The European Money Markets Institute

Issue no. 8

Newsletter March 2024

Contemplating advancements and gazing forward to 2024

Dear readers,

The first quarter of 2024 has flown by, and a lot has already happened at the European Money Markets Institute (EMMI) during the last three months.

Firstly, the final results of the Euribor® consultation paper are now published, and the feedback received was overwhelmingly positive. As most of you know, this is the culmination of several years of intense work, and we are confident that the changes in the methodology of our main benchmark will ease the burden on our panel banks and enable a larger participation in the panel of Euribor® contributors. Of course, this enhanced methodology will continue ensuring the robustness, transparency, and integrity of the Euribor® benchmark. You can read more about the upcoming changes to the Euribor® methodology on page three of this newsletter.

In addition to the progress made with Euribor®, I am very pleased to announce that EMMI is actively working towards the introduction of an Environmental, Social, and Governance (ESG) Commercial Paper (CP) Transparency Monitor . This initiative underscores our commitment to transparency and standardisation within the money markets space. Our ESG CP Transparency Monitor will provide institutions with transparent information about the ESG characteristics of commercial paper, empowering them to make informed decisions that align with their values and objectives. Although there is still work to do, on page four we give you a taste of what's to come.

Regarding the current state of the money markets, since September 2023, the ECB has kept its key policy rates steady, interrupting a series of 10 consecutive interest rate hikes. The transmission of the ECB's monetary policy stance to money market rates worked as anticipated, influencing economic activity moderation and inflation reduction. In the near future, uncertainties loom over forthcoming monetary policy decisions, including the timing and speed of adjustments. Of course, you can read more about it in our customary "Echoes of the Money Market" section.

Last but not least, we have an insightful interview with Michael Schneider, Chair of the Euribor® Oversight Committee, in which we discuss the changes to the Euribor® methodology and their impact on panel banks.

And that should give you enough food for thought. I would like to express my gratitude to all stakeholders for their continued support in helping us navigate this evolving financial landscape.

Kind regards,
Jean-Louis Schirmann
CEO, European Money Markets Institute (EMMI)

Final results:

Euribor® Consultation Paper

The European Money Markets Institute (EMMI) has concluded its public consultation on proposed enhancements to the Euribor® benchmark's methodology with resounding support from industry participants.

The consultation, which aimed to refine the Euribor® hybrid methodology, garnered overwhelmingly positive responses and provided invaluable insights into the future of this critical benchmark.

The proposed enhancements to the Euribor® methodology, designed to ease the burden on contributing institutions and attract more banks to the panel, received widespread acclaim during the consultation process.

The Euribor® benchmark plays a vital role in the global financial system, influencing a broad range of financial products and contracts.

Industry-wide support for reformulation and eligibility tests

Launched in October of the previous year, the consultation elicited praise for the redefinition of Level 2.3 components and the introduction of eligibility tests. Participants commended the changes, recognizing their potential to enhance the benchmark's accuracy and reliability.

According to EMMI, the redefinition of Level 2.3 encompasses various adjustments, including an expanded calculation starting point and a refined Market Adjustment Factor (MAF) to better reflect interest rate fluctuations and changes in perceived credit risks.

Additionally, feedback from stakeholders prompted the introduction of an additional control parameter to address exceptionally adverse market conditions.

Implementation of the new methodology

EMMI has announced its decision to implement the new methodology in a phased manner. The migration of Panel Banks to the revised calculation methodology will occur gradually and is expected to start around end of May 2024, spanning a six-month period. This approach aims to facilitate a smooth transition while minimizing disruptions to market participants.

Valuable insights and recommendations

While the widespread support for the proposed enhancements is encouraging, addressing concerns raised by market participants remains a priority to uphold the benchmark's robustness and integrity. The consultation process has proven instrumental in gathering diverse perspectives, refining the Euribor® methodology, and reinforcing its relevance and reliability in financial markets.

The Euribor® Public Consultation Feedback PDF can be found on our website: www.emmi-benchmarks.eu

ESG CP Transparency Monitor

Standardising in the commercial paper sector

The European Money Markets Institute (EMMI) is gearing up to roll out an initiative aimed at bolstering transparency in the ESG commercial paper market: the ESG CP Transparency Monitor.

Through this initiative, EMMI will gather current information from applicants regarding the key ESG features embedded in their commercial paper programs. This information will then be published in a standardized and harmonized format, ensuring easy access for all interested parties.

The service is expected to be launched in June, and more details will be made available in the coming weeks.

It's important to note that EMMI does not provide judgment or valuation of the information provided by ESG CP issuers. Issuers are responsible for ensuring the accuracy and currency of their data and for meeting EMMI's requirements.

Join us in our mission to facilitate smooth operations in Money Markets and enhance their integration.

Echoes from the euro money markets

Following 10 consecutive rate increases since July 2022,(stopped in Sept 2023) the European Central Bank (ECB) is now expected to cut rates in 2024.

After pricing in interest rate cuts already in April 2024, traders are now adjusting their bets in accordance with policymakers' cautionary statements, indicating that borrowing expenses will stay high for a prolonged duration.

Following the interest rate increase in September 2023, the ECB kept its key policy rates unchanged during the monetary policy meetings in October, December, January, and March.

This stance is evident in the stability of money market rates, which halted their upward trajectory. Currently, these rates remain steady for shorter-term tenors and have begun to decline for longer-term tenors.

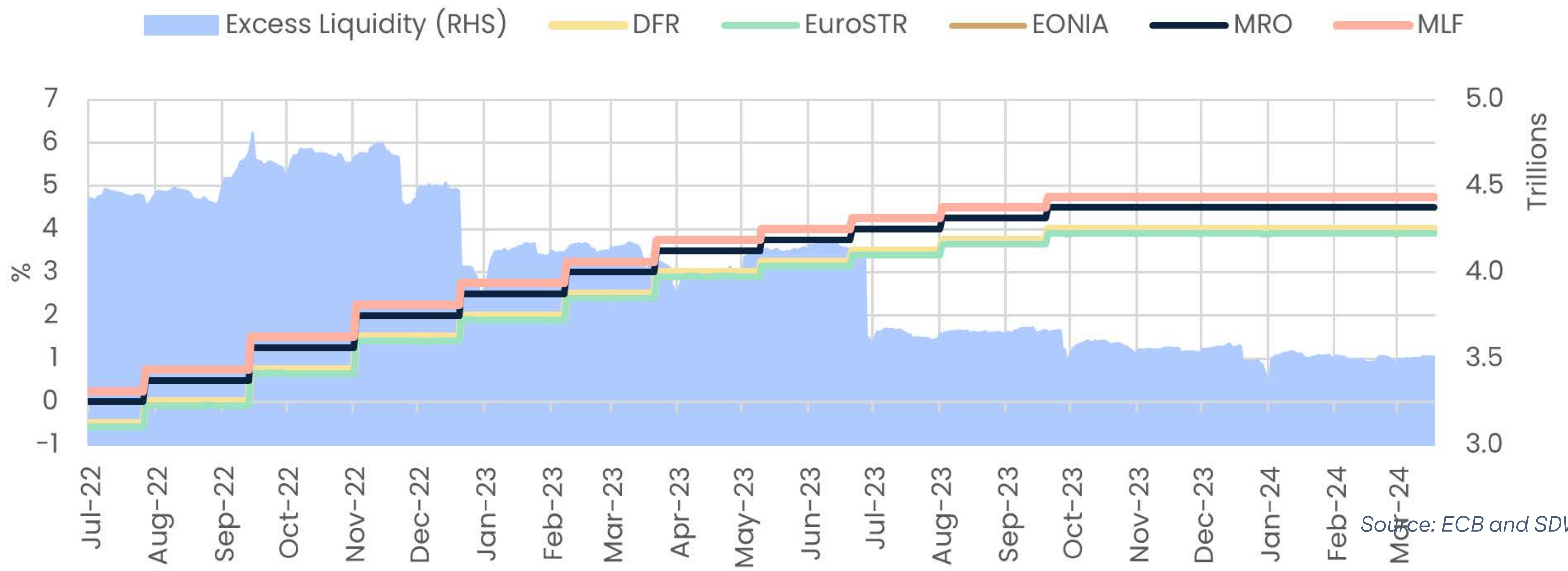
The current monetary policy landscape is marked by historically elevated interest rates, and these rates are having an impact on tempering economic activity and reducing inflation.

European inflation is falling faster than the European Central Bank had expected. It slowed to a 2.6% annual pace in February after peaking at 10.6% in October 2022. Regarding the ECB Balance sheet, the APP portfolio has continued to decline as the ECB discontinued reinvestments of principle payments from maturities as of July 2023.

In addition, the ECB announced that it intends to reduce the PEPP portfolio by €7.5 billion per month on average in the second half of 2024, before totally discontinuing the reinvestment at the end of the year.

As a significant structural adjustment, in March 2024 the ECB announced changes to its operational framework for executing monetary policy.

ECB rates and excess liquidity



Source: ECB and SDW

Euribor® rates stabilised across all tenors but for the 12-month Euribor®, which started to decline as October 2023, standing at 3.87%, 3.86%, 3.93%, 3.92%, and 3.75% for the 1-week, 1-month, 3-month, 6-month and 12-month respectively, on the 18th of March 2024.

The stabilisation of Euribor® rates and the decline of the Euribor® 12-month is mainly driven by the expectations on future ECB rates cuts.

Moreover, the 12-month Euribor® increased by 25bps since January 2024 because of an adjustment in market participants' expectations of the ECB monetary policy.

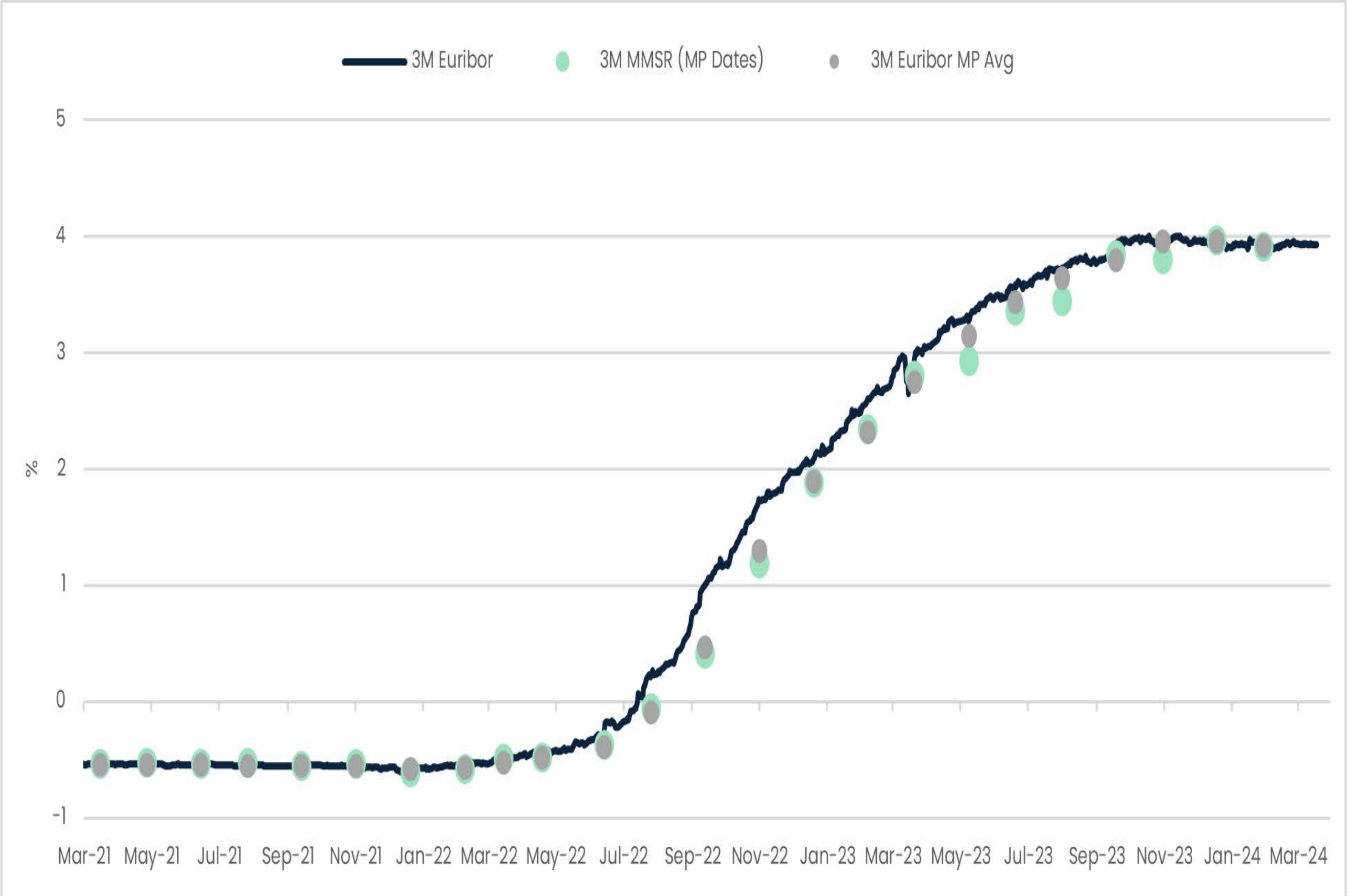
3-month Euribor® (average MP) and 3-month MMSR (average MP) rates have been co-moving since the ECB delivered the first hike in July 2022. On January 30th 2024, rates were matching perfectly.

The Money Market Statistical Reporting (MMSR) dataset, collected on the basis of transaction-by-transaction data from a sample of euro area reporting agents, provides information on the secured, unsecured, foreign exchange swap and overnight index swap euro money market segments.

The universe of banks that report to MMSR are 47 against the 19 of Euribor®, but the 3-month Euribor® MMSR rate have been co-moving.

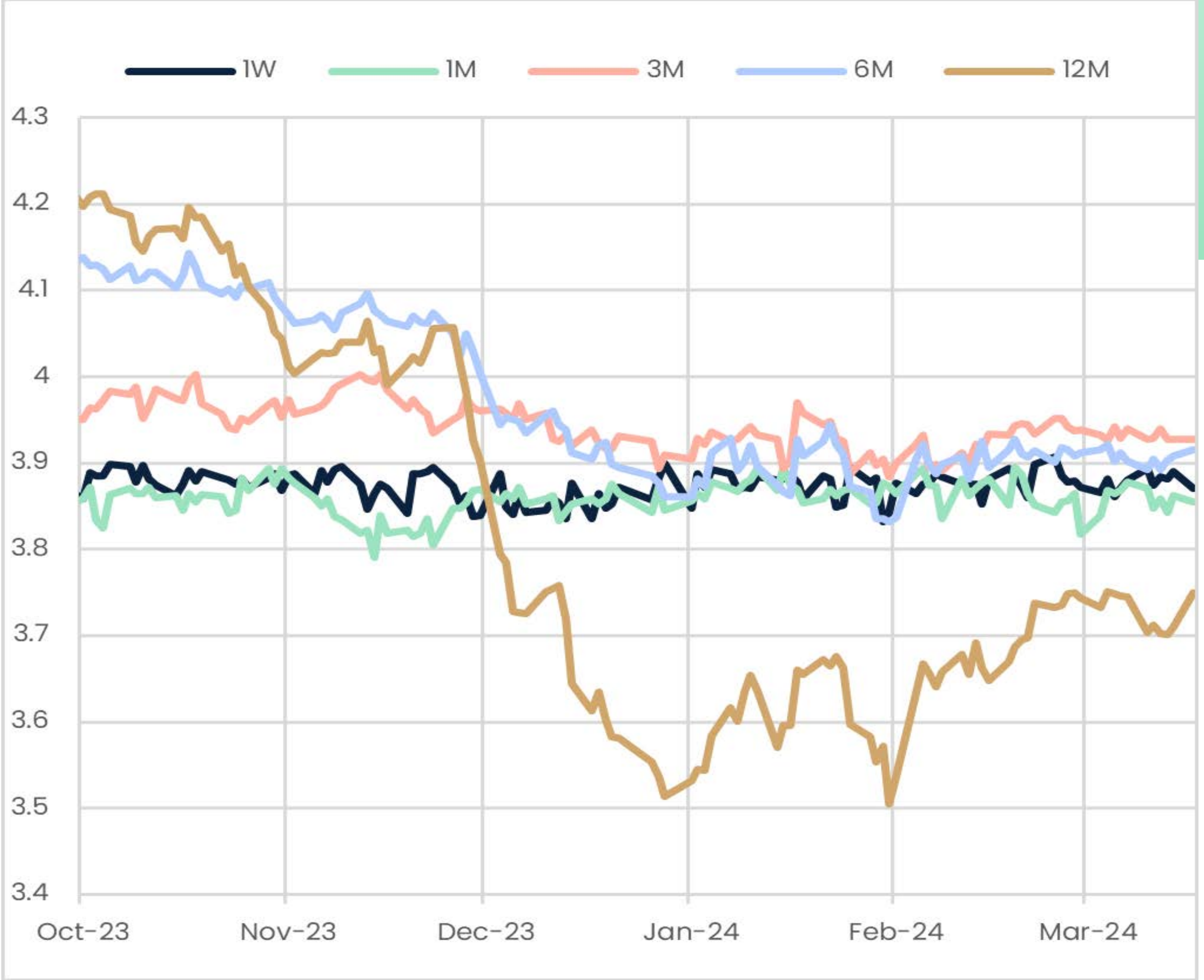
The spread between the two rates is probably attributable to the different Panel Bank composition, the eligibility for MMSR of the transactions with the counterparty S11 (Non-financial corporations), the different accepted time-window associated to communicate transactions and the different universe of eligible instruments.

3-month Euribor® vs 3-month MMSR



Source: ECB and EMMI

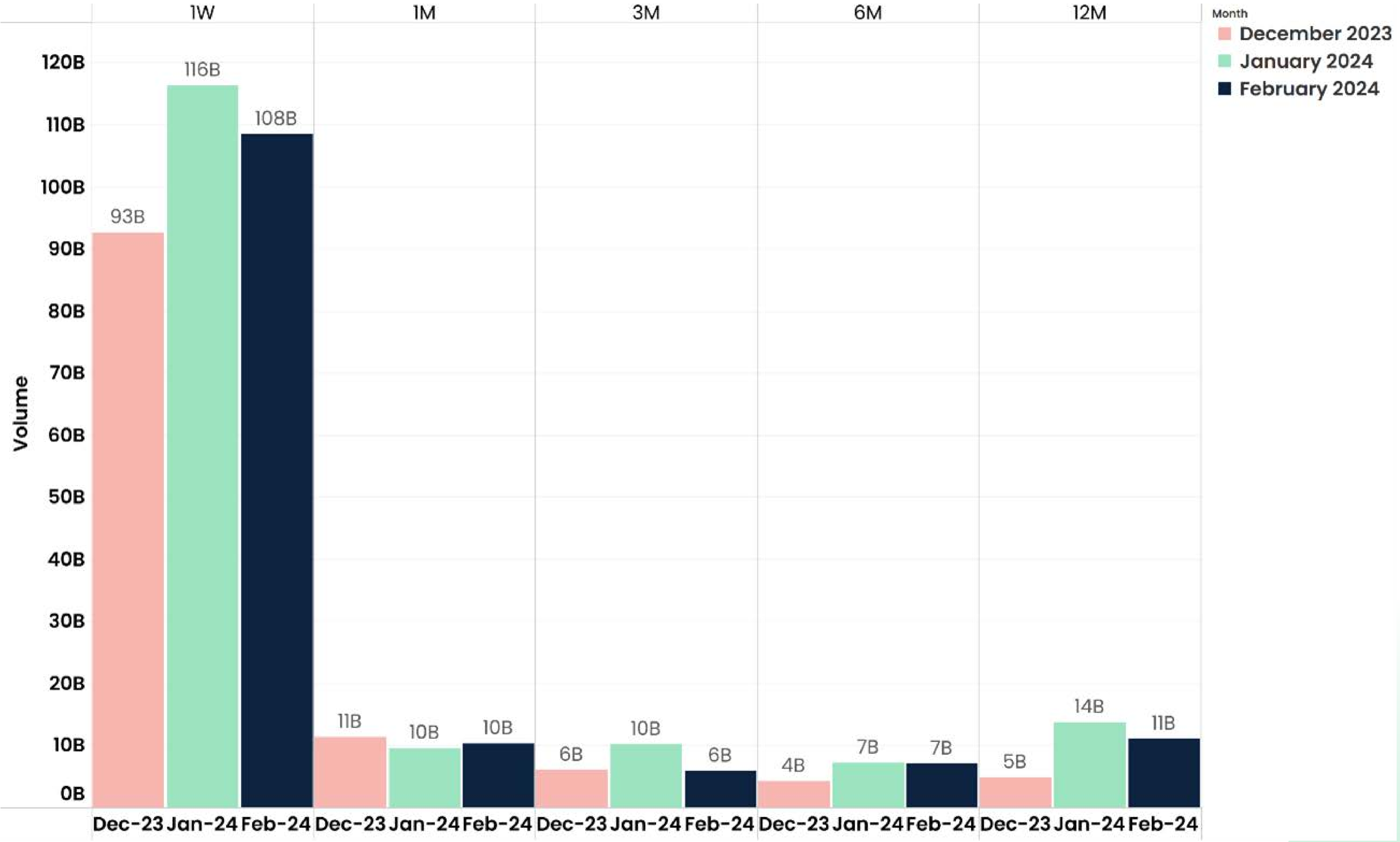
Euribor® rates



Source: ECB and EMMI

Euribor® aggregated volumes reached EUR 142 billion in February 2024, down 15 billion from the previous month. All tenors underlying volume have decreased with the exception of the 1-month and 6-month which remained almost unchanged compared to January 2024.

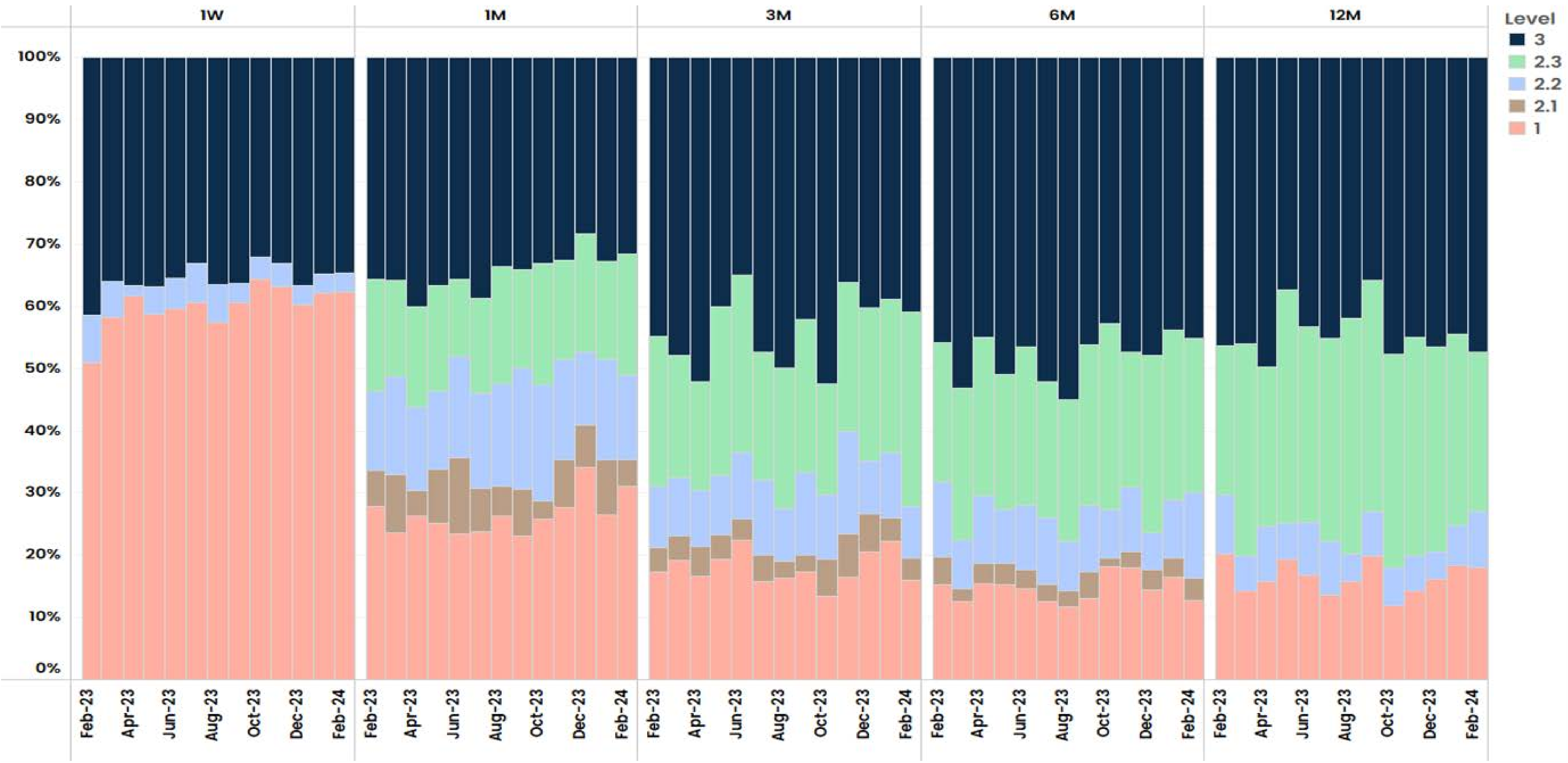
Euribor® aggregate volumes



Source: ECB and EMMI

The Euribor® Hybrid methodology reflects the developments of the underlying volumes. Level 1 contributions show a strong uptrend in the 1-week tenor, confirming increased activity in the shorter tenors of the unsecured market. In contrast, Level 1 contributions in other Euribor® tenors exhibit a slight uptrend or stability.

Use of levels in Euribor® by tenor

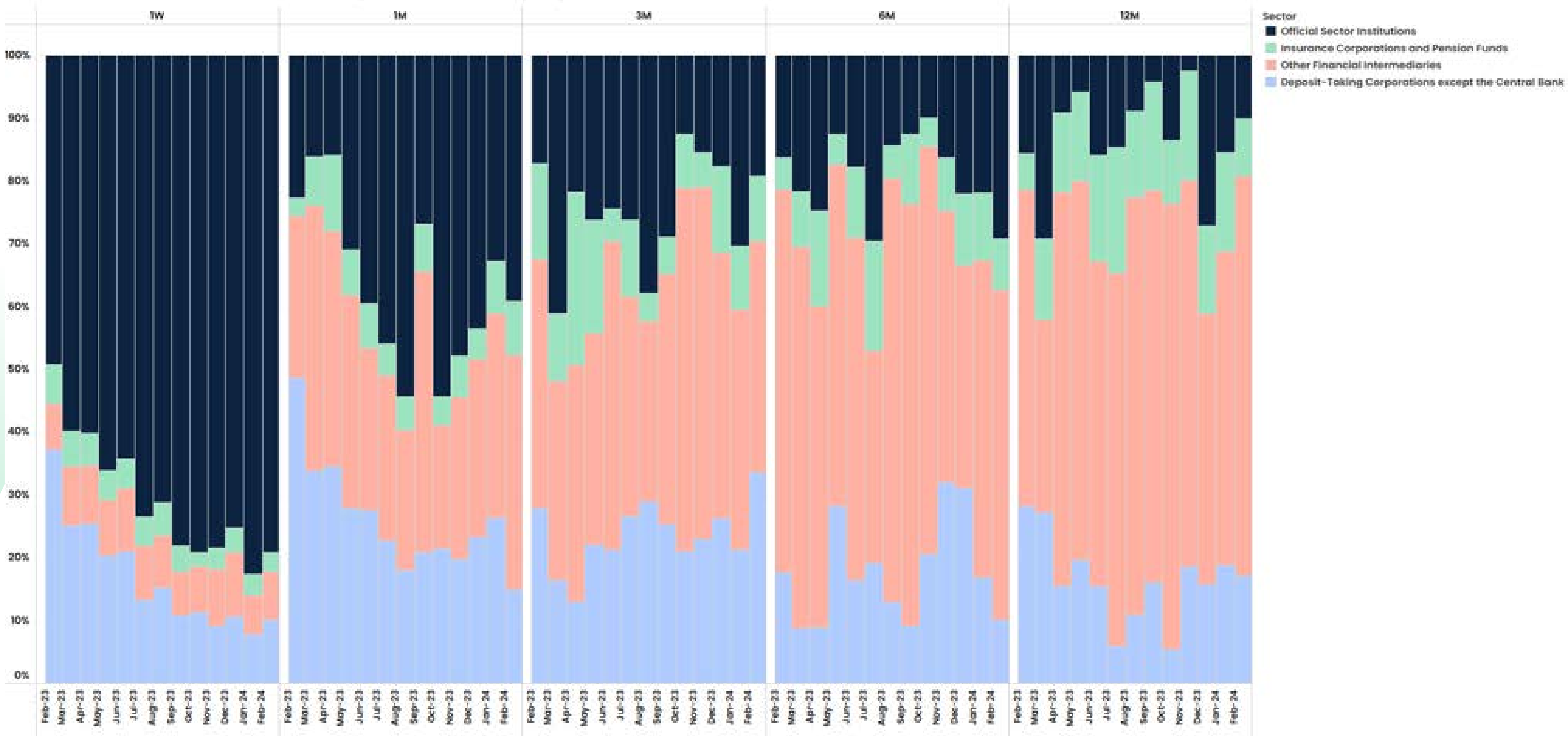


Source: ECB and EMMI

It is observable that the composition of Euribor® counterparty is changing over time, with noticeable pattern in shorter term tenors. The proportion of Official sector institutions compared to the other counterparty sectors has substantially increased since February 2023, to the detriment of Deposit taking corporations, which has instead experienced a substantial decrease. This figure needs to be placed within the context of a significant rise in Euribor® underlying volumes.

Counterparty sectors by tenor

Share of volume used (Level 1 and 2.2) by different counterparty sector



The plot of SUM([Transaction.Nominal.Amount.]) / TOTAL(SUM([Transaction.N... for Publication.Date1 Month broken down by Tenor1. Color shows details about Sector. The data is filtered on Publication.Date1 (MY), which keeps 13 of 38 members. The view is filtered on Sector, which excludes Null.

Source: ECB and EMMI

Euribor® overhaul:

A conversation with Michael Schneider

We sat down for a chat with Michael Schneider about the new Euribor® methodology, and how it will affect panel banks in particular and the industry as a whole. Michael has been the Chair of the Euribor® Oversight Committee since July 2023. Previously, he was Head of Liquidity at DZ Bank.

As Chair of the Oversight Committee, what is your overall assessment of the changes to the Euribor® methodology?

The Euribor® Oversight Committee has achieved a significant simplification of the entire contribution process with the methodology change. While the banks previously used individually developed methods to calculate Level 3, this process is now determined centrally by EMMI.

How do stakeholders perceive the potential impacts of the new methodology on their business operations and financial products?

The new methodology is a sustainable improvement of the process, but does not lead to a different pricing in terms of content. The future calculation in the contribution process for maturities of non-existent money market transactions from Level 1 and Level 2 is a combination of the use of market changes from the Efterm® and existing historical credit spreads to calculate the price. Detailed analyses of past periods have shown that the new method has little or no impact on the pricing behaviour of Euribor®.

On the contrary, the new method is more transparent and standardised than the individual and heterogeneous methods used by the individual panel banks.

The stakeholders' business operations and financial products are not affected by this change.

Are there any specific challenges or adjustments that stakeholders foresee in adapting to the new methodology?

The affected stakeholders are exclusively the panel banks and the benchmark administrator. All other benchmark users will not experience any changes in any processes.

In what ways do you believe the new Euribor® methodology addresses the shortcomings or limitations of the previous approach?

The new method simplifies the entire contribution process and thus improves one of the essential elements of a benchmark: transparency. The Euribor® is primarily based on unsecured money market transactions conducted by the participating panel banks. This essential part of the contribution remains unchanged. Overall, the methodology changes only affect the Level 3 calculation and therefore the fundamental behaviour of the Euribor® quotes will not change. However, I do not see a significant increase in correlation with the derivatives market in the future either, as the participating banks do not follow every movement of the derivative market products directly with the unsecured money market products in their market behaviour, especially on volatile days.

What are your expectations regarding the stability and reliability of Euribor® as a benchmark interest rate under the new methodology?

The robustness of the Euribor® is strengthened with the new methodology, the process is simpler and more transparent and thus also more comprehensible for all those involved in the quotation process.

How do you view the potential implications of the new Euribor® methodology on risk management practices within panel banks?

This is precisely where process simplification comes in. Once the new methodology comes into force all panel banks will simply report their relevant money market transactions. The construction and monitoring of the level 3 required large capacities in the panel banks. Both internal and external control procedures were carried out in accordance with regulations. Panel banks no longer have to send level 3 contributions in case of absence of level 1 and level 2 input data. Nevertheless, the panel banks remain participants in the process in accordance with the Benchmark Regulation and must fulfill certain minimum standards.

Have you identified any potential opportunities or benefits associated with the adoption of the new Euribor® methodology?

Irrespective of the changes in the methodology Euribor® has not lost any of its appeal as a benchmark in the lending, deposit and securities business of European banks in recent years and continues to be the main basis for variable interest rate agreements. However, in order to guarantee the robustness and market representativeness of the money market in the Euribor® benchmark at all times in the future, it is necessary to at least maintain the number of panel banks.

The change in methodology should also be understood as a simplification of the process for exisiting panel banks and therefore a clear positive signal from the benchmark administrator. At the same time this is also an invitation to other leading banks in the eurozone to possibly join the panel in the future.

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

Euribor® - Efterm® - Subscription - Fee Schedule 2024

The European Money Markets Institute