Box 6

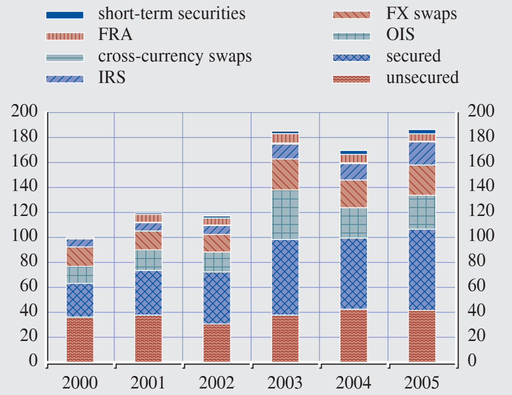
STRUCTURAL TRENDS IN THE EURO MONEY MARKET

On 20 January 2006, the ECB published its sixth study of the structure and functioning of the euro money market. A new feature of the study is that it also covered the 10 Member States which joined the EU on 1 May 2004. Similar to earlier studies, the 2005 study was based on data collected from banks, and it covered the second quarters of 2004 and 2005. To keep the results comparable with earlier studies, the study was split into two parts, the first analysing data from banks residing in countries, which were EU Member States prior to 1 May 2004 and the second focusing on data from banks located in the other EU Member States. This Box reports on some of the main findings of the first part of the study. Overall, four main developments can be identified.

First, the aggregated turnover of the euro money market increased in the year to Q2 2005, returning to levels similar to those seen in 2003. Activity increased in most of the money market segments, while the estimated turnover in unsecured, cross-currency swaps and forward rate agreement (FRA) segments declined slightly from the levels seen in the second quarter of 2004.

Second, the secured (repo) market continued to grow and, at around 35% of the aggregated money market turnover, remained the largest of the money market segments. Increasing turnover in secured markets over recent years has been linked to several factors, including a general increase in securitisation in financial markets, an increasing desire among market participants to limit their counterparty risks, and a further deepening of financial market integration in the euro area. Another development related to the increase in the secured market segment was a substantial increase in tri-party repo activity.[1] This development is welcome from a financial stability point of view, as it reduces counterparty and operational risks related to settlement.

Chart B6.1 Aggregated euro money market turnover by market segment in the countries that joined the EU before 1 May 2004



Source: ECB (2006), *Euro Money Market Survey 2005*.

Third, activity in OTC money market derivatives picked up in the year to Q2 2005, especially in the overnight index swap (OIS) and other interest rate swap (IRS) segments. However, total turnover in the OTC derivatives markets still remained lower than in Q2 2003. One of the reasons for the increase in interest rate swap activity in the first two quarters of 2005 was that market participants' expectations that the ECB would raise interest rates had intensified. Furthermore, in the OIS and IRS segments, the use of electronic trading platforms also increased compared with the previous year.[2] From a financial stability viewpoint, the increase in derivatives trading activity can have both positive and negative impacts. On the one hand, these instruments can be used to hedge interest rate risks, and therefore can have a positive impact on financial stability. On the other hand, they can also be used for speculative purposes, which might raise some concerns from a financial stability viewpoint if this were to lead to a build-up in significant derivatives positions.

Fourth, there were no large changes in measures of concentration and efficiency in different money market segments between Q2 2004 and Q2 2005. For instance, the OTC derivatives markets and short-term securities markets remained the most concentrated money market segments (with the ten largest institutions accounting for around 70-80% of the total turnover), while lending and borrowing in both secured and unsecured markets remained far less concentrated (here the ten largest institutions accounted for around 50-55% of the total turnover).

1 A tri-party repo involves a third party, commonly a custodian bank, acting as an agent to exchange cash and collateral for one or both counterparties with new positions.
2 According to the survey, secured (repo) and FRA products are most often traded on electronic trading platforms, while other money market instruments are more often traded either directly with a counterparty or through a voice broker.