence this dynamic.
- Bund scarcity is alleviating, with the presenter suggesting that the spread between bunds and swaps has reached its fair value. Conditions may change from September 2024 with the implementation of the new operational framework of the ECB, with the possible more extent usage of the ECB standing facilities.
- The revision of the ECB framework is viewed positively for banks. Despite no change in the required reserve, the reduction of the spread between MRO and DFR is welcomed, eliminating stigma in accessing MRO. Once the framework is implemented, MRO will serve as a cap for repo rates, contributing to stability. However, uncertainties remain regarding the structured portfolio and longer-term refinancing operations, with the ECB yet to provide details. Exogenous factors may influence decisions in this regard, which will significantly impact the size of the central bank balance sheet in the future. The presenter's preliminary view suggests longer-term operations should be at least 1 year with an option for early repayment. Predictions on pricing are considered preliminary.

Discussion among members on the following points:

- Determining the level of the neutral rate, denoted as r*, proves challenging. While real yields were negative in the euro area over the past decade, they are currently positive. Moreover, government intervention may increasingly influence this rate in the coming years, particularly considering external factors such as investments in initiatives like the green deal.
- Members engaged in discussions regarding the time lag of ECB monetary policy transmission, linking this observation to potential future interest rate cuts. Notably, it was observed that despite the absence of a significant economic slowdown, the envisaged rate cut is anticipated not to address existing economic issues but rather to restore normalcy.
- Observations were made regarding the Federal Reserve's potential postponement of rate cuts. In contrast, the Eurozone does not demonstrate a pressing need for an extended period of monetary tightening. The disparities in signals between the two economies were emphasized.

	• Members discussed the potential risks associated with the green transition and defense spending on inflation. While acknowledging these risks, members concurred that they are unlikely to have a short-term impact. • Some members commented that high inflation poses less danger than recession. Furthermore, discussions revolved around the potential for improved accuracy in ECB projections concerning inflation and economic growth, considering external shocks. • Members reached a consensus that the new pricing scheme of the ECB's operational framework will suffice to mitigate the stigma associated with the Main Refinancing Operations (MRO). However, doubts linger regarding whether the new operational framework will effectively revitalize activity in the money market. Access to MRO, compared to other means of securing funds in the market, offers a significant advantage in terms of its contribution to the Liquidity Coverage Ratio (LCR). With the new operational framework, the incentive to access MRO is twofold: it aids regulatory compliance and offers favourable pricing. Concerns were raised regarding the risk of favouring one market over another in this context.
Item 2	MEF approach to Money Market by Alessandro Iacono, Head of short-term funding & cash management, MEF Ministero dell'Economia e delle Finanze • The presenter provided an overview of the objectives of the cash management strategies implemented by the Italian Debt Management Office (DMO), detailing its operations within money markets and specifying the constraints, regulations, and available tools. • The presentation also addressed the Italian DMO Repo facility, focusing on the ramifications for debt and cash management. Discussion among members on the following points: • Members engaged in discussions concerning the significance of the Commercial Paper market and the importance of the STEP label for governments, supra national issuers and agencies. • A participant raised a query regarding the potential differential utilization of the reverse repo facility following alterations in the remuneration of government deposits. The presenter affirmed that indeed, such changes influence its usage. • Another member pointed out the unique design of the Ministry of Economy and Finance (MEF) reverse repo facility, noting its distinctiveness in not providing collateral for short-term repos (ON, SN, TN). This particular feature caters to various banking sector requirements, thus indicating its ongoing significance. • A member inquired about the possibility of coordination among different countries in implementing such facilities. The presenter responded that, at present, there is no such coordination in place.

Item 3	Overview and recent developments of covered Bond Market by Nicoletta Bertolini, Head of International Long Term Debt Origination & Private Placement, Intesa Sanpaolo • Since January, there has been a persistent inflow of capital into the covered bond market. Investor demand remains robust, prompting heightened purchasing activity. Notably, both January and February witnessed significant primary market activity within the covered bond sector. While the absolute figures for 2024 compared to 2023 indicate a slight increase, the crucial distinction lies in the shift of investor interest. In 2023, the focus predominantly centered on the short end of the curve, whereas the onset of 2024 witnessed a notable surge in issuance targeting longer-term investments. This marks a significant shift from the previous year's trends. More specific, while there was considerable interest in issuing covered bonds with maturities ranging from 7 to 10 years in 2023, demand failed to match supply. At present the scenario has reversed entirely, with the 7 to 9-year maturity bucket accounting for a substantially larger proportion compared to the previous year. • The spread between covered bonds and senior preferred bonds has reached its historical minimum, indicating a significant increase in demand for covered bonds. This surge in demand is driven by substantial inflows, particularly from prominent asset managers located in the UK, who are eager to secure current Interest levels in anticipation of expected rate cuts. • Anticipated for the future is a stabilization of covered bonds around their current levels, accompanied by a widening of yields in other asset classes. Discussion among members on the following points: • A member asked how the presented environment is perceived from the perspective of issuer-side funding requirements, particularly in light of the Net Stable Funding Ratio (NSFR) considerations. The presenter elucidated that funding needs could vary depending on the entity. For instance, the upcoming US elections might influence pricing dynamics in the second half of the year, prompting some institutions to engage in pre-funding activities. • Members discussed on the various maturities at which covered bonds were issued in 2024 compared to the previous year. Additionally, they engaged in discussions regarding the distinct legal framework outlined for Italian banks concerning the issuance of short-term covered bonds.
Members roundtable	• Members engaged in discussions regarding the current state of the economy, analysing the latest economic trends and deliberating on the impact of the European Central Bank's (ECB) monetary policy stance. • Members deliberated on the potential for future changes in the remuneration of government deposits. Despite varying perspectives among members, some had anticipated that the remuneration

	could be adjusted to 0 during the recent review of the ECB operational framework, although this adjustment did not occur.
Item 4	Potential use of new technology for wholesale central bank money settlement by Mirjam Plooij, Team Lead at, Market Innovation and Integration division, Directorate General Market Infrastructure and Payments, ECB. • The presentation encompassed the industry's interest in distributed ledger technology and tokenization, underlying the European Central Bank's (ECB) efforts to solicit feedback from the market regarding the potential utilization of this technology. • An explanation was provided regarding the Eurosystem's exploration into how settlement in euro using central bank money could occur in the presence of emerging technologies such as Distributed Ledger Technologies (DLT). This included an overview of the primary objectives, potential threats, and prospective scenarios for the future. Discussion among members on the following points: • One member noted that the introduction of multi-ledger technology could potentially complicate matters for banks further. Meanwhile, another member questioned who would bear the costs associated with this new technology. Specifically, they wondered whether banks anticipated additional business opportunities arising from its implementation. • Furthermore, a member suggested that cost reduction could be a driving factor, although it was highlighted that if only one or a few bank adopted the new technology, the benefits might not be significant. Another member emphasized the relevance of the ongoing maintenance costs, drawing parallels with the energy-intensive process of bitcoin mining. • Overall, members shared a consensus that the project appeared to be progressing toward implementation. Concerns were expressed regarding some banks' readiness in terms of IT resources to execute these changes. • The presenter emphasized that the project is currently in the exploration phase. Additionally, she highlighted that this exploration does not constitute a commitment by the Eurosystem to provide any solution(s) in the future. It is ultimately the market's responsibility to demonstrate the added value of DLT for wholesale business cases . The ECB's objective is to ensure preparedness in the event that Distributed Ledger Technology (DLT) becomes predominant in the market. Therefore, the ECB aims to be equipped to adapt to potential changes in the technological landscape.
Item 5	Results of the public consultation on Euribor methodology changes by Remo Capparelli and Fabio Nunziante Cesaro, Benchmark Officers, the European Money Markets Institute • R. Capparelli outlined the current Euribor waterfall methodology and transparency indicators, encompassing Euribor levels, underlying volumes, and counterparty decomposition.

	• F. Nunziante Cesaro presented the revised Euribor methodology that will come into effect in 2024, elucidating its technical aspects and the alterations in terms of reduced obligations for panel banks acting as Euribor contributors. Discussion among members on the following points: In response to a question from an EMMEC (or several) member(s), EMMI : • Clarified that the possibility of including S11 (Non-financial corporations) as an eligible counterparty for Euribor would be reviewed within the framework of the annual Euribor methodology review. It was explained that such counterparty type has not been included thus far due to the fact that many transactions that take place against Non-financial corporations do not occur at market rates. • Disclosed ongoing efforts to expand the Euribor panel. Additionally, it was emphasized that the implementation of the new methodology would alleviate the burden on panel banks in their daily contributions to Euribor. • Mentioned that the European Securities and Market Authority (ESMA) has been consistently informed about all stages pertaining to changes in the Euribor methodology. • Clarified that the Euribor panel and the Money Market Statistical Reporting dataset are distinct sources, with no foreseeable integration between them. • Explained that the entire process of determining Euribor rates is fully automated and does not necessitate manual intervention. • Confirmed that the simulated Euribor rates under the new methodology over the past three years have aligned with the published Euribor rates, with no significant differences in benchmark volatility. • Clarified that Efterm has consistently been published using level 2 input data, as the methodology took substantial recommendations from the Risk-Free Working Group into consideration. However, level 1 input data are currently unavailable in the market. • Clarified that no discontinuation of any Euribor tenors is foreseen.
Members roundtable	• Members observed that the market is not reacting according to geo-politics events.
AOB	• L. BRANDTNER extended an invitation to the EMMEC working group to attend the annual event of the Austrian Treasury Market Association (TMA), scheduled for October 11th and 12th. • EMMEC members were notified that, owing to a busy period in Frankfurt in June, hotel bookings for the forthcoming EMMEC meeting should be arranged well in advance.

	• All members are invited to submit suggestions for topics for the forthcoming EMMEC meeting in June to EMMEC secretariat.