Issue Nº6

Newsletter

July 2023

The European
Money Markets
Institute

Navigating new frontiers

Dear readers,

Summertime is here, bringing warmth and sunshine to our days. As the temperature rises, so does our excitement for the upcoming developments in the financial world.

We have been hard at work on the ambitious project to enhance the Euribor methodology, with a focus on facilitating the contribution of panel banks by removing their burden of providing a level 3 contribution. Our proposal, that we are going to detail in October, will consist of removing the expert judgment layer from the methodology while significantly strengthening the model-based and formulaic approach in the level 2 calculations. In the last quarter of 2023 we will be launching a consultation among all benchmark stakeholders to gather their valuable insights and perspectives on the forthcoming methodology. We believe in the power of collaboration and look forward to engaging with the community in shaping the future of Euribor.

The second half of this year promises to be truly exhilarating, filled with surprises and noteworthy achievements. One such achievement worth celebrating is the record-breaking trading activity in Euribor futures and options contracts. With a staggering 49.5 million contracts traded, this surpasses the previous monthly volume record set in January 2013. This outstanding accomplishment further solidifies Euribor's strong and sustainable position in the market. In this edition, we have the privilege of featuring an insightful analysis by Matthew Horton, Head of Interest Rate Derivatives at ICE, who sheds light on this remarkable achievement.

Additionally, we highlight the inaugural meeting of the European Money Market Expert Committee (EMMEC) held in Zurich in March 2023. EMMEC serves as a platform for collaboration and knowledge exchange among representatives from national associations of money market professionals in Europe. Composed of experts in short-term markets, this forum aims to foster the sharing of best practices and expertise. We are honoured to manage the secretariat of this committee, and in this edition, Frédéric Pailloux, Chair of EMMEC, shares his first impressions of getting the main issues addressed and the ambitious goals of this new think tank.

As always, we bring you a comprehensive summary of major money market events, ensuring you stay informed and up to date. Additionally, our Euribor transparency indicators provide valuable insights into market dynamics.

We hope you thoroughly enjoy reading this edition and find inspiration in the exciting developments taking place. We eagerly anticipate your interest in our next newsletter, where we will continue to provide valuable insights and updates from the money market segment.

Kind regards,
Jean-Louis Schirmann
CEO – The European Money Markets Institute

An insightful perspective on Euribor

Matthew Horton, Head of Interest Rate Derivatives, ICE
Euribor maintains a sustainable and strong long-term position. The latest events relating to this benchmark confirm this observation.
We are delighted to discuss Euribor with Matthew Horton (Head of Interest Rate Derivatives at ICE). Matthew has over 20 years' experience within financial services and has been with ICE since 2014. He manages the interest rate derivatives business at ICE Futures Europe including Euribor, Gilts, SONIA, SARON and SOFR. Prior to ICE, he held roles at BGC Partners and Citi in interest rate derivatives and options trading in London and New York.

> ***When uncertainty proliferates in the market, the investors want critical and trusted benchmarks to underpin their trades.***

In March 2023 ICE reported a record 49.5 million Euribor futures and options contracts traded. This surpassed the monthly volume record set in January 2013. How do you interpret this development?

The performance of ICE's Euribor contracts, both futures and options, points to how market participants turned to a reliable interest rate benchmark to manage the significant market moves resulting from regional bank fallout in the U.S. This highlights the dependability of Euribor-linked derivatives as a tool to hedge risk effectively on a global scale. Futures markets, thanks to their transparency, often operate as a safe haven for investors. When uncertainty proliferates in the market, those investors want critical and trusted benchmarks to underpin their trades. Since its inception, Euribor has fulfilled this function in the face of various macro-economic fallouts. ▶

The Eurozone trades on the basis of both risk-free rates and term rates, unlike other regions of the world. How do you see this coexistence going forward?

We are comfortable with the coexistence, as demonstrated by other jurisdictions in the past where IBOR rates sat alongside risk-free reference rates. But the bottom line remains that Euribor continues to function well, and our record trading figures demonstrate this strength. ICE is committed to supporting the benchmark and we remain focused on investing heavily in liquidity providers and technology, as well as backing any other potential improvements that would add to the robustness of the rate.

Last year, we welcomed a new panel bank as a contributor to Euribor. In addition, the European Money Markets Institute announced a coming centralisation of the Euribor level 3 calculation by the administrator. How do your stakeholders react to this news?

ICE, like our customers, is in favour of all steps taken to bolster the strength of the benchmark and we warmly welcome these changes to further enhance liquidity and the simplicity of the rate. Our relationship with EMMI is an extremely important one. We both strive to create a fair market for lenders, borrowers and participants using Euribor as a reference for financial instruments and contracts.

> ***"Our relationship with EMMI is an extremely important one. We both strive to create a fair market."***

Published for the first time on 30 December 1998, a few days ahead of the introduction of the euro, Euribor is a euro money market benchmark calculated for five maturities: one week, and one, three, six and twelve months. It measures *'the rate at which wholesale funds in euro could be obtained by credit institutions in current and former European Union and European Free Trade Association countries in the unsecured money market'.*

European Money Market Expert Committee

The objective of European Money Market Expert Committee (EMMEC) – facilitated by the European Money Markets Institute (EMMI) – is to provide participants with a platform to exchange views, expertise and best practices related to topics such as market liquidity, treasury, payment and settlement, market infrastructures, regulation, and trends and evolutions in financial markets.
EMMEC will meet four times per year. Its inaugural meeting took place in Zürich in March 2023. The governance was validated and Frédéric Pailloux (Deputy Global Head of Treasury at Société Générale), was elected as Chairman. We asked Frédéric to tell us more about this first meeting.

> ***The exchanges of views and brainstorming between senior treasurers were enriching for everyone.***

EMMEC brings together a panel of representatives from various national bank treasurers' associations. How has this initiative been received and in what spirit did discussions take place?

The first EMMEC meeting was a real success, according to the feedback received from participants (treasurers representing their national associations) and observers.
A wide range of subjects was covered including markets, regulations, and management flows.
The exchanges of views and brainstorming between senior treasurers were enriching for everyone. Any ideas exchanged had a strong concern for market integrity, in compliance with the actual European regulations and competition law.
The format of EMMEC allows challenges to be addressed at a European level, which is very specific to EMMEC. The answers to questions from members, observers and readers of the minutes are available on the dedicated publicly available website. ▶

What ideas emerged from the topical issues discussed?

Key topics discussed and which should remain on the agenda are the potential consequences of the financial turbulence during March 2023 on markets and regulations (with expectations of higher controls and tighter constraints); the end of TLTRO; the impact of normalisation of rate curves on banks and credit lending; instant payments and effects on liquidity management; and the impact of social media on speed of money transfers.

How will EMMEC evolve in the coming years? What are its long-term ambitions?

We aim to provide an independent, transparent and professional European think tank addressing challenges relating to money markets, foreign exchange and credit markets for the benefit of the financial community. With the expansion of the group to include other European countries and therefore more senior treasurers, the output should cover more markets and the group's contributions will be even richer. ■

> ***"We aim to provide an independent, transparent and professional European think tank."***

The minutes of EMMEC meetings can be consulted <u>here</u>.

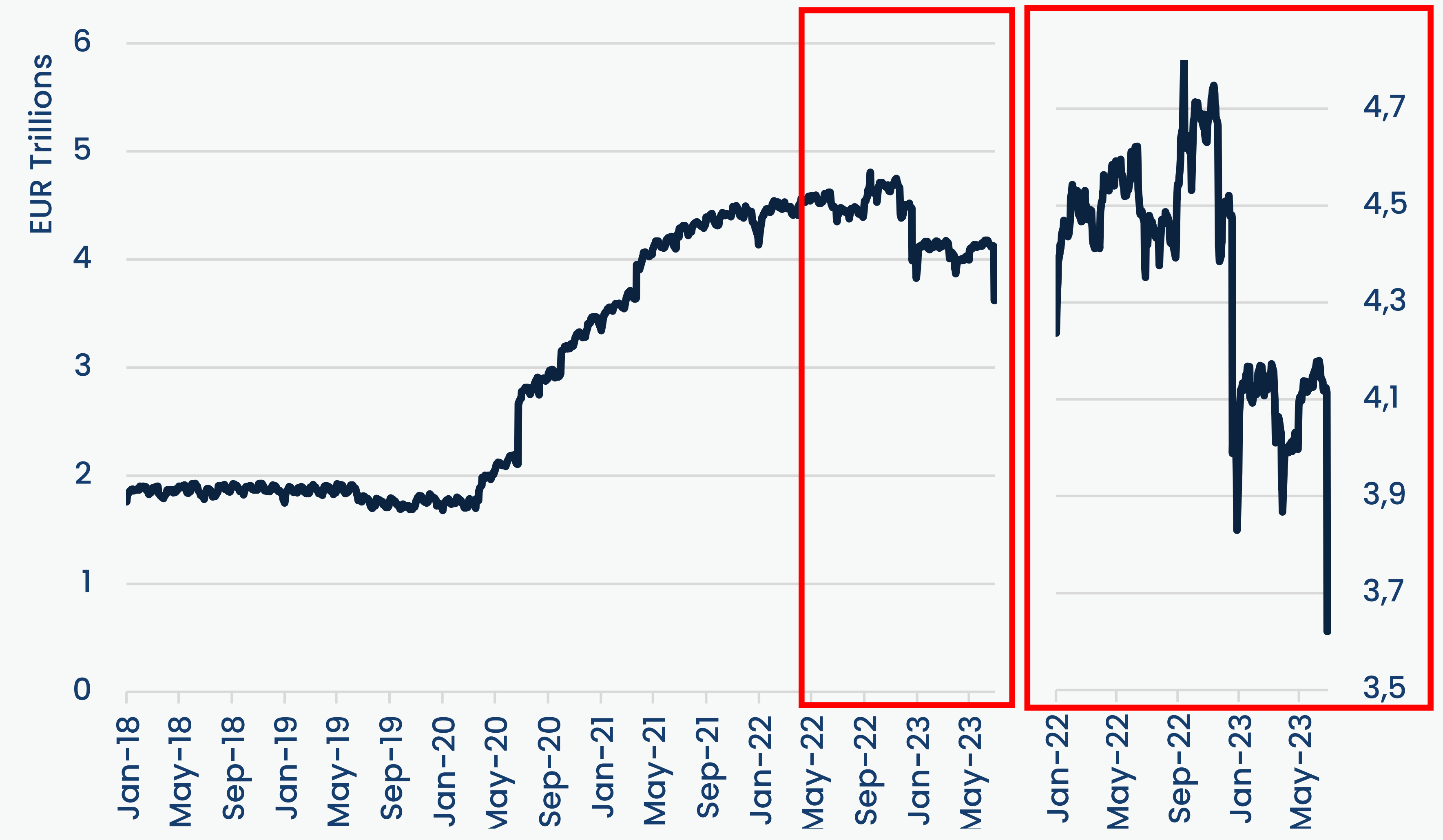
Echoes from the euro money markets

Key events closely related to the money market

Money market developments in Europe have been influenced by a number of changes in the European Central Bank's monetary policy decisions.

Inflation experienced a slowdown, with a decrease from 10.6% in October 2022 to 5.5% in June 2023. Core inflation, a concern in the first part of 2023, reached its peak at 5.7% in March and declined to 5.4% in June, re-accelerating after a slowdown in May as the cost of services picked up. Europe's economic growth contracted by 0.1% between January and March, which was lower than the predictions of many market participants. The European Central Bank (ECB) raised its three key interest rates by 400 basis points since July 2022, with the Deposit Facility Rate (DFR) at 3.5%, the Main Refinancing Operations Rate (MRO) at 4%, and the Marginal Lending Facility Rate

Chart 1 – Excess liquidity



Source: ECB

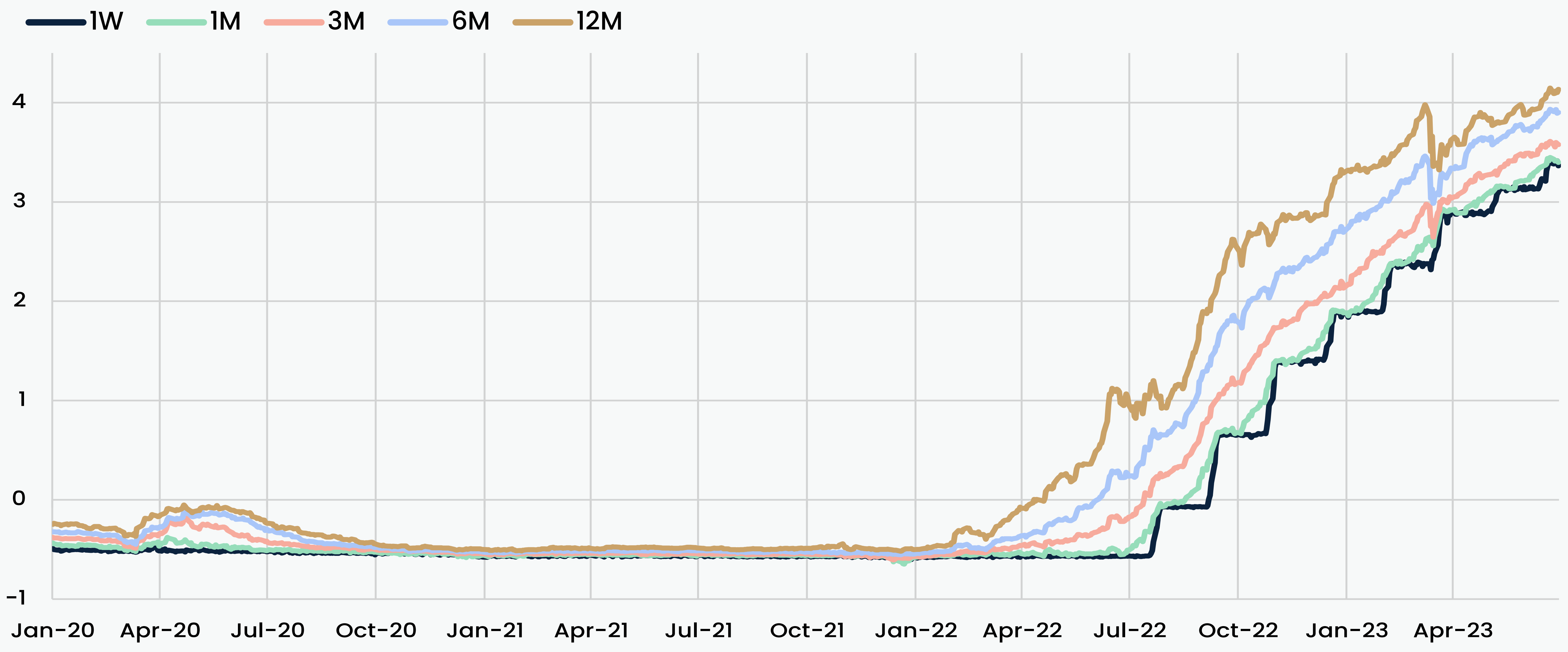
(MLF) at 4.25%. Further rate hikes are expected in the upcoming July and potentially September monetary policy meetings.
The ECB has confirmed that it will discontinue reinvestments under the Asset Purchase Programme (APP) starting from July 2023. Principal payments from maturing securities purchased under the APP were fully reinvested until the end of February 2023. Subsequently, the APP portfolio has been reduced by EUR 15 billion per month, and

this reduction will continue until the end of the second quarter of 2023. Regarding the Pandemic Emergency Purchase Programme (PEPP), the Governing Council confirmed the ECB's intention to reinvest the principal payments from maturing securities purchased under the programme until at least the end of 2024.

In terms of Targeted Longer-Term Refinancing Operations (TLTRO), a total of EUR 29.46 billion was repaid on June 28, 2023, in addition to EUR 477 billion repaid at the end of the month due to the maturity of the largest operations (TLTRO III.4). This represents over half of the total amount repaid since the ECB tightened the programmes's terms in October 2022. As a result, June's repayments will reduce the outstanding TLTRO amount to approximately EUR 600 billion.

Excess liquidity has continued to decline, with the most significant drop occurring due to the June TLTRO repayment. The level of excess liquidity is currently at EUR 3.62 trillion, the lowest level since more than two years, as depicted in Chart 1.

Chart 2 – Euribor rates

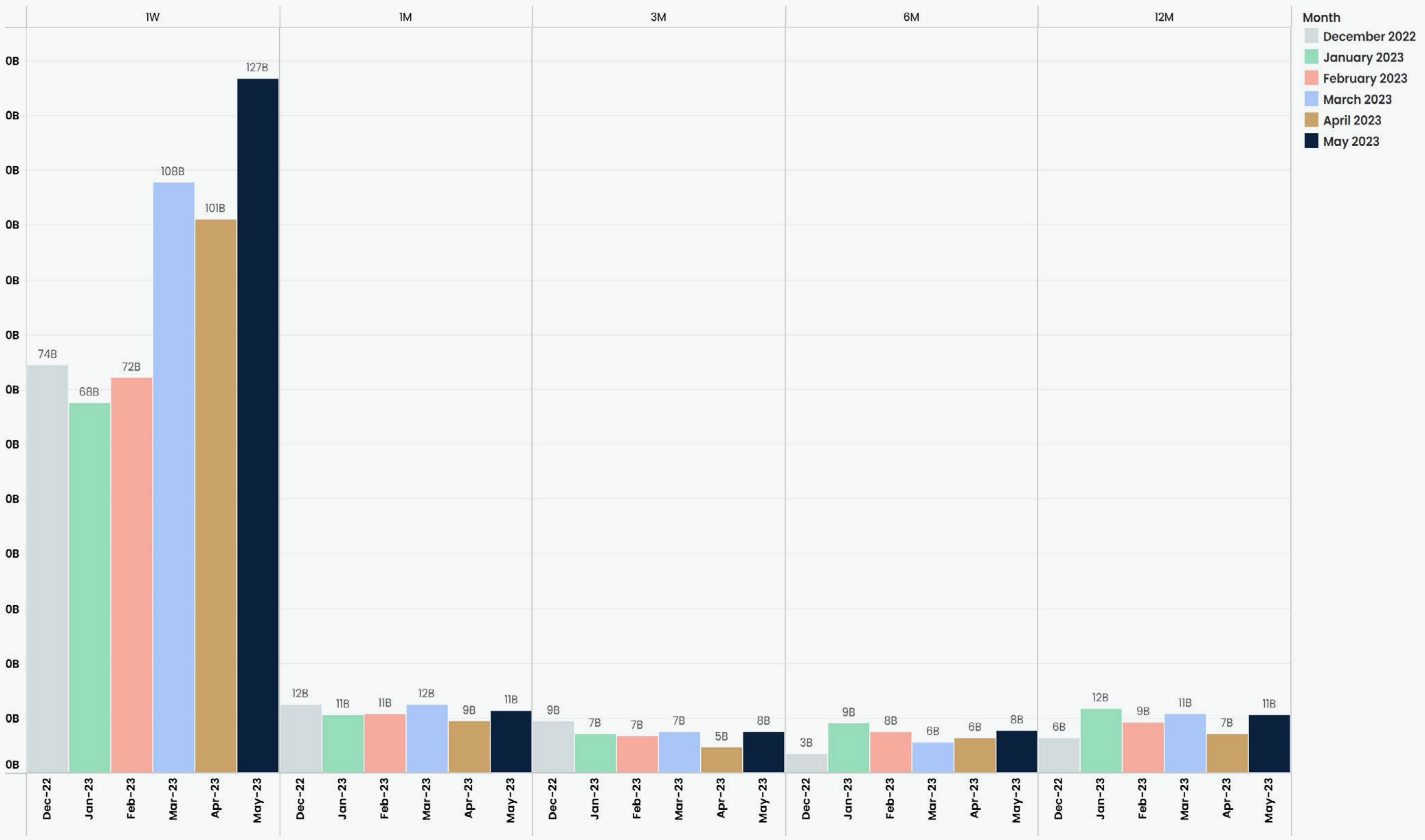


Source: *The European Money Markets Institute*

Euro money markets developments & Euribor rates

Euribor rates have experienced a significant increase in the last month, primarily due to the ECB's key interest rate hikes. Market participants do not anticipate a decline in rates in the near future, and this expectation is reflected in longer tenors. The underlying volumes of Euribor rates have shown a positive trend in the first part of 2023, particularly in the 1-week tenor, with underlying volumes peaking at EUR 130 billion in May (Chart 3). Consequently, Level 1 contributions represent a

Chart 3 – Euribor underlying volumes

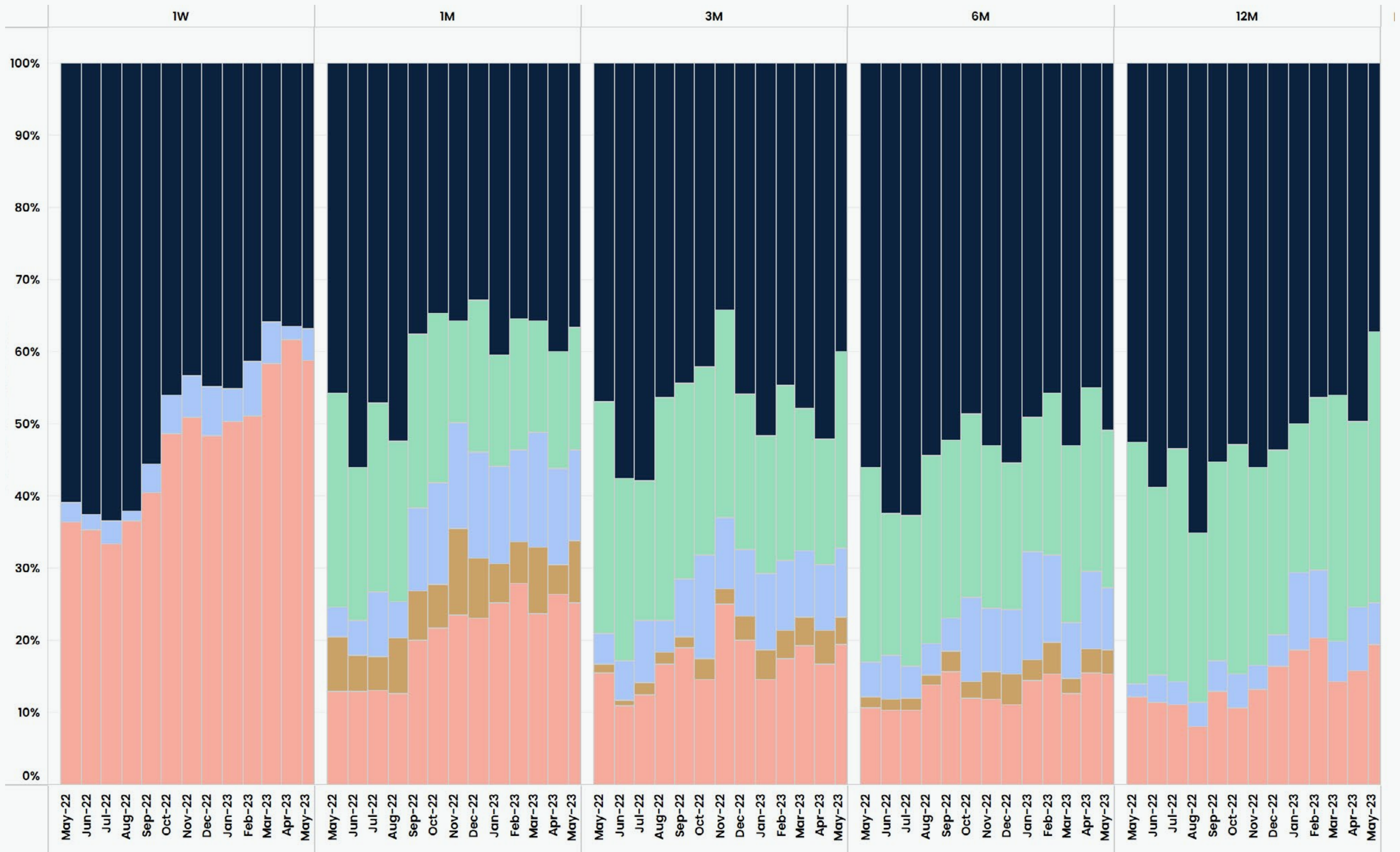


Source: The European Money Markets Institute

greater proportion compared to the other levels in recent months. The spreads between Euribor and Overnight Index Swaps (OIS) rates, after displaying negative values in short-term tenors, have now turned positive, confirming the temporary nature of that variation.

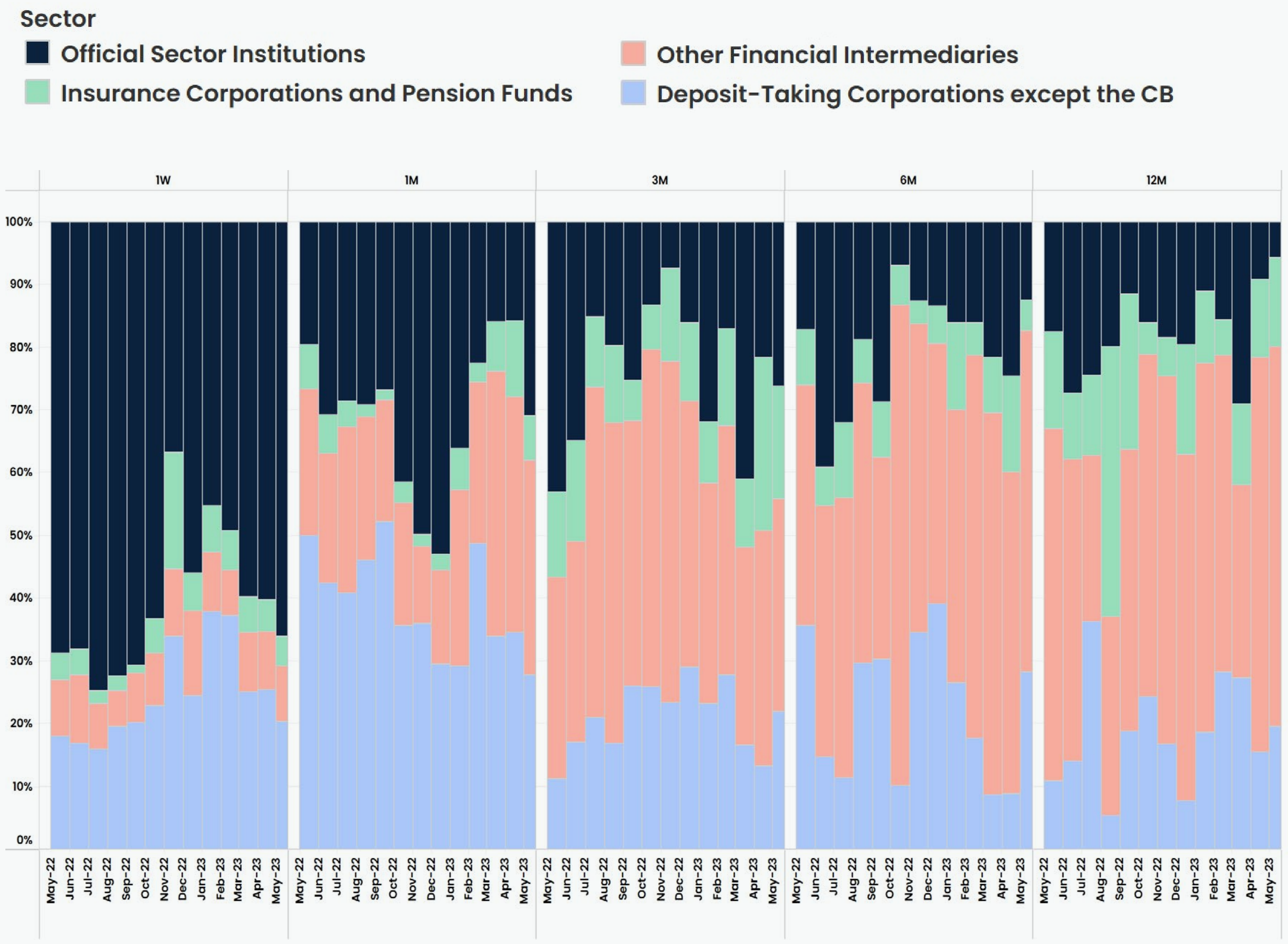
Euribor rates align with the MMSR rates, as demonstrated in the 3-month tenor in Chart 6.

Chart 4: Use of each level of the Hybrid Methodology



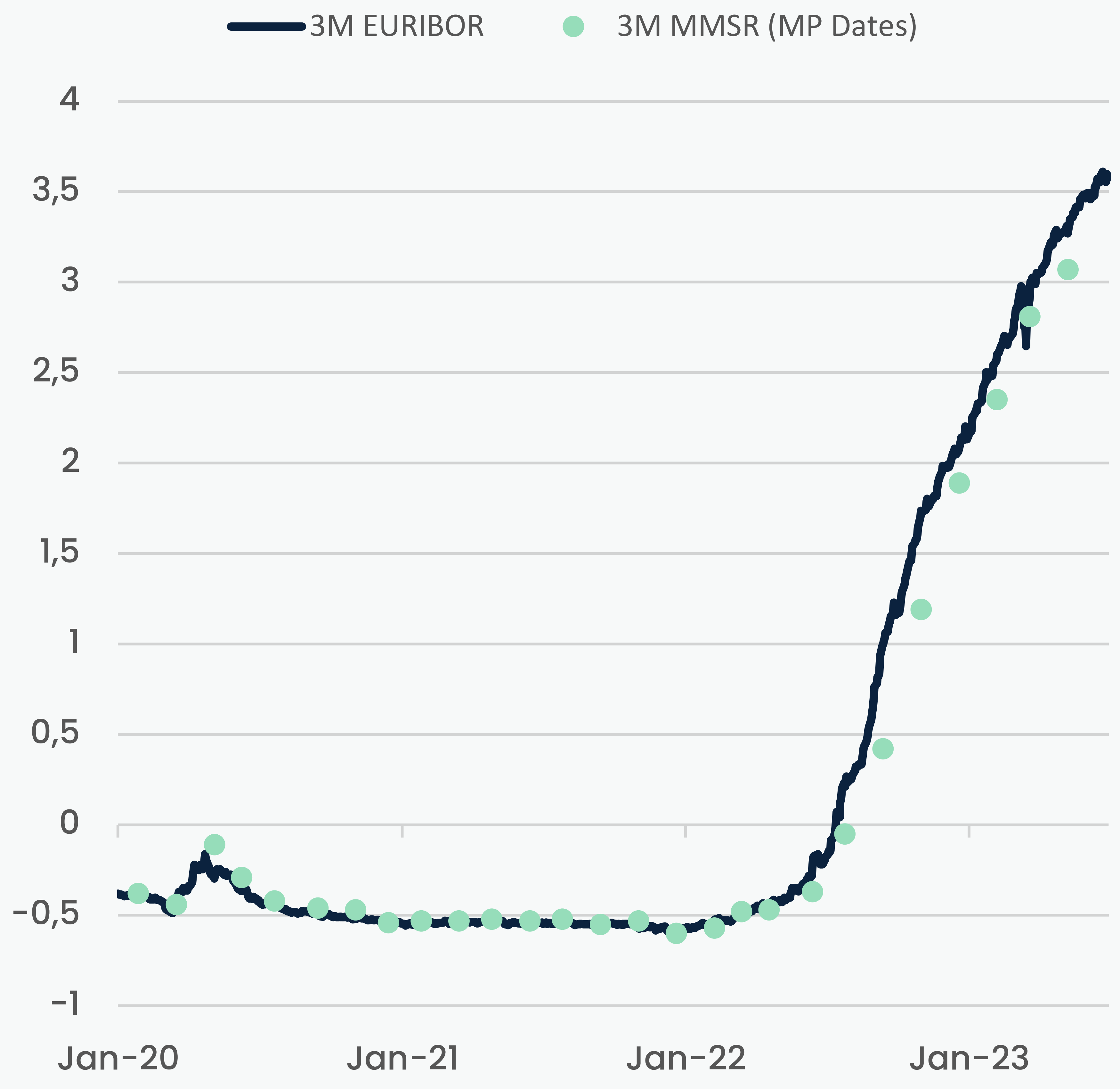
Source: The European Money Markets Institute

Chart 5: Counterparty sector share of volume in Euribor



Source: The European Money Markets Institute

Chart 6: 3-month compared to MMSR data.



Source: ECB, The European Money Markets Institute

Any questions?

For any enquiry or question related to our activities, please do not hesitate to contact us:

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Our web pages

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