EMMEC Meeting - Summary

Meeting title	EMMEC meeting
Date and time	17 June 19.00 – 18 June 2025 16.30
Location	Hybrid: • ACI France premises – Paris, France • Conference call (Teams)
Attendees	EMMEC Members - physical F. BESET (Rabobank) – Chair - ACI Netherlands F. PAILLOUX - (Société Générale) – ACI France H. WESTERMANN (Commerzbank) - AEFMA Germany L. BRANDTNER (Raiffeisenlandesbank Oberösterreich) - TMA Austria C. ORIGER (BCEE - Banque et Caisse d'Épargne de l'Etat) - LFMA Luxembourg J. LARDINOIS (Belfius Bank) - ACI Belgium O. HUBERT (Natixis) – ACI France A. ADOTTI (Banca Iccrea) – Assim Forex Italy B. VAN DER VEEKEN (De Volksbank) – ACI Netherlands EMMEC Members – online F. SPAHN (DZ Bank) - AEFMA Germany S. CIMINO (UniCredit) - Assiom Forex Italy C. HUSS (Union Bancaire Privée) - LFMA Luxembourg G. SANCHEZ DE ROJAS (Banco Santander SA) - ACI Spain F. Nocera (Cassa Depositi e Prestiti) – Assiom Forex Italy M. BADIA ORTEGA (Cecabank) – ACI Spain G. SÁNCHEZ DE ROJAS IGLESIAS (Banco Santander) – ACI Spain C. WICHMANN (Danske Bank) - ACI Denmark F. I. ALCAIDE (CGD) – ACI Portugal M. BADIA ORTEGA (CECA Bank) – ACI Spain Guest speakers Raymond Torres – Funcas Maria Encio, Raul Novelle, Ronald Ruehmkorf - ECB Adam Kurpiel – Société Générale Observers E. WITT – ECB P. NICOLOSO – ECB J. PIASKO – Julius Baer

	P. BYRNE – Bank of Ireland **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. • Acceptance of ACI Portugal's candidacy as a new member • Introduction of new delegates from Assiom Forex • Announcement of the retirement of J. Piasko (Julius Baer) • Noted that this was the last meeting attended by R. Capparelli as EMMI secretariat
Item 1	**Members' roundtable:** • **Current Market Conditions**: Participants noted that money market spreads remain very tight, supported by continued ample liquidity. In Italy, not only are spreads compressed, but there volatility has been declining. In contrast, relative yields in France and Germany are somewhat elevated and exhibit greater volatility. This has led some Italian banks to increase their holdings of French and German government securities, attracted by the yield differential. Despite high liquidity, loan growth remains subdued, while retail deposits continue to increase significantly. • **Outlook on Sovereign Risk and Political Developments**: The perceived stability of Italy's debt sustainability has improved, with market participants expressing a more constructive outlook. France, however, is viewed with more caution due to heightened political uncertainty and ongoing fiscal concerns. The situation in the United States is considered especially uncertain, both from a political and fiscal standpoint. This uncertainty could influence European banks' access to U.S. dollar funding. Participants emphasized the need to monitor U.S. public finances closely, as a lack of fiscal adjustment could lead to a steeper yield curve and prompt intervention by the Federal Reserve. • **Geopolitical Tensions and Cross-Border Flows:** Ongoing tensions in the Middle East have so far had limited impact on European banks' core operations, largely due to the prevailing high liquidity levels. Nevertheless, Italy has seen significant capital inflows, some of which are thought to originate from Middle Eastern sources. • **Quarter-End Expectations in the Secured Market**: Given the abundance of liquidity and the ready availability of collateral, participants do not anticipate any significant tensions in the secured market around the end of the second quarter (June 2025).

	• **€STR Dynamics and MMSR Reporting Expansion**: There was a discussion on the potential effects of the recent expansion of MMSR (Money Market Statistical Reporting) reporting agents on €STR. Members noted that the inclusion of new reporting agents will lead to a noticeable increase in €STR underlying volumes, though the rates are expected to be unaffected. • **Changing Narrative Around Sovereign Debt Risks in Europe**: Previously, concerns around sovereign debt were considered isolated to a few countries. However, a shift in perception is emerging, with debt sustainability now seen as a broader issue across more euro area countries. Participants highlighted that current tight spreads may not be sustainable and could widen after the summer. • **TARGET2 Working Hours Consultation**: Members discussed the ECB's ongoing consultation on the potential extension of TARGET2 operating hours. The change is considered relevant for banks' treasury operations and liquidity planning, with some members highlighting possible operational and liquidity management implications. • **Impact of Recent Power Outage in Spain:** Spanish banks reported no material impact from the recent power outage, with only a few smaller institutions experiencing minor operational disruptions. Working conditions in main offices were as normal thanks to backup generators taking over. The following days there was no significant effect on customer behaviour or on banks' liquidity positions.
Item 2	**European macroeconomic outlook in light of US policy changes by Raymond Torres** - Director for Macroeconomic and International Analysis, Funcas. • **Overview of U.S. Policy Shifts and Global Implications**: Mr. Torres provided a comprehensive overview of recent policy developments in the United States and their potential implications for the European economy. He highlighted the interconnectedness of the Eurozone with both the U.S. and China, noting that policy shifts in either country—particularly those related to trade, industrial policy, and fiscal stimulus—contribute to heightened uncertainty for Europe. • **Resilience of the Eurozone Economy and Fiscal Capacity**: Mr. Torres emphasized that the Eurozone economy has shown resilience in recent quarters, even amidst global headwinds. However, he noted that the U.S. is preparing a substantial fiscal stimulus, and that some European countries with available fiscal space may also follow suit. This divergence in fiscal capacity across the EU could lead to asymmetric effects within the region. • **A Twin Shock: Demand and Uncertainty**: Mr. Torres concluded that recent U.S. policy changes are creating a dual challenge for Europe: a demand shock stemming from shifting global trade dynamics, and an uncertainty shock tied to both economic and geopolitical unpredictability. Business investment is seen as particularly vulnerable under these conditions. Q&A and discussion among members:

	• In response to questions about the macroeconomic outlook, Mr. Torres indicated that current projections foresee the ECB's Deposit Facility Rate (DFR) at 1.75% by year-end. A second rate cut remains possible, but the timing is less certain. While inflation is expected to continue its gradual convergence towards the ECB's target, Mr. Torres recalled the persistent uncertainty surrounding the outlook, which may lead to less rate cuts than otherwise justified. • On the issue of deglobalization, members acknowledged that while greater economic autonomy may enhance perceived resilience, it comes with substantial economic costs. Deglobalization tends to disrupt supply chains and reduce efficiency, potentially putting upward pressure on inflation due to higher production costs and reduced international cooperation. • Members raised concerns about the risk of escalation in the Israel-Iran conflict and its potential impact on global oil supply. Mr. Torres confirmed that any serious disruption in energy markets could feed through to inflation and may further complicate the ECB's monetary policy decisions, particularly the interest rate path. • In a discussion on how Europe can remain competitive and attract capital, Mr. Torres referred to the Draghi Report, which advocates for deeper integration and stronger investment frameworks. He also mentioned Eurobonds as a valuable instrument for fiscal solidarity, though stressed these measures are not sufficient on their own to resolve the EU's structural challenges. • The group further debated the feasibility of additional rate cuts by the ECB later this year. Opinions were mixed, with some members expressing skepticism about the realism of such a scenario given persistent inflation risks and global uncertainty.
Item 3	**EUR swap spreads – drivers and outlook** by Adam Kurpiel - Head of Rates Strategy, Société Générale. **Swap Market Structure and Comparisons:** Mr. Kurpiel began by providing a structured overview of the asset swap market, focusing on how spread types. He explained that swap spreads are commonly derived by comparing swap rates with Euribor benchmarks. However, with the growing prominence of the €STR curve, comparisons are increasingly being made against this risk-free benchmark as well. **Collateral Scarcity and Repo Market Indicators:** The presentation featured a detailed comparison between the Schatz-€STR spread and repo rates, emphasizing their use as indicators of collateral scarcity. Mr. Kurpiel highlighted the repo-€STR spread as a key metric for assessing scarcity. He noted a strong correlation between the evolution of this spread and German government net issuance, particularly when adjusted for holdings by the Eurosystem under asset purchase programmes. • **Jurisdictional Differences in GC Repo and Specialness Premiums:** Mr. Kurpiel presented data on GC repo rate spreads versus €STR across different jurisdictions, underscoring regional divergences. He further

analyzed the specialness premium—the difference between general collateral and special collateral repo rates—for Germany, France, and Italy. The German collateral market, in particular, displayed the highest premium, reflecting heightened demand and limited supply.

- Liquidity Trends and Autonomous Factors: Turning to the broader liquidity environment, Mr. Kurpiel discussed the recent developments in excess liquidity. He stressed that ongoing QT is now the key driver of excess liquidity decline, while autonomous factors, such as government deposits and banknotes in circulation, are now having less impact. Yet private inflows to money markets continue to curb the decline in excess liquidity. The current fragmentation in liquidity distribution across the Eurozone was noted, with Italian banks having the highest usage of standard ECB refinancing operations. However, the stable or non-increasing trend in their ECB funding suggests that money markets remain functional and resilient.
- Euro Repo Market Activity: A notable point in the presentation was the recent increase in repo transactions involving public institutions as counterparties, which contributed to a surge in underlying volumes in the euro repo market.
- Model-Based Analysis of Bund Asset Swap Spreads: Mr. Kurpiel concluded by sharing insights from an internal Societe Generale model designed to forecast asset swap spread movements for the 10-year German Bund. He highlighted a notable deviation between the model's projections and the recent market developments. Potential explanations for this divergence were discussed, links are found with equity cost of funds and swap curve dislocation between 10y and 30y driven by regulatory changes for Dutch pension funds.
- Dutch Pension Fund Reform, Mr. Kurpiel provided further insights in the expected impact that the reform of pension funds (going from Defined Benefit to Defined Contribution) will have on hedge ratios and long term interest rates around key transition dates in '26 and '27.

Q&A and discussion among members:

- A member inquired about Mr. Kurpiel's expectations regarding the relationship between Euribor and €STR. In response, Mr. Kurpiel presented recent trends and analytical insights, showing that €STR reflects both the decline in excess liquidity and the impact of changes in the overall monetary policy stance. Specifically, he noted that the €STR–DFR (Deposit Facility Rate) spread, which widened to approximately +10 basis points during the ECB's rate hiking cycle, has recently narrowed and is now hovering around –7 basis points.
- Based on Societe Generale's internal research, Mr. Kurpiel explained that:
    - A €1,000 billion reduction in excess liquidity would lead to a 4 basis point widening of the 3-month €STR spot basis.

	◦ A 25 basis point ECB rate cut would result in a 0.4 basis point widening of the same basis. • In response to another question, Mr. Kurpiel mentioned that some trading desks are increasingly considering a shift from Euribor to €STR instruments, particularly in light of market structure evolution and risk management practices. Members mentioned that Euribor fixings can influence results more strongly as they are structurally longer than overnight.
Item 4	**Euro Money Markets Study 2024** by Maria Encio - Senior Economist, ECB and Raúl Novelle Araújo -Financial Markets Analyst, ECB. • Following some introduction and history the main conclusions were presented: for the period under review (2023-2024) money market volumes expanded, rates converged and this was driven by reduction in excess liquidity, availability of collateral and ECB policy decisions. These different points were then discussed in more detail. • Volumes increased in each segment with secured being the biggest segment in terms of daily flows, however looking at outstanding amounts the FX swap market is the biggest: secured trades are on average more short term. • Rates converged over the period, with secured rates being more reactive than unsecured rates to the reduction of excess reserves. Spreads of secured rates vs DFR were narrower than €STR – DFR spread. • There's seemingly an unexploited arbitrage opportunity of unsecured rates being lower than secured rates. This can be explained by several factors: market access constraints (some bank clients do not have access to secured market) and effects due to timing of transactions (secured activity is spread out throughout the day but most in the morning and unsecured more in the afternoon when secured market is less liquid). Additionally, the more favourable regulatory treatment of secured transactions compared to unsecured transactions—particularly in terms of liquidity requirements and minimum reserve ratios—also plays a role in driving this rate differential. The improved collateral availability can be attributed to both an increase in supply and a reduction in demand. On the supply side, new issuance and lack of reinvestment of maturing assets by the Eurosystem have contributed to greater availability of collateral. On the demand side, the shift in the monetary policy cycle—from rate hikes to rate cuts—has led to a repositioning from short to long, thereby reducing the demand for bonds in the repo segment. This trend is also clear when looking at the lower proportion of repo transactions with rates significantly away from DFR ("specials"). • ECB policy adjustments were also discussed: 1/ change in remuneration of public sector deposits, 2/ change in remuneration of MRR, 3/ changes in market operations and operational framework. These adjustments resulted in a good pass-through of policy changes to the money market, increased market activity

	involving public entities, and some end-of-month shifts of unsecured borrowing into the repo and FX swaps segments. • In a second part a set of graphs were shown which are intended to be updated annually: money market trading composition comparative charts, banks trading direction, counterparties and dominance of trades with NBFI's, insights in maturity of instruments and calendar effects. • The ECB also expressed gratitude for the reporting agents as this study was done in large part thanks to the MMSR data they provide. Q&A and discussion among members: • Members questioned if anything could be published that would show market making vs hedging of banks. In the OIS segment ECB speakers explained that this might be difficult given the confidentiality constraints for the publication of data: in all cases it shouldn't be possible to trace results back to specific institutions. • Members questioned how open repos are treated for the maturity bucketing graphs. The speakers clarified that, in the charts showing flows, open repos are classified as overnight transactions. However, in the charts showing outstanding amounts, the difference between the final date on which the repo is not rolled over and the starting date of the open repo is considered, thereby accounting for the effective maturity and avoiding a double-counting They also noted that there appears to be a slight lengthening in the duration of repo transactions compared to 2020-2021
AOB	• The following was discussed: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/14443-Amendments-to-the-treatment-of-securitisation-exposures-under-the-Liquidity-Coverage-Ratio-Delegated-Regulation_en • Some topics and presenters are identified for the September meeting. • The potential locations of the December meeting were identified and will be confirmed shortly.