Box 3

MAIN FINDINGS OF THE EURO MONEY MARKET SURVEY 2012

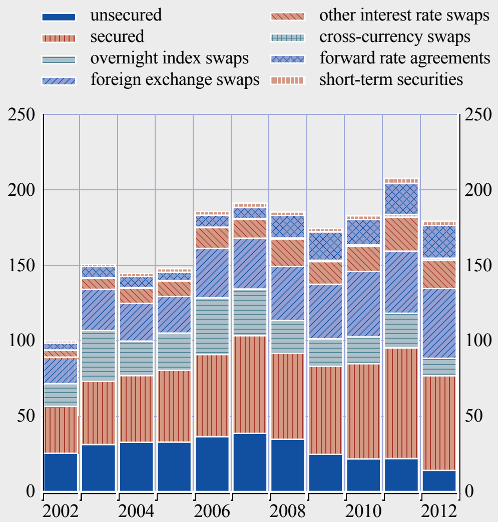
On 28 September 2012 the ECB published the results of the Euro Money Market Survey 2012, which were based on data collected from banks in 28 European countries (the EU Member States plus Switzerland) and covered developments in various segments of the euro money market in the second quarter of 2012. This box reports the survey's main findings.[1] Overall, the survey results suggest a strong impact of the euro area sovereign debt crisis as well as of the Eurosystem's extraordinary policy measures that aim at restoring market functioning and the proper transmission of monetary policy in an environment where the euro money market remains fragmented.

The overall turnover in the euro money market decreased by 14% in the second quarter of 2012 compared with the second quarter of the previous year (see Chart A). After a significant increase in turnover in 2011, aggregate turnover fell back to below 2010 levels in the second quarter of 2012. This decline could be attributed to both the ongoing euro area sovereign debt crisis and the related impairment of the interbank market, as well as to the surplus liquidity environment that prevailed in the euro interbank market as a result of the high allotment at the two three-year longer-term refinancing operations (LTROs) in December 2011 and February 2012.

The most notable decline in turnover took place in the segment of overnight index swaps (OISs), where turnover declined by 50%, and in the unsecured market, where turnover contracted by 36%. Market activity in the unsecured segment remained highly concentrated in the overnight market (with a share of more than 70%), while turnover in the segment beyond one month remained very limited (only around 2% of total unsecured activity). The contraction in the unsecured market can be explained by the general trend towards secured lending and a shortening of maturities against the backdrop of greater risk aversion to counterparty credit

Chart A Aggregate average turnover of the euro money market

(Q2 figures in the period from 2002 to 2012; index: aggregated average daily turnover volume in 2002 = 100)



Source: ECB Euro Money Market Survey 2012.
Note: The panel comprised 105 credit institutions.

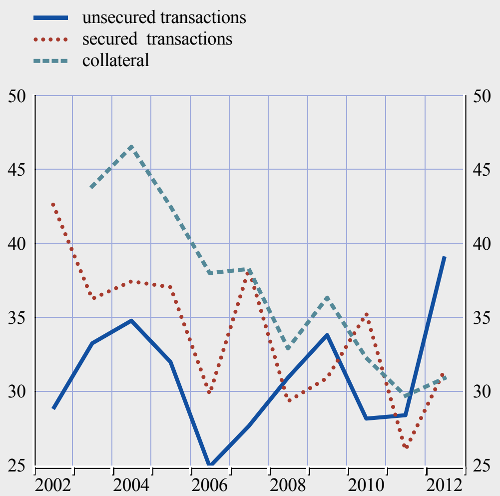
1 For more details, see ECB, *Euro Money Market Study*, December 2012.

risk. At the same time, the high level of surplus liquidity provided by the Eurosystem reduced the demand for interbank funding, while stricter regulatory requirements tend to reduce the supply of unsecured interbank lending.

The decline in money market activity was particularly pronounced compared with the previous year, as the second quarter of 2011 was a time before the intensification of the euro area debt crisis when surplus liquidity had temporarily subsided and activity in the money market had picked up substantially. This effect is also very noticeable in the substantial decline in the OIS segment – the environment of high surplus liquidity, combined with the low level of interest rates (close to the zero percent rate of the deposit facility) and low volatility of the overnight EONIA rate, have significantly reduced the need for hedging interest rate risk.

Chart B Share of domestic counterparties and collateral

(percentage of total)



Source: ECB Euro Money Market Survey 2012.
Note: The panel comprised 105 credit institutions.

The secured market remained the largest segment of the euro money market, although turnover declined by 15% in the second quarter of 2012, which was broadly in line with the findings of the latest International Capital Market Association's European repo market survey.[2] The decline in turnover was driven by a 26% decrease in overnight activity. The share of secured market activity cleared through central clearing counterparties (CCPs) increased further and accounted for 55% of secured market transactions (compared with 51% in 2011). While in previous years activity through CCPs picked up considerably after more European banks had joined the international repo platforms, in 2012 even the CCP-cleared repo business declined (albeit at a slower pace than all repo transactions), on account of, among other things, increased margin requirements following rating downgrades and higher yields on debt securities of some euro area countries under stress in the second quarter of 2012. Demand for repo was also lower because many banks had had their funding needs for 2012 fulfilled with liquidity received from the Eurosystem's LTROs.

The continued decline in the relative share of unsecured lending, as well as the increase in the share of transactions settled through CCPs, indicate heightened concerns about counterparty credit risk, especially with respect to banks from euro area countries under stress. Except for unsecured transactions, the data on the geographical structure of counterparties and used collateral show, however, only some limited signs of a stronger preference for domestic banks and collateral (so-called "home bias"). In the unsecured market, the share of domestic counterparties increased significantly from around 28% in 2011 to around 39% in 2012, while for the secured market the share of domestic collateral increased slightly from 26% to around 31% (see Chart B).[3]

2 See International Capital Market Association, "European repo market survey", No 23, August 2012.

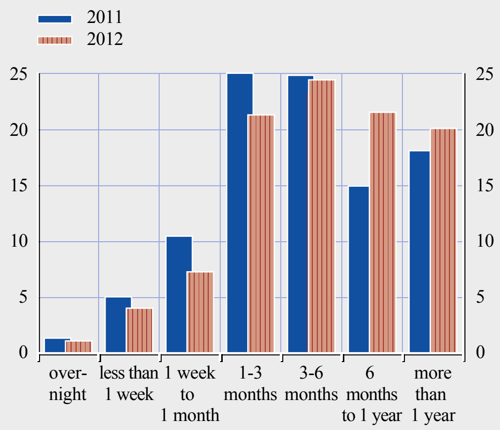
3 For a bigger panel of 172 credit institutions, for which only 2011 and 2012 data were available, the results were quite similar: in the unsecured market the share of domestic counterparties increased from around 31% in 2011 to around 43% in 2012, while for the secured market the share of domestic collateral remained broadly unchanged at around 30%.

There has been a slight trend away from domestic collateral – also related to the euro area sovereign debt crisis – as repo investors are often less willing to trade repos with collateral issued in the same country as the counterparty for countries with perceived elevated sovereign and counterparty credit risk (so-called "wrong way" correlation risk).

The only market segment where activity picked up significantly was in the derivatives market, namely foreign exchange (FX) swaps (up by 12%), as such swaps remained an important secured cash funding instrument for European banks and had benefited from the move away from unsecured transactions. Another sign of the resilience of the FX swap market is the fact that the increase in activity took place also for the longer maturities (see Chart C). Furthermore, a wider use of e-commerce platforms continued to support activity in this market segment, as the survey showed that the share of electronic trading increased in most market segments.

Chart C Maturity-weighted breakdown of average daily turnover in the foreign exchange swap segment

(percentage of total)



Source: ECB Euro Money Market Survey 2012.
Note: The panel comprised 172 credit institutions.

The overall turnover in the outright secondary market for short-term securities declined by 9%, whereas the turnover for the short-term paper issued by credit institutions increased by 12%, a trend that could also be indirectly supported by an increase in the outstanding amount of short-term European paper (STEP). Some of this increase could potentially be explained also by the eligibility of these short-term securities as collateral for the Eurosystem's operations.