

# **THE ROLE OF NON-BANKS IN THE EURO MONEY-MARKETS AND ITS EFFECTS ON LIQUIDITY**

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## **PRESENTATION TO THE ECB MONEY MARKET CONTACT GROUP**

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# INTRODUCTION

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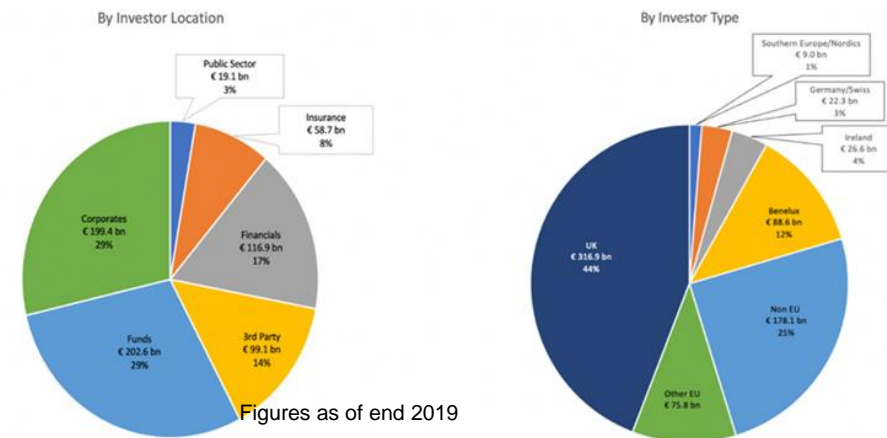
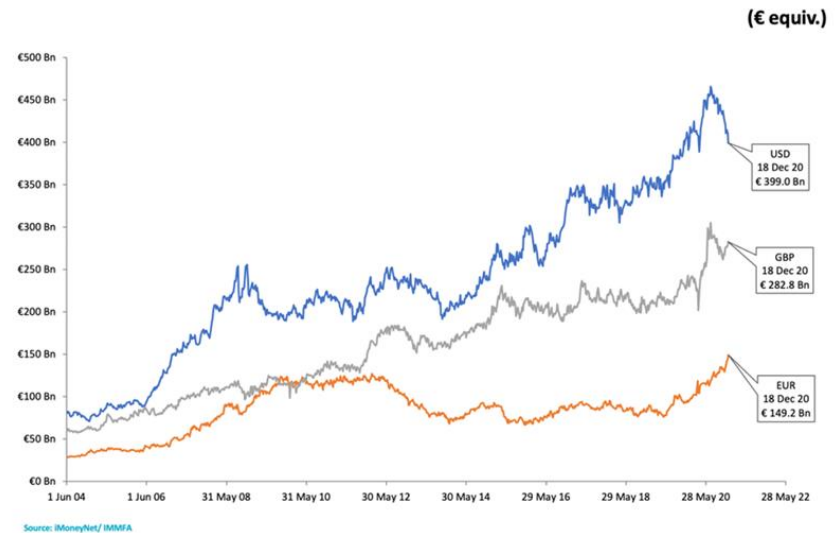
- The growing importance of non-bank market participants in the euro area money-markets poses the question of the impact on liquidity in times of increased volatility or liquidity shortages
- Beyond aspects of liquidity and pricing, what is the relevance of the non-bank sector to the real economy financing and its capacity to absorb external shocks ?

- **TOPICS EXPLORED IN THIS PRESENTATION**

- ✓ Cyclicalitiy
- ✓ Liquidity models & transformation
- ✓ Stress-testing
- ✓ Leverage
- ✓ Concentration
- ✓ Interconnection

# THE GROWING IMPORTANCE OF THE NON-BANK SECTOR IN EURO MONEY-MARKETS : EXAMPLE OF THE FUND INDUSTRY

- Since the global crisis and especially since the inception of the ECB QE, assets under management in the asset management industry have grown steadily and stand now at their highest.
- Short-term money-market funds are widely used by investors to manage liquidity and as alternatives to cash accounts held in banks



# PART OF NON-BANKS IS GROWING IN SPITE OF DECLINING RETURNS

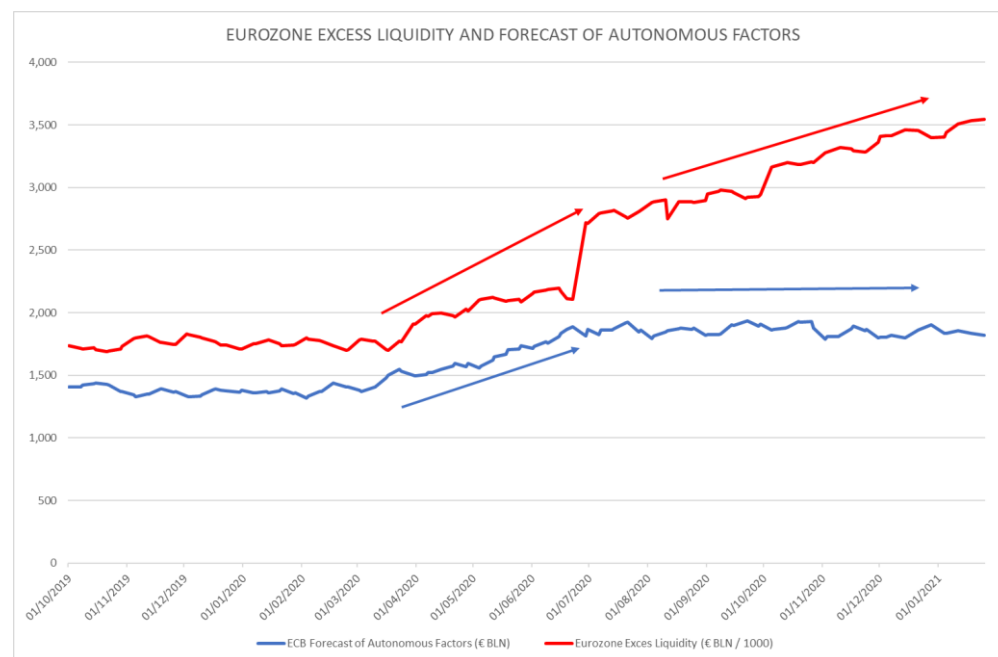
- As of February 2021, returns on EUR prime /LVNAV Money-Market Funds stand below the ECB Deposit Facility Rate

EUR PRIME/LVNAV MMFs	Assets					Yield				WAM	WAL	Agency Rating					
	Accum	Dist	Total	Change	Change %	7 Day	7 Day	30 Day	30 Day			Moody	S&P	Fitch			
						Gross (%)	Net (%)	Gross (%)	Net (%)								
Amundi Money Market Fund-Short Term (EUR)	-	-	-	-	-	-	-	-	-								
BlackRock ICS-Instit Euro Liq Fund	35,881	-	35,881	-2,347	-6%	-0.58	-0.65	-0.58	-0.65	41	43	Aaa-mf	AAAm	AAAmmf			
Deutsche Managed Euro Fund	8,962	-	8,962	-128	-1%	-0.56	-0.63	-0.55	-0.62	56	58	Aaa-mf	AAAm	AAAmmf			
Fidelity Instit Liquidity Fund-Euro	-	-	-	-	-	-	-	-	-			Aaa-mf	AAAm	AAAmmf			
Goldman Sachs Euro Liq Resv Fund	12,457	-	12,457	-217	-2%	-0.58	-0.63	-0.58	-0.62	32	32	Aaa-mf	AAAm	AAAmmf			
HSBC Euro Liquidity Fund	9,152	-	9,152	90	1%	-0.55	-0.63	-0.54	-0.62	44	51	Aaa-mf	AAAm	AAAmmf			
Invesco Euro Liquidity Portfolio	1,036	-	1,036	9	1%	-0.58	-0.65	-0.58	-0.64	53	53	Aaa-mf	AAAm	AAAmmf			
JPM EUR Liquidity LVNAV	15,792	-	15,792	-314	-2%	-0.57	-0.61	-0.57	-0.61	47	47	Aaa-mf	AAAm	AAAmmf			
LGIM Euro Liquidity Fund	1,261	-	1,261	20	2%	-0.58	-0.59	-0.58	-0.59	40	42	Aaa-mf	AAAm	AAAmmf			
Morgan Stanley-Euro Liquidity	9,613	-	9,613	224	2%	-0.57	-0.63	-0.57	-0.63	47	49	Aaa-mf	AAAm	AAAmmf			
State Street EUR Liquidity LVNAV Fund	6,361	-	6,361	-45	-1%	-0.57	-0.67	-0.57	-0.67	48	50	Aaa-mf	AAAm	AAAmmf			
UBS (Irl) Select Money Market Fund-EUR	1,328	-	1,328	133	11%	-0.58	-0.63	-0.59	-0.64	43	46	Aaa-mf	AAAm	AAAmmf			
<b>Total/Net</b>	<b>101,843</b>	<b>-</b>	<b>101,843</b>	<b>-2,575</b>	<b>-3%</b>	<b>-0.57</b>	<b>-0.52</b>	<b>-0.57</b>	<b>-0.52</b>								
<b>Maximum</b>										56	58						
<b>Median</b>										46	48						
<b>Minimum</b>										32	32						
<b>Range</b>										24	26						

Source IMMFA

## GOVERNMENT DEPOSITS

- During the Covid crisis in March 2020, Autonomous Factors increased as a consequence to the increase of the Eurozone excess liquidity, albeit at a slower pace
- The Autonomous Factors may reduce liquidity available in money-markets...
- ...and increase volatility all the more so as Government deposits are very sensitive to price and do not deal below the ECB DFR



## CORPORATE FIRMS

- MMFs are widely used by Corporates to manage and invest their excess short-term liquidity
- The Covid crisis in March 2020 affected corporate liquidity and confidence : massive withdrawals from MMFs triggered a freeze on term money-markets as asset managers sought to maintain or even increase liquidity buffers and refrained from investing in financial or non-financial short-term paper
- Liquidity was retrieved after the implementation of PEPP & CSPP
- Corporate firms withdraw liquidity from funds as programs mature in 2021



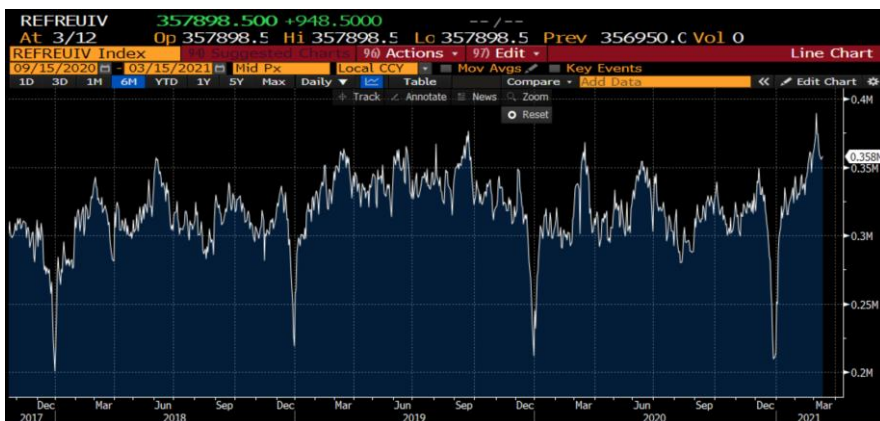
Source Bloomberg : Amundi Cash Corporate Fund

## REPO SEGMENT SHOCK PROOF BUT HIGHLY CYCLICAL

- Euro secured funding market maintains volumes and prices during the COVID crisis...



- ...but remains highly sensitive to regulatory constraints.



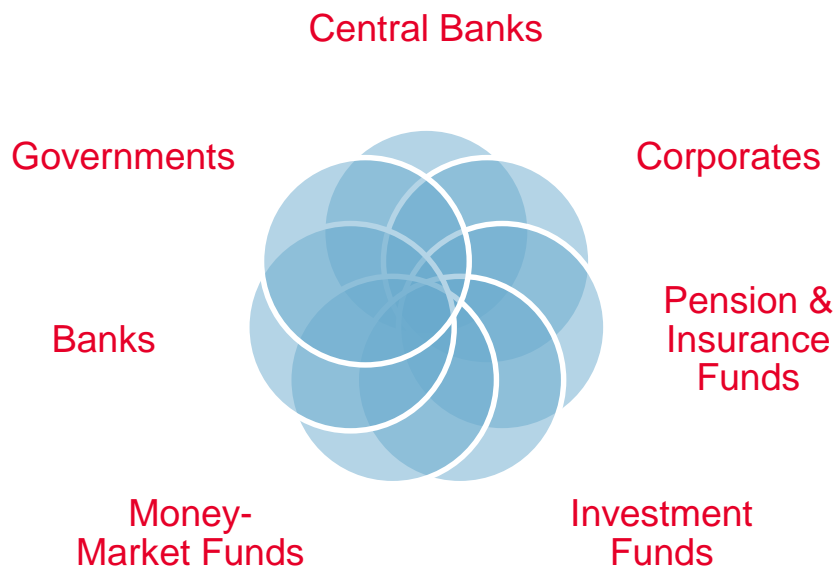
- A sector with high volumes, tight margins and costly in terms of leverage ratio.

Source Bloomberg : Repo Fund Rate Volumes (left charts) and Yield (right charts)

## INCREASED INTERCONNECTION AND DEPENDENCIES

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- During the Covid crisis Corporates drew on bank committed lines and withdrew cash from Money-Market Funds
- MMFs recovered liquidity by selling bank short-term paper
- Banks regulatory ratios were degraded, confidence was shaken
- EUR term unsecured market segment froze completely
- ECB had to step in to restore market confidence and functioning





## HIGHER RISKS TO MARKET STABILITY ?

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- **Risks migrated from banks to non-banks and from a highly regulated environment to a less watched sector**
- **Transformation of liquidity from short to long term relies on modeling and stress-testing**
- **Behavioral models and stress testing scenarios can show inefficiencies (redemptions during the Covid crisis in March 2020 surpassed needs defined by models)**
- **Liquid assets can be subject to market stress when used as a substitute to less-liquid ones : as Equity markets collapsed last March, Euro government securities were pledged in lieu of Equity securities in a chain of settlement fails**
- **Investment in illiquid and long-term assets funded on short-term maturities relies on confidence and low volatility**

## CENTRAL BANK RESPONSE TO THE NON-BANKS ROLE

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- **To what extent is the development of the non-bank sector relevant to the financing of the real economy ?**
- **Is this sector able to absorb exogenous shocks ?**
- **Can there be any further significant increase in the role of non-banks in the Euro money-markets without an adjustment in regulation and Central Bank monetary policy ?**