Emma Cooper
Head of the Global Fixed Income Financing BlackRock
Sebastien Figue
Head of Paris Central Treasury, BNP PARIBAS ALM Treasury

13th March 2025

ECB Money Market Contact Group

Primary dealers' intermediation capacity and repo markets

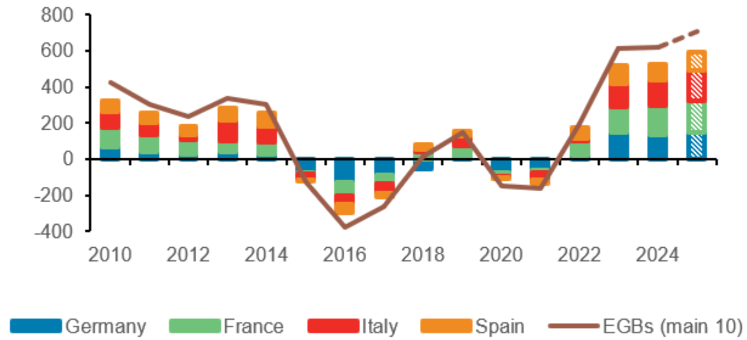
European Landscape

Intermediation

Sponsored Clearing

European landscape: QT + EGB supply on the rise

EGB net supply net of QE/QT hits a record high in 2025
(Eur bn)



**Including retail issuance.*
Sources: National Treasuries, ECB, Bloomberg, BNP Paribas forecasts.

QT on the go, additional supply on top of it.

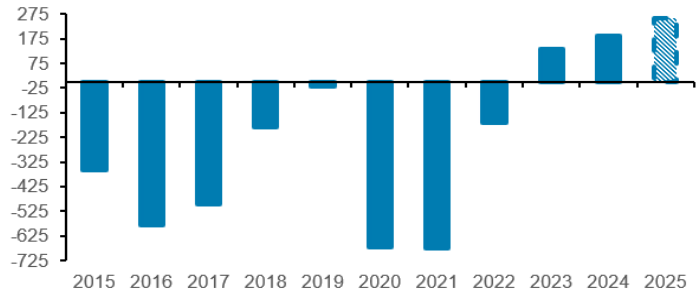
Expandatory supply

- Net supply reaches a record high in 2025
- Italy and Netherlands specifics
- Large budget deficits
- Green and infrastructure spendings

Recent developments

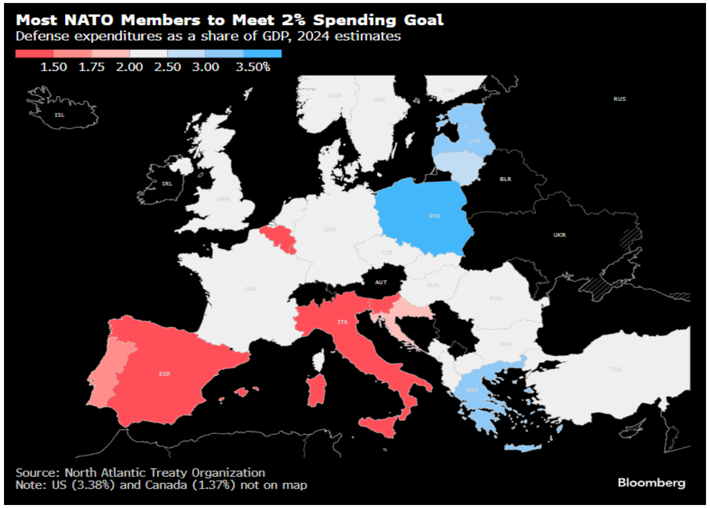
- Germany "Whatever it takes"
- European project for Defense

QT set to accelerate : BNPP estimates of QT across APP and PEPP



Sources: ECB, Bloomberg, BNP Paribas forecasts

Defense spendings elevated in 2024, much more to come.



European Repo Market Landscape

The European repo market continues to grow, navigating record levels of net supply, declining excess liquidity and the demand for intermediation increasing.

European Repo market size (bn)

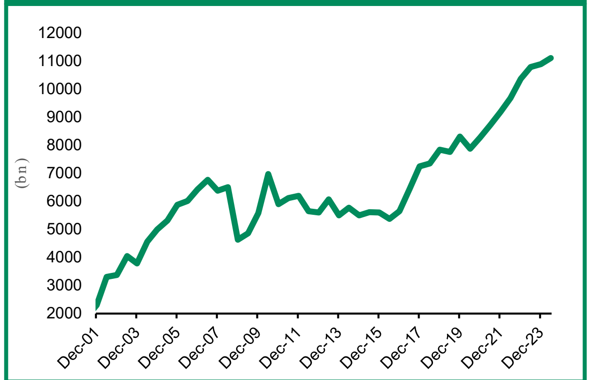


Chart 1. European repo market has seen immense growth over the past 10 years, growing €5.5trn to around **€11.1trn.**

Net EGB Supply (net QE/ QT)

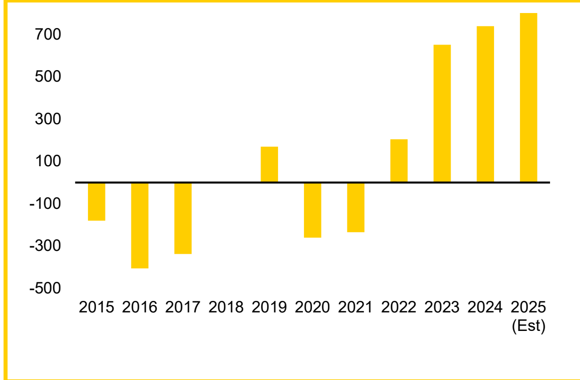


Chart 2. Supply net of QE/ QT has seen record high levels in Europe, requiring private market intermediation, up to **~€800bn (est) for 2025.**

ECB Excess Liquidity

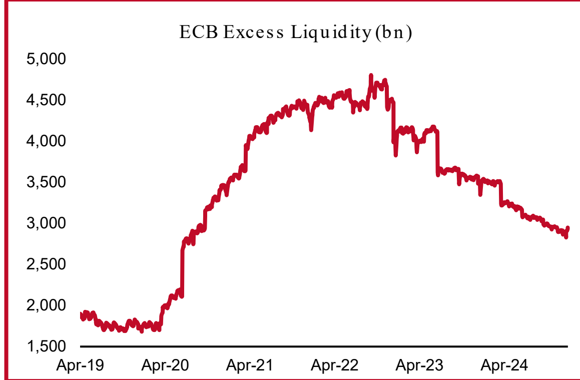


Chart 3. Excess liquidity in Europe has seen a large decline mainly driven by TLTRO III repayments and QT from a high of €4.7trn to under **€3trn.**

EUR MMKT fund AUM*

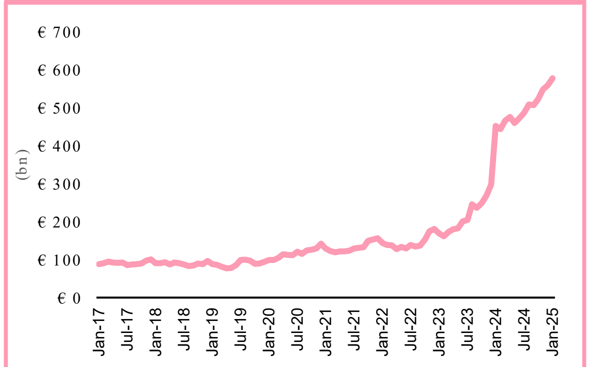


Chart 4. Money Fund inflows have seen a **steep trajectory**. Any reversal of this trend could lead to funding gaps and higher repo rates.

Counterparty Concentration

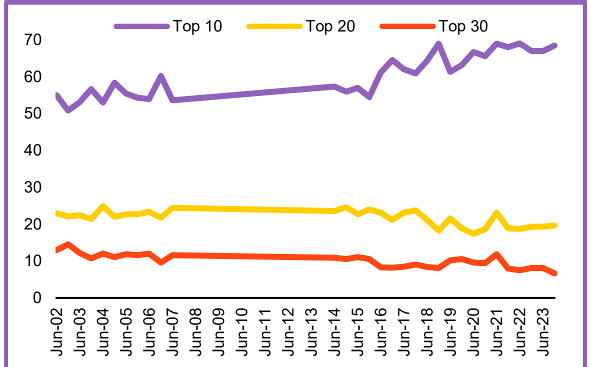


Chart 5. Concentration for the top 10 counterparties has increased from close to **50% up to 70%** over the years.

Growth

- European Repo market growth is likely to continue, meaning a bigger demand for bank intermediation.
- Repo Markets **may** struggle to absorb **all** funding needs if excess liquidity in the Eurosystem drops below 2trn €.

Increased concentration

- As repo markets grow, we expect the **concentration** of the top 10 counterparties to **increase further**.

Higher funding costs

- Wider spreads are expected to continue as we see **excess cash in the system decrease** while **supply** expectations for 2025 reach **record highs**.

Sources: Chart 1. ICMA June 2024 Repo Survey; Chart 2. Barclay's Research '2025 sovereign issuance compendium'; Chart 3. *Bloomberg ECB Excess Liquidity; Chart 4. iMoneyNet ; 5. ICMA 2001 -2024 Repo Survey*

Increasing Intermediation Costs Globally

High levels of global supply have created challenges for the market to transfer liquidity, as banks face increasing capital costs and balance sheet constraints

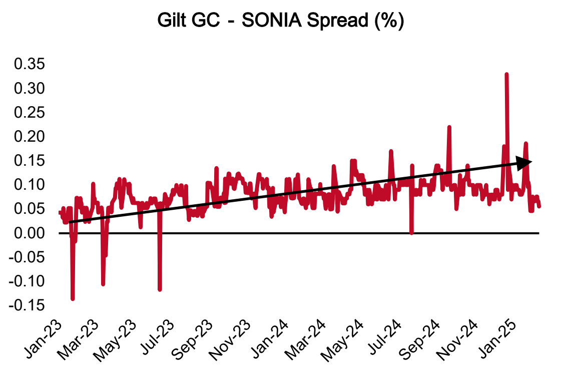


Chart 1. Gilt GC, as a spread to Gilt OIS, continues to trend higher, especially around statement dates and supply events.

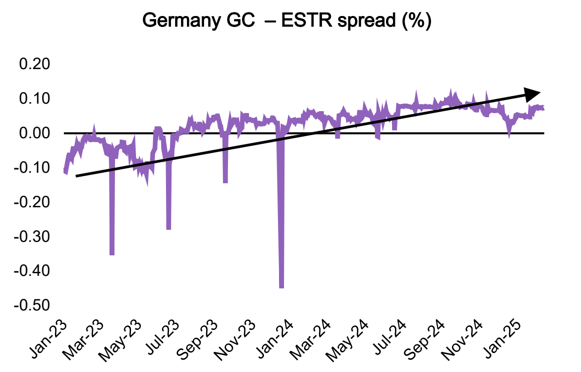


Chart 2. EGB spreads to ESTR are now positive as we have moved away from the collateral scarcity environment, which dominated post COVID.

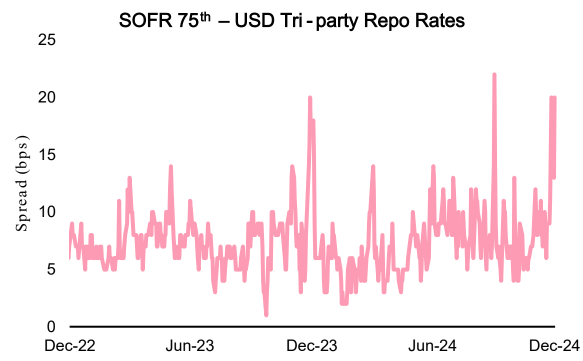


Chart 3. In the US funding spreads have widened, and we see increased volatility in GC levels especially around statement and settlement dates.

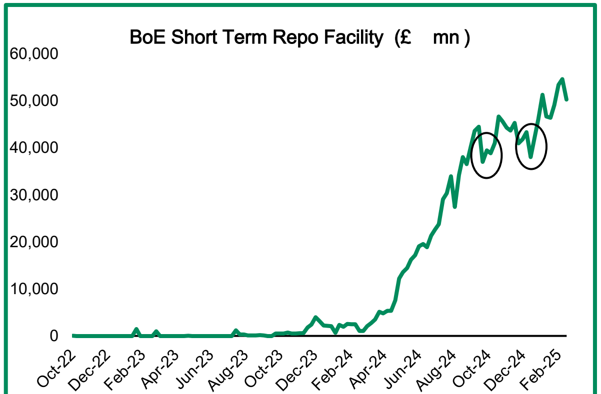


Chart 4. BoE STR usage has increased, but we have observed a reduction over the past two quarter ends, as it is a balance sheet intensive product

Intermediation

As **demand for funding increases** given the large amount of supply outstanding, we expect intermediation to become more challenging, as bank balance sheets have not grown at the rate of global government debt.

Central Bank Facilities

As **excess liquidity continues to decline**, central bank facilities such as the MRO could shift from a backstop to additional cash raising tool. However, such tools are also balance sheet intensive.

Regulatory impact

<u>Bank</u>: **Increasing regulation** (Leverage ratio, RWA, GSIB) **limits the ability to serve clients**. Regulation significantly limits access to a banks balance sheet.

<u>End user</u>: faces **rising funding costs,** and difficulties in **accessing repo markets** at certain times of the year. Investors need the ability to raise short-term cash and are **increasingly reliant on repo markets,** as market liquidity for the outright sale of assets has declined.

Sources: Chart 1. BlackRock, Chart 2. BlackRock; Chart 3. The Fed; Chart 4. Bloomberg

Primary Dealers capacity to intermediate, headwinds and enablers

Regulatory framework

Capital allocation is key

- GSIB, Leverage ratio, RWA's, FRTB for MtM activities
- OCI and CSRBB for non-MtM books
- Punitive regulations = reduced access to Balance Sheet

Bank's internal framework

Balance Sheet vs profitability

- Market share / Rankings
- Strategic clients servicing
- Leverage exposure's allocation

Market structure

Fragmentation can be negative

- Illiquid bonds / bonds held to maturity
- Repo specialness vs "no way out"
- Lower number of lines would help
- Issuers who can tap illiquid lines help the functioning

Positive factors

Competitive advantage

- EGB's relative value
- Delay for new regulations
- EU issuances, Capital Market harmonization

Treasury Repo Market

US repo markets are more developed than European repo markets given they benefit from the Fed's Reverse Repo and FICC's Sponsored Repo Programs. This ability to transfer liquidity within the system has increased repo market capacity at a time when dealer balance sheets have been more constrained due to increased supply and higher demand for intermediation. The move to mandatory Treasury Clearing however, could introduce unintended consequences such as market consolidation and widening liquidity gaps.

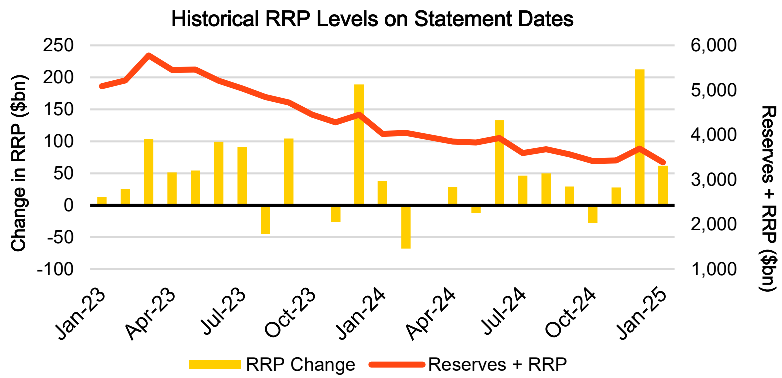


Chart 1: Ongoing **QT reduces liquidity from the system**. This reduces the flow of funds, especially on statement dates, leading to an increase in RRP balances.

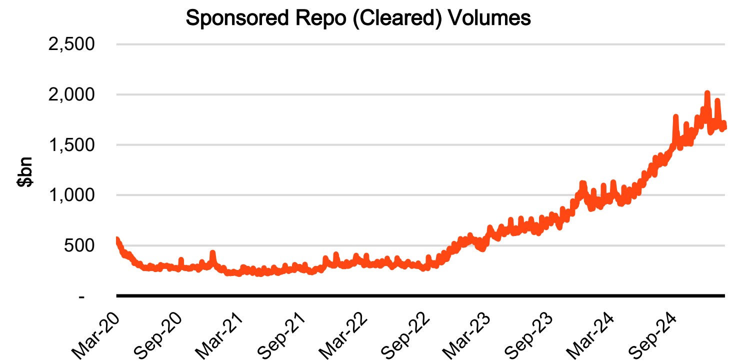


Chart 2: Outstanding Treasury debt has **grown by 60%** over the past 5 years; **increasing adoption of Sponsored Repo since 2022** has enabled Dealers to increase treasury holdings despite regulatory constraints.

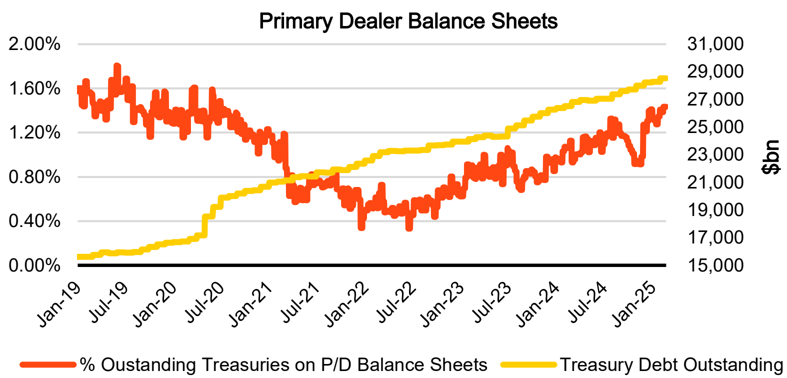


Chart 3: The adoption of Sponsored Repo has **mitigated balance sheet constraints** and cross-jurisdictional exposures for banks. This improvement in intermediation has **increased capacity in funding markets**

Ongoing items to be addressed for US mandatory clearing

Margin

Introducing a capital efficient margin regime is integral to increasing treasury liquidity

Infrastructure and technology build out

Clearing is operationally complex, especially with multiple models and CCPs still refining their frameworks, requiring additional development

Regulatory & balance sheet considerations

Clearing alone does not resolve bank capital treatment issues

Legal and accounting uncertainties

Documentation will need to evolve to accommodate new clearing agencies and access models

Sources: Chart 1. NY Fed, Federal Reserve H.4.1; Chart 2. DTCC; Chart 3. NY Fed, Treasury.gov

Repo Clearing in Europe

The European repo ecosystem is more complex than the U.S, and the clearing model is still evolving. There is no one size solu tio n to repo market optimisation; we believe clearing for the buy side should be seen as an additional voluntary tool to support market fu nct ioning during times of stress & low bank intermediation.

Why is adoption of client clearing in European CCPs low?

Liquidity

CCP liquidity is concentrated in short dates. Banks are incentivised to clear if they observe increased netting opportunities: maturity mismatches across their client base (MMF's in overnight vs Pension funds in term) does not increase the amount of netting, leaving a maturity mismatch

Market Structure

Limited Sponsored Agent Banks are supporting client clearing and few custodians have developed CCP workflows and connectivity

Margin

Clearing introduces VM and IM which increases the overall cost of the trade and increases procyclicality risks during times of market stress

Buy-side Access

Inconsistent access models based on underlying client / fund, Client eligibility differs across CCPS: for larger asset managers, not all clients get access

Client Eligibility

Further clarity on limits and haircuts applied to Money Market Funds

Opportunities for Industry Engagement

- **Partner with CCP's** to evolve buy side models to incentivise voluntary adoption across client types.
- **Enhanced CCP margin transparency** & **Expand collateral eligibility** to address procyclicality risks
- **Standardised maturities** to increase netting opportunities
- **Enhanced transparency** into buy & sell liquidity axes at CCPs
- Better understanding of **bilat vs cleared cost analysis** from banks
- **Scalable workflows** using existing infrastructure
- Improve **client access** through Custodian & PB adoption

We recommend observing the evolution of US Repo Treasury clearing and working to incentivise EU buy side voluntary adoption.

Discussion

Can Capital Market union help the bank’s capacity to efficiently intermediate ?

What is needed to enable banks to increase Intermediation capabilities ?

Is mandatory clearing necessary in Europe? How can industry increase adoption?

What other solutions are there to enhance intermediation capacity ?

To what extent does regulatory capital and liquidity requirements (e.g., Basel III, LCR, NSFR) constrain banks' ability to act as intermediaries in repo markets?

Important Information

This material is for distribution to Professional Clients (as defined by the Financial Conduct Authority or MiFID Rules) only and should not be relied upon by any other persons.

In the European Economic Area (EEA): this is Issued by BlackRock (Netherlands) B.V. is authorised and regulated by the Netherlands Authority for the Financial Markets. Registered office Amstelplein 1, 1096 HA, Amsterdam, Tel: 020 – 549 5200, Tel: 31 -20-549-5200. Trade Register No. 17068311 For your protection telephone calls are usually recorded.

Any research in this document has been procured and may have been acted on by BlackRock for its own purpose. The results of such research are being made available only incidentally. The views expressed do not constitute investment or any other advice and are subject to change. They do not necessarily reflect the views of any company in the BlackRock Group or any part thereof and no assurances are made as to their accuracy.

This document is for information purposes only and does not constitute an offer or invitation to anyone to invest in any BlackRock funds and has not been prepared in connection with any such offer.