ICMA

International Capital Market Association

The future of the European Repo market

Tuesday, 11 June 2013

Thomson Reuters, London

Keynote Address

Francesco Papadia

I wish to thank Conception Alonso for her useful suggestions

In order to get an idea about the future let´s look first at the **past**:

1. The role of the Repo market during the crisis

2. The trend growth of the Repo market

The Repo market has lessened the burden on the ECB during the crisis

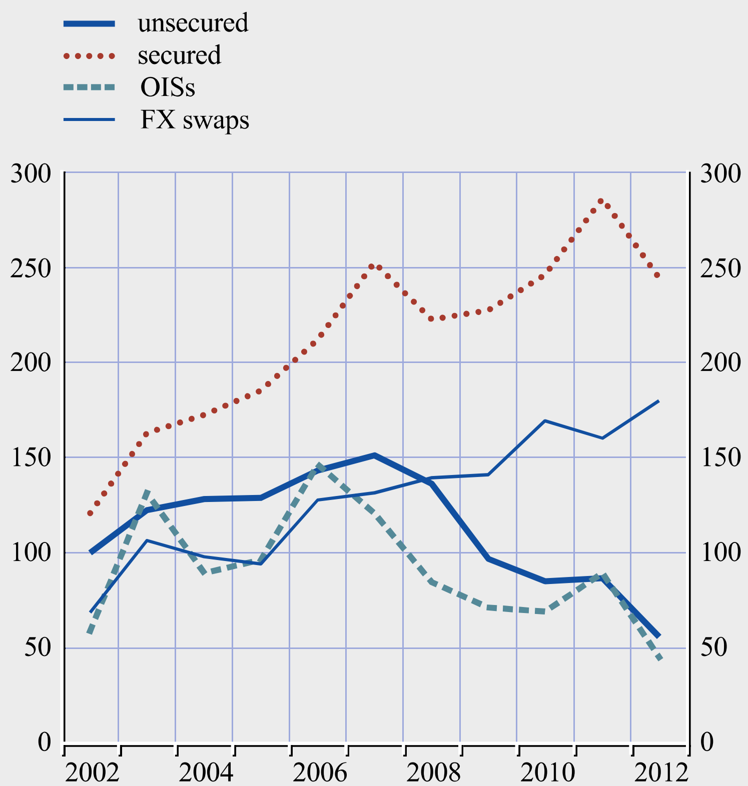
Change in euro money market turnover and increase in Eurosystem balance sheet (2008 – 2011)

Reduction in unsecured turnover (bn)	Increase in secured turnover (bn)	Net reduction of turnover (bn)	Increase in Eurosystem balance sheet (bn)	Substitution between Eurosystem and market intermediation (%)
(1)	(2)	(3) = (1) – (2)	(4)	(5) = (4) / (3)
327	212	115	113	98

The Repo and the swaps are the real winners in the money market

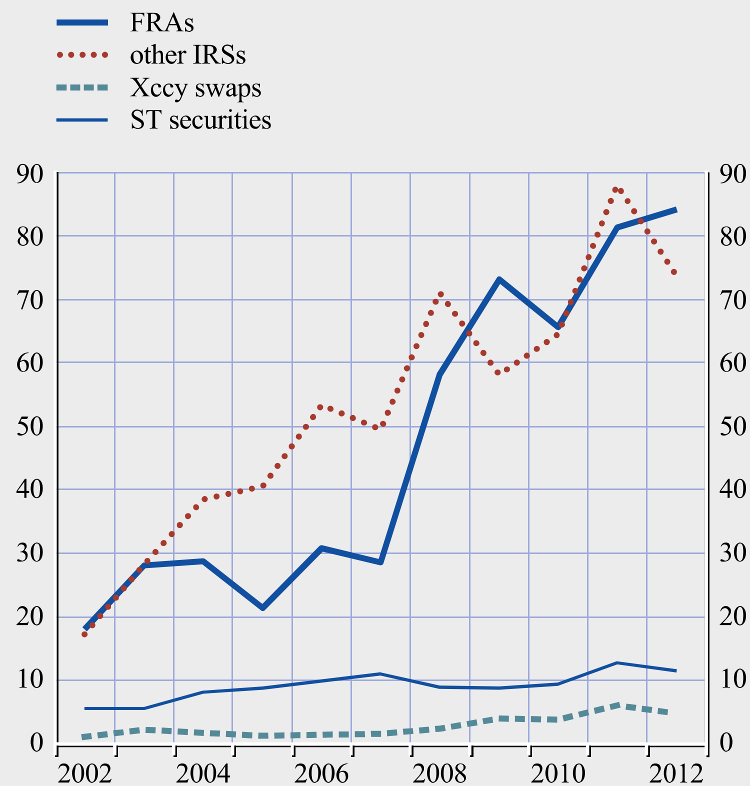
Average daily turnover in various segments

(index: unsecured transaction volume in 2002 = 100)



Note: The panel comprised 105 credit institutions.

(index: unsecured transaction volume in 2002 = 100)



Note: The panel comprised 105 credit institutions.

The Repo segment dwarfs the unsecured one

»

Table 6 Aggregate euro money market survey volumes for 2012

(EUR millions)

	Constant panel	Total panel
Unsecured	**94,443**	**127,805**
lending	32,373	52,840
borrowing	62,070	74,965
Secured	**414,359**	**446,505**
lending	178,399	192,257
borrowing	235,960	254,248
Derivatives	**657,363**	**810,715**
OIS	76,516	100,322
FX swaps	305,185	391,074
IRS	124,940	150,144
Xccy swaps	7,992	12,862
FRA	142,730	156,313
Outright transactions	**19,510**	**23,244**
TOTAL	**1,185 ,675**	**1,408,270**

ICMA
International Capital Market Association

Let´s now turn to the **present** and specifically to the attitude of regulators towars Repo

- Liquidity regulations are favouring the secured money market segment
- The Repo (and the swaps) segment are looked at by central banks as source of reference rates immune from credit risk

Let´s now move to the **future..**

- Availability of collateral
- Effects of the financial transactions tax on the Repo segment

To shift the collateral supply curve:

- Improve the quality of assets
- Improve risk management techniques (portfolio approach)

ICMA International Capital Market Association

The FTT: unsettled thoughts, still two comments

- Nice Pigovian taxes can be found in the financial sphere

- It is not obvious that the FTT is one of them

Why tax secured interbank lending but not unsecured one?

- Making secured lending uneconomical for (variably short) maturities?

- Forcing a permanent shift of interbank transactions from the market to the central bank?

Conclusions

- The growth of the repo market has avoided even more of a dislocation of the money market during the crisis, thus lessening the burden on the ECB to avoid that this would translate in even more acute economic consequences
- The repo market has achieved brisk trend growth since the launch of the euro, such that it now dwarfs in importance the unsecured market
- Banking and liquidity regulation is favouring the growth of the repo market with respect to the unsecured interbank market
- The repo market is seen by central banks as a possible source of reference rates alternative to LIBOR and EURIBOR

ICMA
International Capital Market Association

Conclusions/2

- There are tools that the industry could pursue to increase the availability of collateral for repo operations
- Well targeted taxes on some financial activities can kill two birds with one stone, raising revenue and remedying negative externalities
- The proposed FFT doesn’t seem to belong to this kind of taxes as it would tax repo interbank lending but not unsecured one, leading to a dry-up of repo lending on shorter maturities and possibly to a severe dry up of the entire money market, to be offset by central bank intermediation