

Box 6

MAIN FINDINGS OF THE EURO MONEY MARKET SURVEY 2010

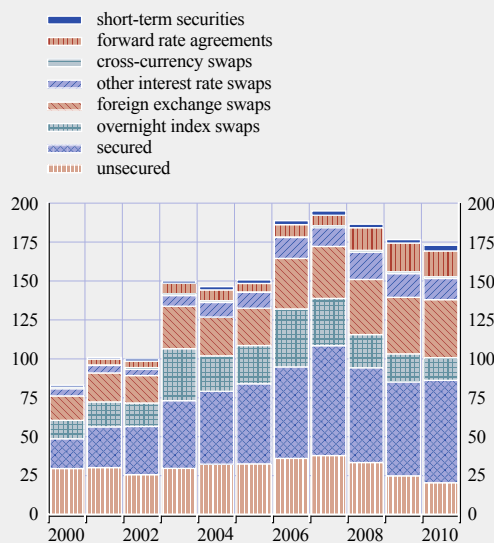
On 23 September 2010, the ECB published the results of the Euro Money Market Survey 2010, which were based on data collected from banks in 27 European countries and covered developments in various segments of the euro money market in the second quarter of 2010. This box reports on the survey's main findings.

The survey revealed that major changes triggered by the demise of Lehman Brothers and the introduction by the ECB of enhanced credit support measures in October 2008 continued to impact the functioning of the euro money market.

The overall turnover of the euro money market decreased for the third consecutive year, falling by 3% in the second quarter of 2010, as compared with the second quarter of the previous year (see Chart A). This decline could partly be attributed to the intensification of the financial crisis during the reporting period, and the surplus liquidity environment that prevailed in the euro interbank market as a result of the high allotment volumes in the ECB's liquidity-providing operations. The most notable decrease in activity took place in the segment of overnight index swaps (OISs), where turnover declined by 19%, and in the unsecured market segment, where turnover contracted by 18%.

Chart A Aggregated average daily turnover in the euro money market

(Q2 figures in the period from 2000 to 2010; index: aggregated average daily turnover volume in 2002 = 100)



Source: ECB.
Note: The panel comprised 85 credit institutions in 2000 and 2001, and 105 credit institutions thereafter.

Unsecured market turnover contracted across all maturities, although the most marked declines were at longer maturities. The contraction in unsecured activity could partly be explained by the shift to secured funding as a result of a greater aversion to counterparty credit risk and by the decline in demand for liquidity on account of the environment of surplus liquidity following the high participation and high allotment volume in the ECB's one-year longer-term refinancing operation (LTRO) of June 2009. In addition, an increasing reliance on the issuance of short-term debt securities (such as certificates of deposit) by banks, at the expense of the attraction of interbank deposits, may also to some extent explain the decline in unsecured turnover. This substitution could have been supported by the Eurosystem's temporary acceptance of some categories of banks' certificates of deposit as eligible collateral, thereby increasing the attractiveness of these assets for investors. Finally, in some jurisdictions changes in liquidity regulations may also have prompted banks to hold larger very short-term (overnight) liquidity buffers in the form of riskless deposits with the Eurosystem, rather than to lend these funds in the interbank market on an unsecured basis. New liquidity regulations may also have provided incentives for banks to lengthen the maturity of their liabilities, and thus reduced their demand for unsecured short-term cash.

The secured market remained the largest segment of the euro money market and continued to grow, expanding by 8% in the second quarter of 2010, broadly in line with the findings of the International Capital Market Association's European repo market survey.¹ The increase in turnover was driven by higher activity in maturities of up to one month, which continued to account for the largest part of the secured market and grew by 14%. By contrast, turnover in other maturity brackets, except for the maturity bracket from one to three months, decreased. Activity in the secured market cleared through central counterparties (CCPs) increased further and accounted for 45% of total secured market turnover (as compared with 41% in 2009). In addition to lower counterparty credit risk, the increase was also due to more European banks joining repo platforms developed by CCPs. Tri-party repo market activity also showed growth in turnover, increasing by 26% over the previous year.

Activity in the derivatives market continued to contract this year, recording a decline of 7%, largely on account of OIS transactions. Given the low volatility of the EONIA after the allotment of the June 2009 one-year LTRO by the ECB, the need for hedging short-term interest rate risk was reduced, and thus contributed to lower activity in OISs, particularly for maturities of up to one month. Foreign exchange swaps were the only derivatives segment that expanded (+3%) as such swaps remain an important cash funding tool for European banks and are relatively secure financial instruments – in particular since foreign exchange swaps are cleared mainly via CLS Bank, which eliminates currency settlement risk.

Turnover in the short-term debt securities markets surged by 67% in the second quarter of 2010, as compared with the second quarter of 2009, and this may partly be explained by the increased use of short-term debt securities as eligible collateral for the Eurosystem's operations.

In terms of concentration among market participants, the market share of the top 20 banks showed a tendency to increase in the unsecured market and in most of the derivatives segments. For the secured market, the concentration was broadly unchanged. The unsecured market

¹ International Capital Market Association, "European repo market survey", September 2010.

remained the least concentrated segment, followed by the foreign exchange swap and the secured market segments.

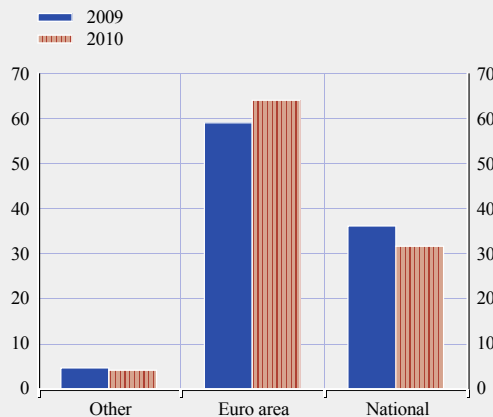
The decline in unsecured market turnover and the continuous expansion of the secured segment, in particular for transactions settled through CCPs, indicate that heightened counterparty risk remains a feature of the euro money market.

Concerns about sovereign risk have also affected the euro repo market. Indeed, data on the geographical breakdown of the collateral used in bilateral repos show that the share of collateral issued in the same country of origin as the counterparty providing the collateral declined from 36% in 2009 to 32% in 2010 (see Chart B). At the same time, the share of

collateral issued in the euro area, but outside the country of origin of the counterparty providing the collateral, increased from 59% to 64%. This could partly be due to the increased reluctance of banks to trade repos against collateral made up of government bonds from the same country as the counterparty providing the collateral in countries where concerns about sovereign credit risk were particularly elevated in May and June 2010.

Chart B Geographical breakdown of collateral in bilateral repos in 2009 and 2010

(Q2 2009 and Q2 2010; percentages)



Source: ECB.

Note: The panel comprised 172 credit institutions.