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Money Market Update:

Naughty German bankers, French banks still king in repo, and a desperate ECB

January 27, 2026

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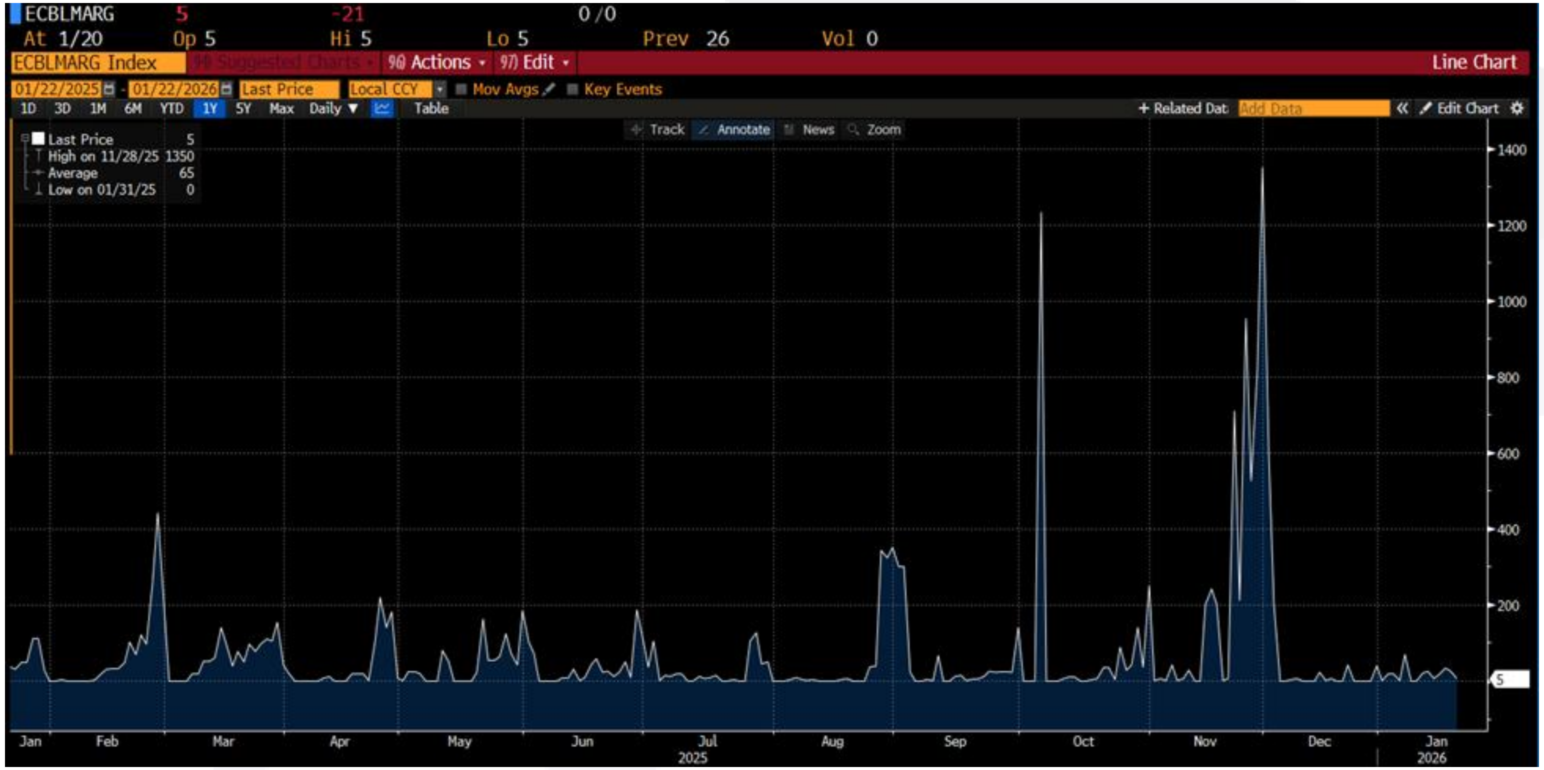
Key Points

- **When we dissect recent Eurozone money market developments, we still see the same old picture of a stable market: gradual and linear increases in money market spreads because of ongoing ECB QT and a large amount of bank reserves locked up at Euroclear.** Thus, we haven't yet reached the steep part of the demand curve for reserves. And we won't reach that point this year even though excess reserves will barely stand at 2 trillion euros by year-end;
- **Yes, there has been a sudden spike in ECB marginal lending.** But that's an oddity and not a sign of a shortage of reserves in pockets of the Eurozone banking system. Likely a single German bank was to blame for the spike;
- **Excess reserves have decreased by almost fifty percent from the peak, but demand for ECB refinancing has remained low and stable.** Much to the chagrin of the ECB, which has sent out a press release begging banks to borrow;
- **French banks have increased their repo borrowing and French Target2 liabilities have increased further, but without unsettling the money market.** With France having finally adopted its austerity-lite budget, we do not need to worry about France for a while;
- **The euro has richened in the basis and now commands a premium over the dollar.** That reflects divergent money market developments. In the US bank reserves are slowly increasing because of the Fed's bill purchases, which has anchored US money market rates. Excess reserves in the Euro Area continue to fall at a relatively brisk pace – meaning that money spreads will tighten further. The Fed prefers ample reserves and as little borrowing by banks as possible. The ECB wants a much lower level of excess reserves and banks to show up much more often at refinancing;
- **In the greater scheme of things, an unconstrained President Trump will likely shrink US net capital inflows ('sell America', 'quiet quitting' of US assets).** That, and increased demand to hedge dollar exposure, could explain the basis having flipped from a dollar premium to a euro premium.

Marginal lending spikes

- **One of the few indicators that points to increased demand for reserves, is recourse to the Eurosystem's marginal lending facility.** We had a couple of spikes in overnight borrowing in Q4, when borrowings jumped to a billion euros – significant when we consider that recourse to the regular standing facilities has been languishing around 20-25 billion euros;
- **Remember, recourse to the marginal lending facility is penalized with an interest rate 25bps over Main Refinancing rate (which applies to LTROs and MROs);**



Blame zee Germans

- **With a little bit of work, one can find which national central bank is doling out bank reserves with marginal lending.** With some delay, the ECB publishes the disaggregated balance sheet of the Eurosystem. So, the balance sheets of all the national central banks, plus the ECB itself;
- **Luck would have it that the borrowing spike of 1.35 billion euros took place on 28 November, which was the reference date for the disaggregated balance sheet.** Furthermore, the ECB publishes the release dates of the disaggregated balance sheet in advance. Meaning that the borrowing bank(s) should have known that there would be some information out in the open;
- **It turns out one – or perhaps more than one – German bank was fully responsible for the spike.** Unfortunately, the ECB does not publish information on the number of counterparties that borrowed. However, if you dig around a bit in public regulatory announcements, it's not very difficult to come up with a suspect…

Disaggregated financial statement of the Eurosystem[1]

Reference Date:	28.11.2025
Denomination:	EUR millions

[1] For further information on the figures presented in this table please refer to the explanatory note

Assets	Germany	Total Eurosystem
1 Gold and gold receivables	**349,991**	**1,128,571**
2 Claims on non-euro area residents denominated in foreign currency	**86,595**	**497,351**
2.1 Receivables from the IMF	54,615	224,404
2.2 Balances with banks and security investments, external loans and other external assets	31,980	272,947
3 Claims on euro area residents denominated in foreign currency	**975**	**21,273**
4 Claims on non-euro area residents denominated in euro	**79**	**30,228**
4.1 Balances with banks, security investments and loans	79	30,228
4.2 Claims arising from the credit facility under ERM II	0	0
5 Lending to euro area credit institutions related to monetary policy operations denominated in euro	**6,462**	**24,580**
5.1 Main refinancing operations	2,255	12,068
5.2 Longer-term refinancing operations	2,857	11,162
5.3 Fine-tuning reverse operations	0	0
5.4 Structural reverse operations	0	0
5.5 Marginal lending facility	1,350	1,350
5.6 Credits related to margin calls	0	0
6 Other claims on euro area credit institutions denominated in euro	**4,545**	**20,486**
7 Securities of euro area residents denominated in euro	**792,608**	**4,082,148**
7.1 Securities held for monetary policy purposes	792,608	3,769,203
7.2 Other securities	0	312,945
8 General government debt denominated in euro	**3,995**	**20,171**
9 Other assets	**22,473**	**318,909**
Intra-Eurosystem assets	**1,054,288**	**0**
Participating interest in ECB	2,786	0
Claims equivalent to the transfer of foreign reserves	10,802	0
Other claims within the Eurosystem	0	0
Claims related to TARGET	1,040,700	0
Net claims related to the allocation of euro banknotes within the Eurosystem	0	0
TOTAL ASSETS	**2,322,011**	**6,143,717**

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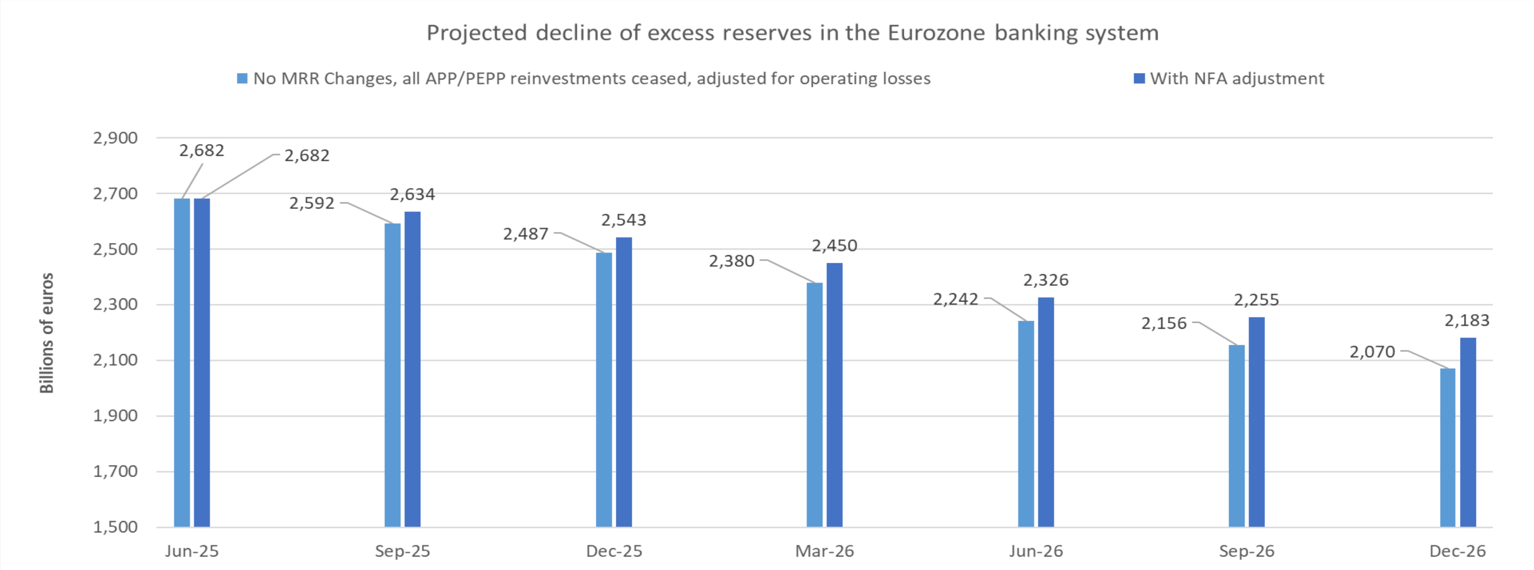
Full steam ahead for QT

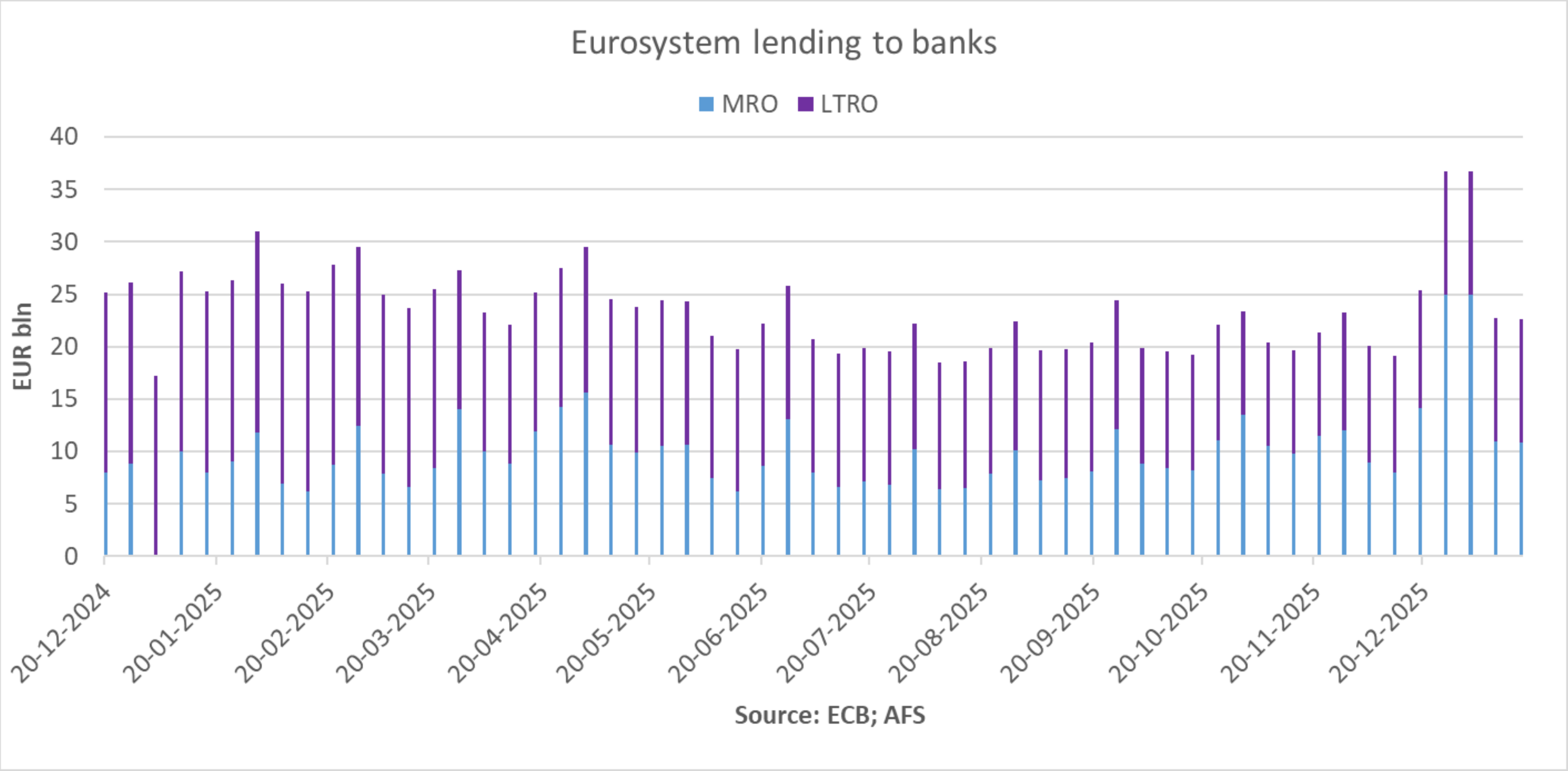
- **In the greater scheme of things, ECB QT is proceeding according to plan.** Based on the ECB's publicly available redemption schedule, this year 502 billion euros in bonds will roll off the Eurosystem's balance sheet. Because other so-called autonomous factors on the Eurosystem balance sheet will likely keep adding liquidity, bank reserves will fall by less than the notional QT amount of 502 billion euros;
- **In particular, I estimate that non-monetary asset purchases (Net Financial Assets in ECB jargon) will boost bank reserves by about 5 billion euros a month.** That's a bit higher than the average monthly pace over the past twelve months (3.6 billion euros), though net asset holdings growth accelerated in recent months.
- **Note that I assume quarterly growth of 10 billion euros in MRO/LTRO uptake.** A rather optimistic assessment, I know.



Source: ECB; AFS

MRO/LTRO demand in the gutter

- **ECB QT has destroyed 1.2 trillion euros in reserves, but demand for refinancing hasn't budged.** Except for year-end spikes, the total stock of MROs and LTROs outstanding is low and stable at 20-25 billion euros.



Begging central bankers

- **Even the ECB is getting impatient with banks not showing up at the regular refinancing window.** On December 19, the ECB sent out a rather unusual press release, begging banks to at least give the MROs/LTROs a try for symbolic amounts:

PRESS RELEASE

Counterparties invited to regularly test their operational readiness to access Eurosystem standard refinancing operations

19 December 2025

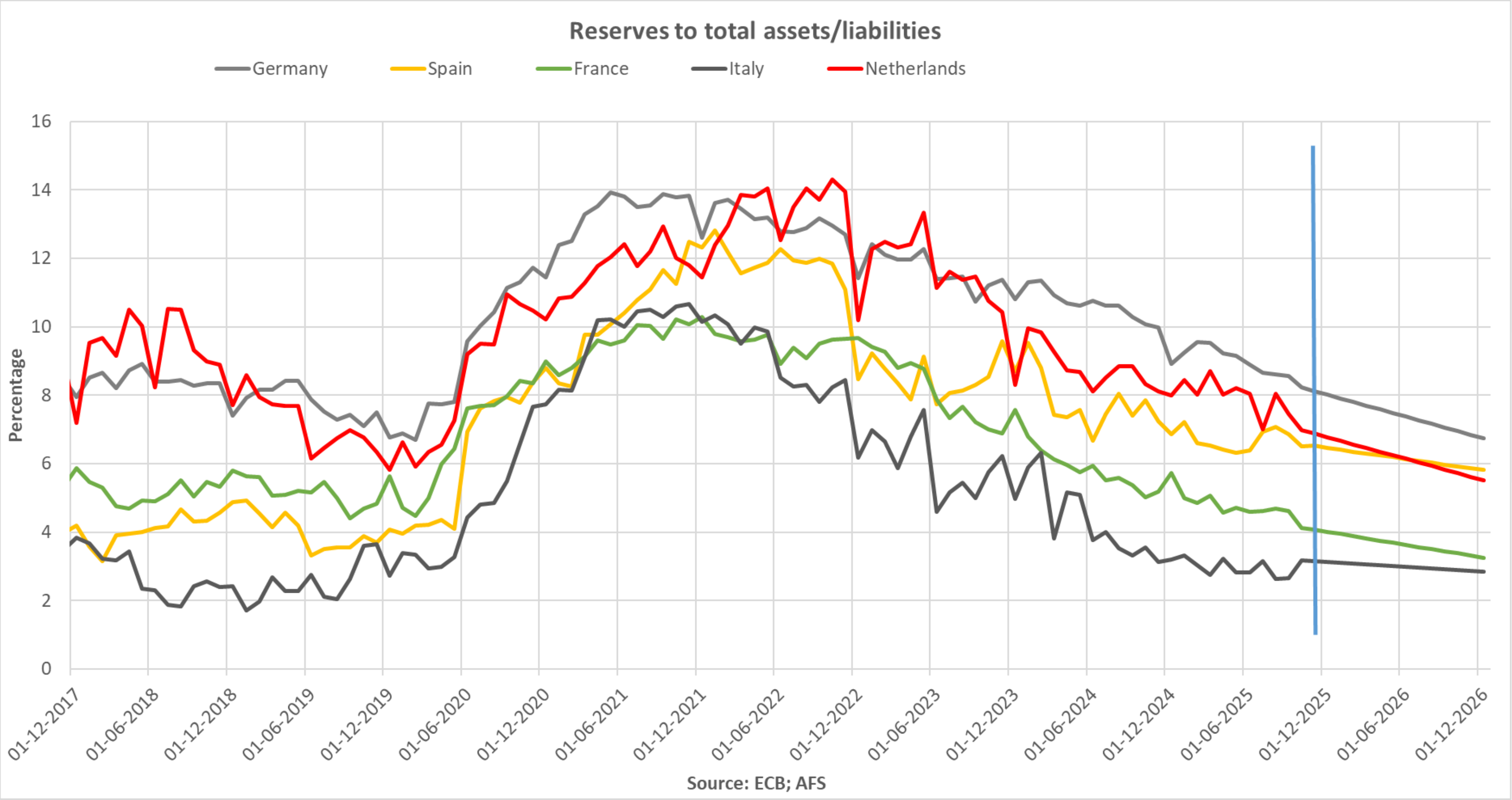
- Counterparties invited to access Eurosystem standard refinancing operations at least once a year, with a bid amount at their discretion
- Eurosystem standard refinancing operations seen as an integral part of banks' day-to-day liquidity management

Although excess liquidity remains significant, the amount of central bank liquidity currently available to banks in the euro area has declined from its peak at the end of 2022 and is expected to continue declining gradually as the Eurosystem balance sheet normalises.

In this context, the ECB expects counterparties to step up their operational preparedness as of 2026 by voluntarily testing their access to the main refinancing operations (MROs) and/or the three-month longer-term refinancing operations (LTROs) at least once per year, with a bid amount at their discretion and against collateral in accordance with the Eurosystem general collateral framework.

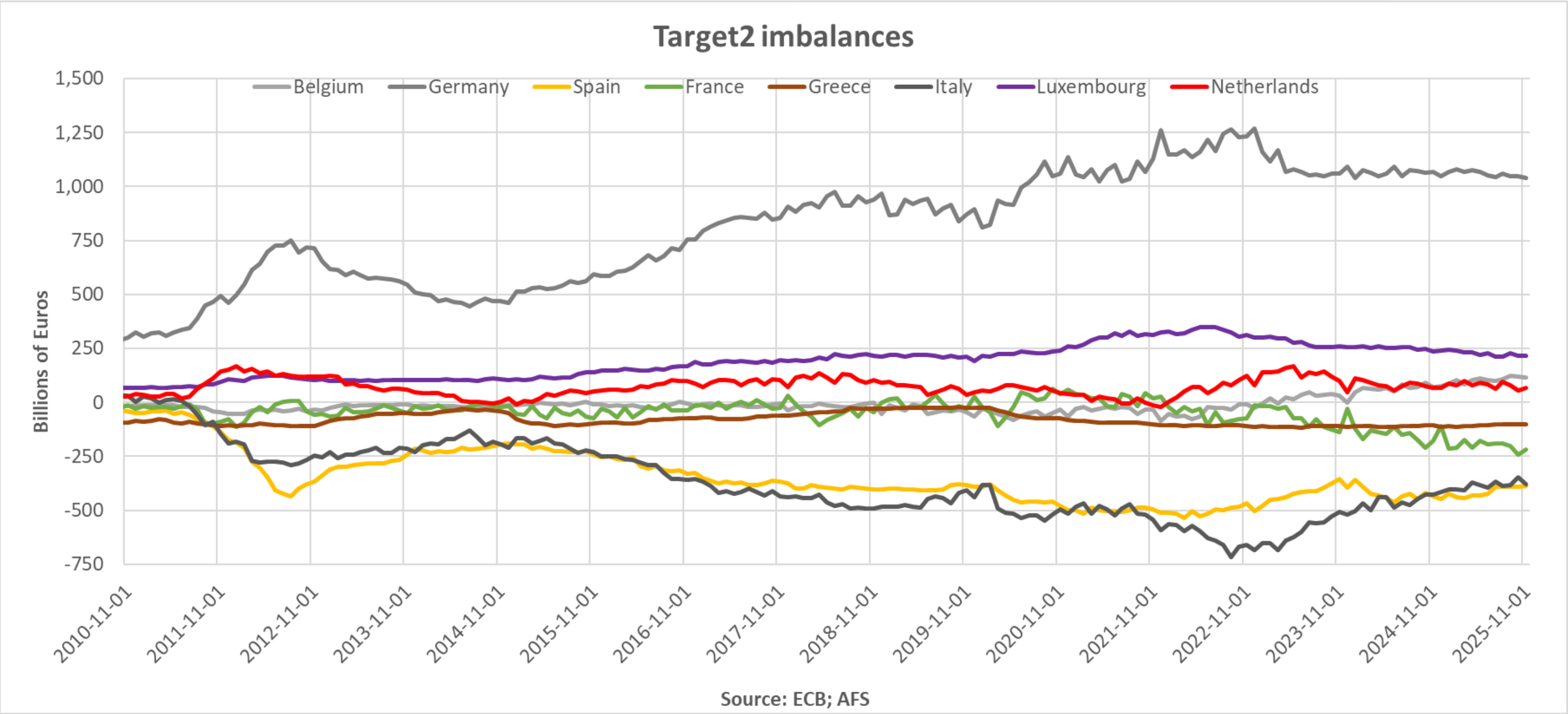
The French problem

- **I used to be quite worried about the liquidity position – reserves to total assets/liabilities – of French banks.** French banks have lost reserves to the benefit of Italian banks in 2023-2025, a trend I expect will continue based on intra-Eurozone capital flows.



Target2

- **Target2 balances allow us to track the net flow of bank reserves between member states.** When Target2 liabilities increase or Target2 claims fall in a member state, bank reserves decline in this member state and rise elsewhere in the Eurozone (and vice versa);
- **French Target2 liabilities stood at a record 240 billion euros last October before falling to 217 billion euros in November.** French banks losing reserves hasn't had an appreciable effect on money market benchmarks. And neither do we at AFS see a relative increase in quoted prices for unsecured borrowing by the big French banks.



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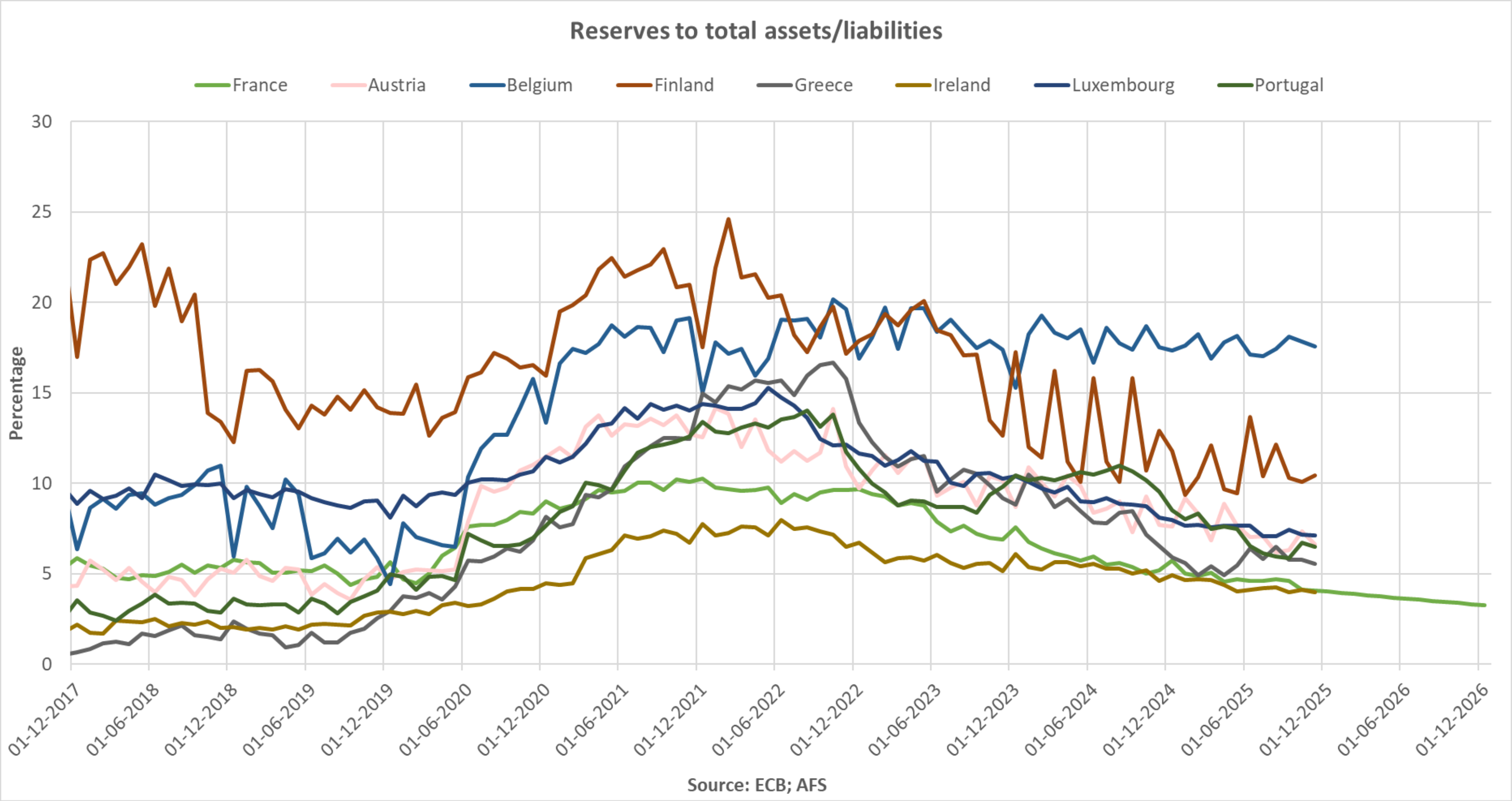
Belgium=liquidity sink

- **If you look closely at the Target2 graph on the prior page, you may have noticed that Belgian Target2 claims are on the rise.** That's because of Euroclear in Brussels still acts as a liquidity sink, having drained roughly 150 billion euros in reserves from the Eurozone banking system. These reserves are sterilized, or locked up – much like banks' required reserves are equally immobile;
- **Euroclear cannot reinvest the proceeds of Russia's foreign exchange holdings, which in large part are invested in French and German sovereign debt.** When governments redeem the bonds, they pay in bank reserves to the custodian, Euroclear. Euroclear cannot invest the reserves reflecting the principal of maturing bonds in the market. It is, however, allowed to invest the interest it receives from the Eurosystem on the reserves that reflect the principal of Russia's redeemed government bonds.

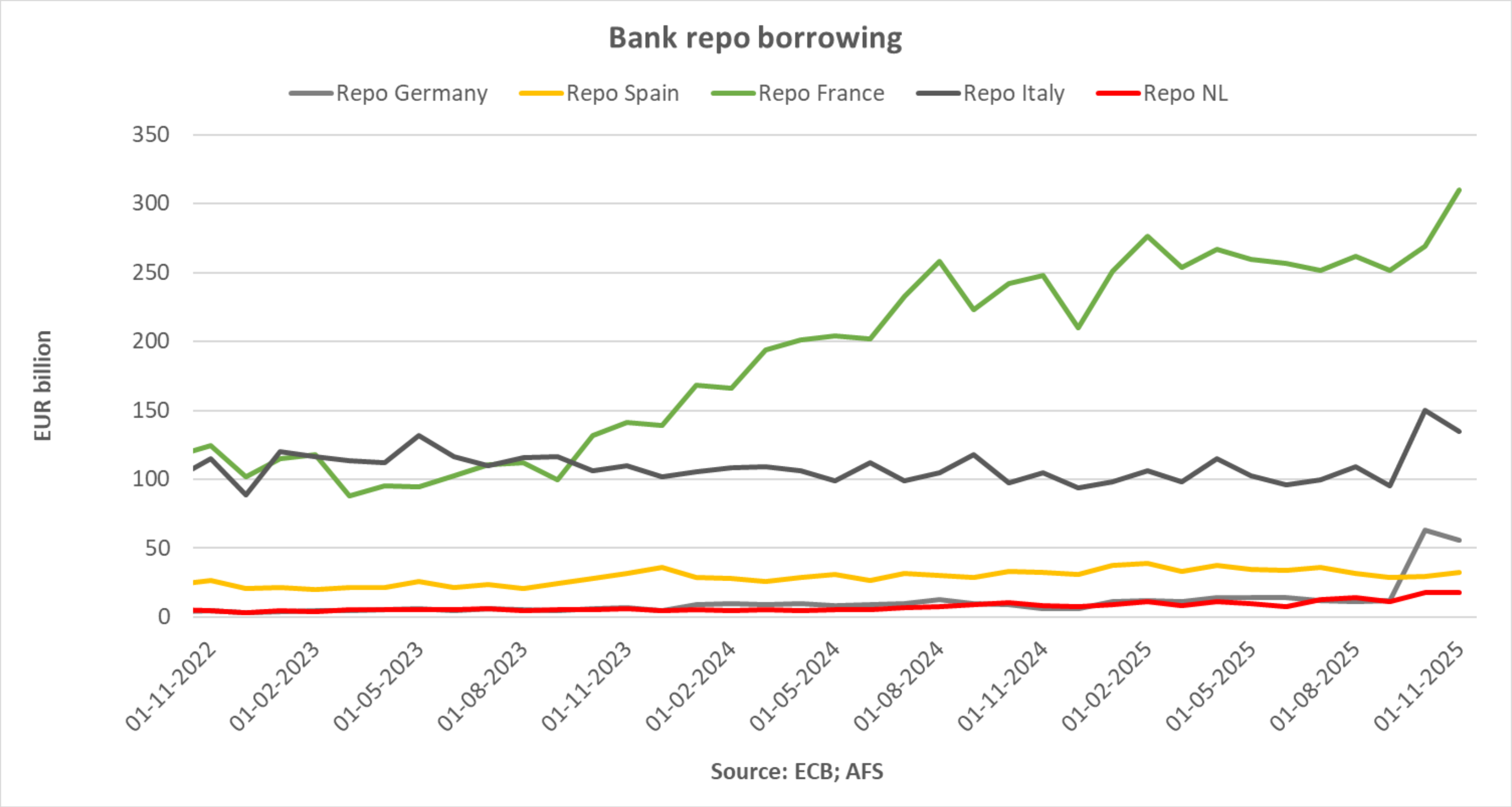
Belgium=liquidity sink

- **We can see Euroclear's peculiar position as the Euro Area banking system by looking at the reserve ratio of the banking system.** The banking system of Belgium appears unduly liquid, with an unchanged reserve ratio since the ECB kicked off Quantitative Tightening in 2023.



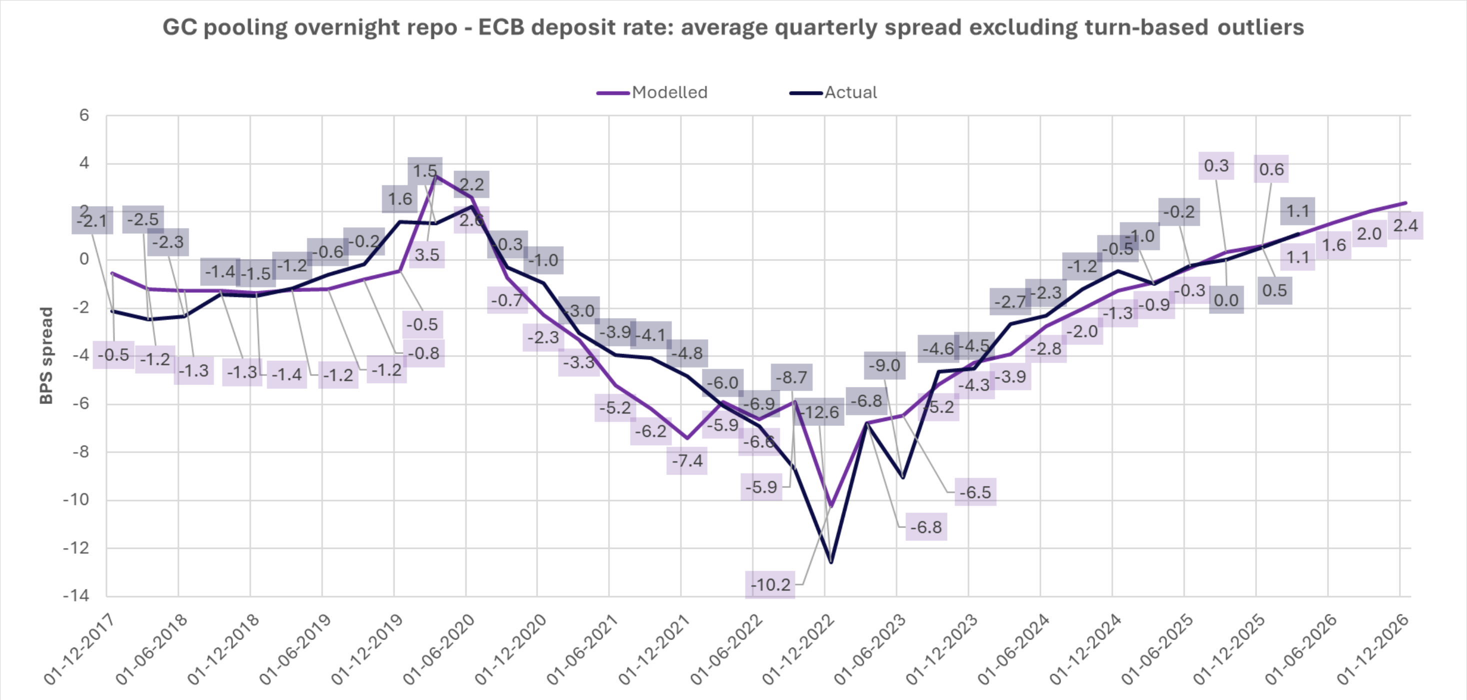
King in Repo

- **Elsewhere, French banks are still king in repo space, with notionally the largest amount of repo borrowing outstanding.** Still, French banks’ increased recourse to the repo market has yet to affect the repo benchmark that we track, Eurex GC repo.



No repo spikes

- **Almost two years ago (time flies…) I concocted a simple model for the spread between ECB DFR and Eurex GC repo.** That model still works like clockwork. Average quarterly settlements of GC repo (excluding turn-based outliers) are exactly where I expect them to be;
- **The model is linear, with the independent variable being the ratio between bank reserves and 'collateral.'** Collateral is defined as the sum of Dutch, French, German sovereign and agency bonds, plus extreme high-quality covered bonds. Basically, the composition of the Eurex ECB HQLA basket. Note that I exclude Eurosystem holdings and the ever-shrining pool of Russian holdings since the are not freely available in the secured market (ECB-held bonds only available at a stiff penalty rate).



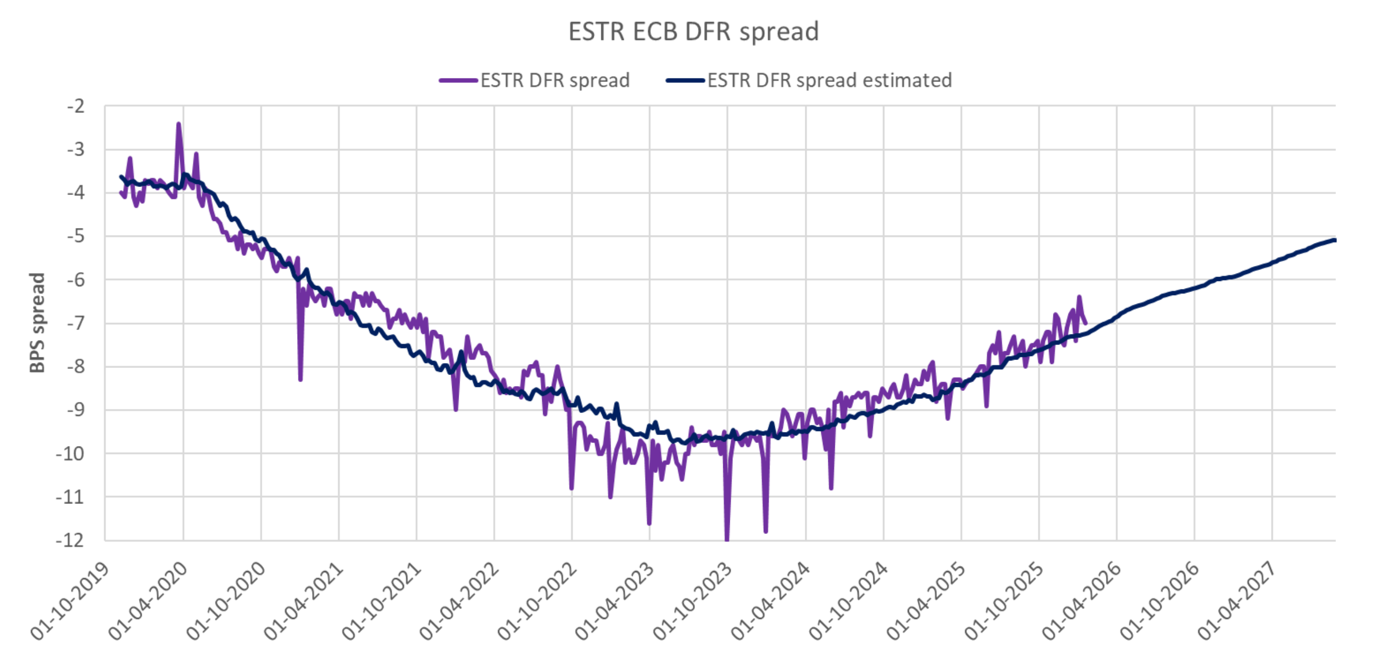
Source: ECB; Bloomberg; Finanzagentur; AMECO; AFS

Repo is normalizing

- **The key takeaway from the steady increases in GC repo relative to ECB DFR is that we're still at the linear part of the demand curve for reserves.** Meaning that the tightening of the GC repo-DFR spread is still proportional to the decrease in bank reserves and the increase in collateral;
- **At some point we will reach the steeper part of the demand curve for reserves.** When we arrive at this point, increases in GC repo relative to ECB DFR will be proportionally stronger. That's when the model finally breaks down;
- **Around the summer, the GC repo-DFR spread should match the spread on the eve of the pandemic (late 2019).** So, we're currently still in a normalization phase.

ESTR in the slow lane

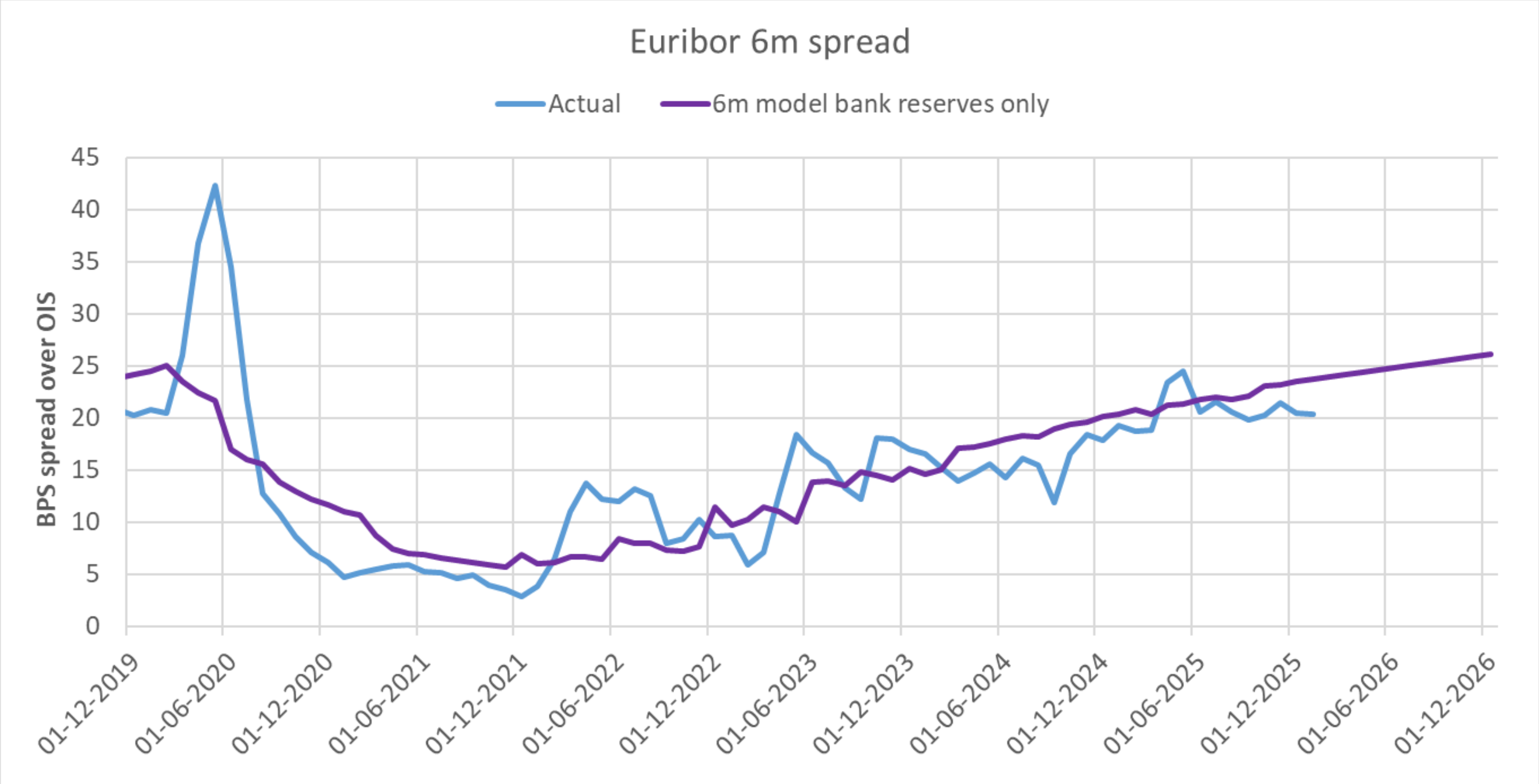
- **ESTR-DFR spread normalization has lagged repo-DFR.** That's because of the double whammy of ECB QT and persistent and structural fiscal deficits, which have turbo-charged non-Eurosystem holdings of government debt. Put differently, unsecured money market spreads tighten because of the decline in excess reserves. But secured rates are rising faster because of the rapid growth in collateral;
- **The ESTR model has autonomous factors on the Eurosystem balance sheet and unborrowed bank reserves as independent variables, allowing for a timely weekly forecast.** Actual settlements appear volatile, but that's because I took the week-end settlement, not the weekly average settlement (laziness with Bloomberg). In any case, the story is the same: we're still at the linear part of the demand curve for reserves. And spread increases are still proportional to decrease in bank reserves.



Source: ECB; Bloomberg; AFS

BOR-OIS lagging

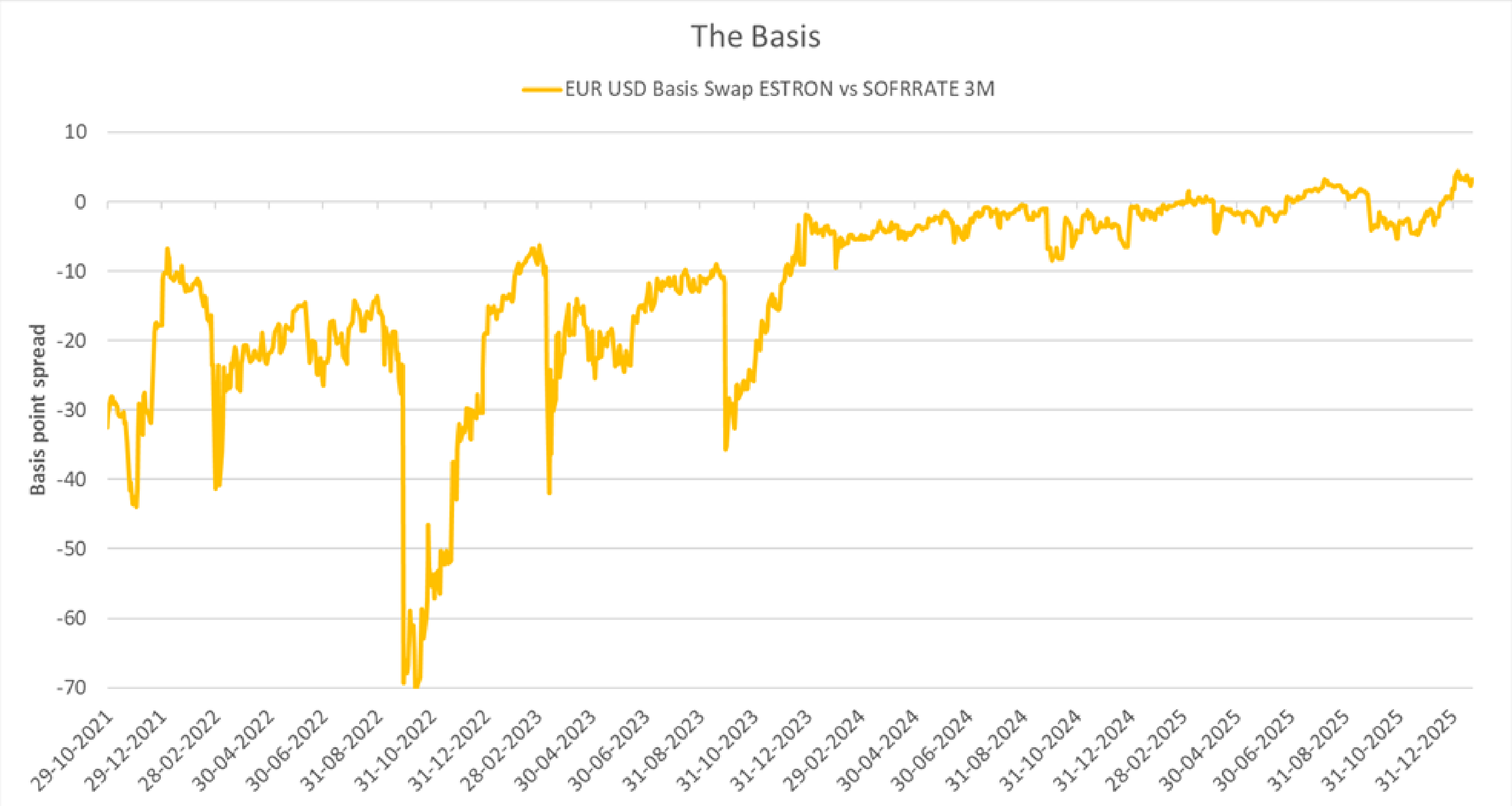
- **Unsurprisingly, Euribor-OIS spreads aren't going places either.** Here's the spread between Euribor 6-month and 6-month OIS. The average monthly spread is stable at 20bps or thereabout. Put differently, 6-month Euribor is about equal to the MRO/LTRO. That hasn't incentivized banks to borrow from the Eurosystem despite the favorable regulatory treatment of MROs/LTROs (LCR-booster if non-HQLA collateral is pledged: one-on-one increase in HQLA but corresponding liquidity outflow).



Source: ECB; AMECO; Bundesfinanzagentur; Bloomberg; AFS

EUR richening in the basis

- **A remarkable money market development is the richening of the euro in the basis.** The euro now commands a premium in the basis, though it's a far cry from the richness of the dollar in the days of yore. The richening of the euro in the basis is not confined to money market tenors – we also see it in the longer tenors. Perhaps it reflects the 'sell America' or the 'quiet quitting' of US assets narratives.



Source: Bloomberg; AFS

FX arbi remains open

- **Still, the move in the basis hasn't affected the dollar>euro arbitrage in the FX swap market.** If you are a bank in the Eurozone and can source dollars cheaply (at around fed funds) and swap them to euros, you make a nice, risk-free profit of about 8bps:

90<GO> Restore default for EURUSD

Chart | Refresh | Export | Settings

Same Currency | Multi-Currency | Central Bank

Currencies EUR ↔ USD -- via -- Pricing Date 01/22/26 Auto Refresh

Spot Source BGN Direct Input

Fwd Source BGN RFQ CNF Show Outrights

Imply EUR Yield FX Swap to EUR Depo

		7) FX Swap		8) EUR Yield (d)		9) USD Yield		EUR Implied Yield		Spread	
Term	Date	Bid	Ask	Bid	Ask	Bid	Ask	Bid	Ask	Bid	Ask
10) ON	01/23/26	1.168480	1.168484	1.9217	1.9217	3.9668	3.9720	2.2722	2.3390	0.3505	0.4173
11) TN	01/26/26	1.168535	1.168537	1.9218	1.9218	3.9672	3.9724	2.2714	2.2972	0.3496	0.3754
12) SP	01/26/26	1.1687	1.1687								
13) SN	01/27/26	1.168754	1.168756	1.9217	1.9217	3.6400	3.9720	1.9211	2.3147	-0.0006	0.3930

- **I haven't calculated historical data for this arbitrage, but I know for a fact it has existed for years.** The arbitrage only stops working when there is US money market turmoil, like we experienced last year around the time of the unprecedented (in duration) Federal government shutdown.

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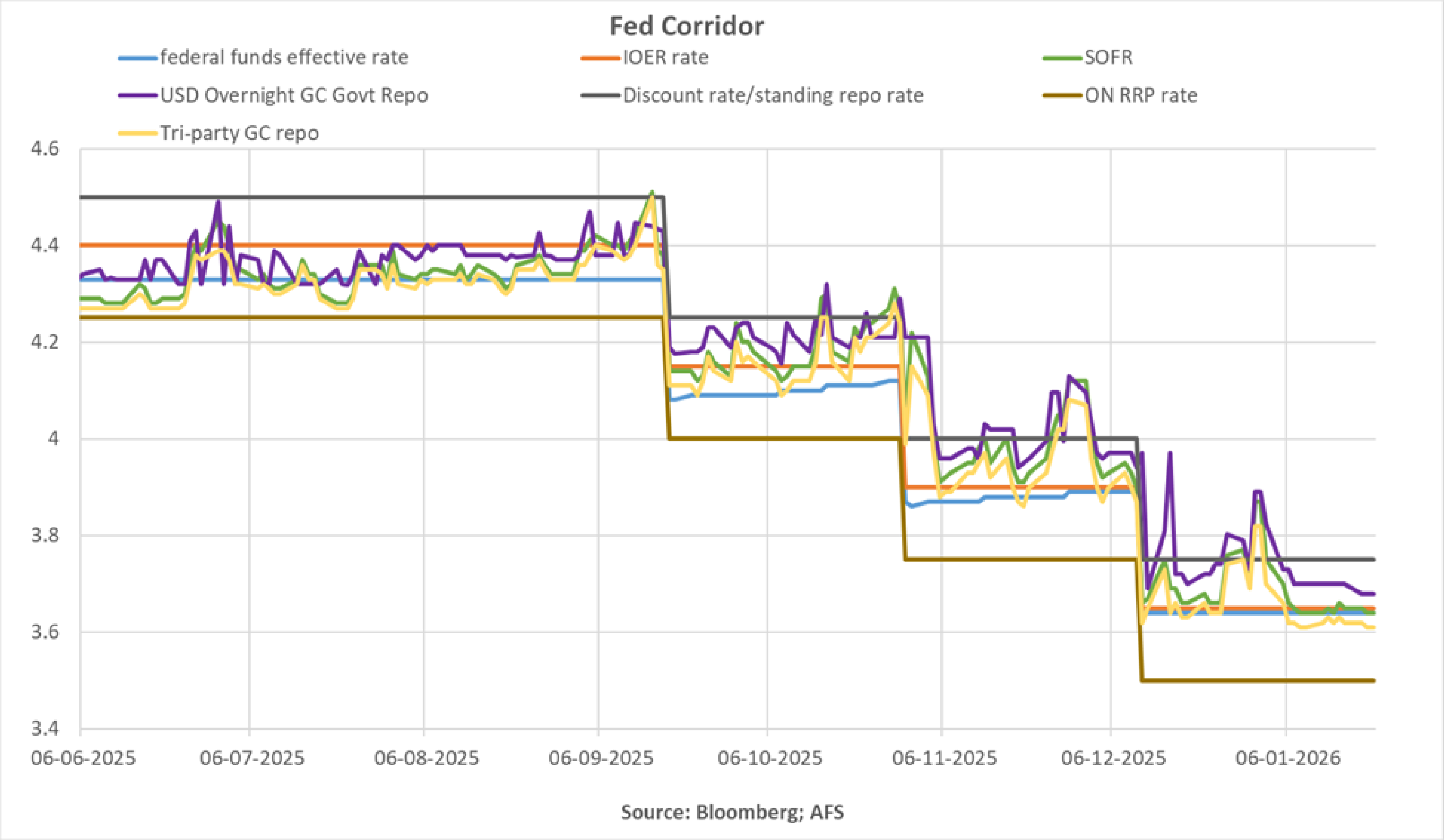
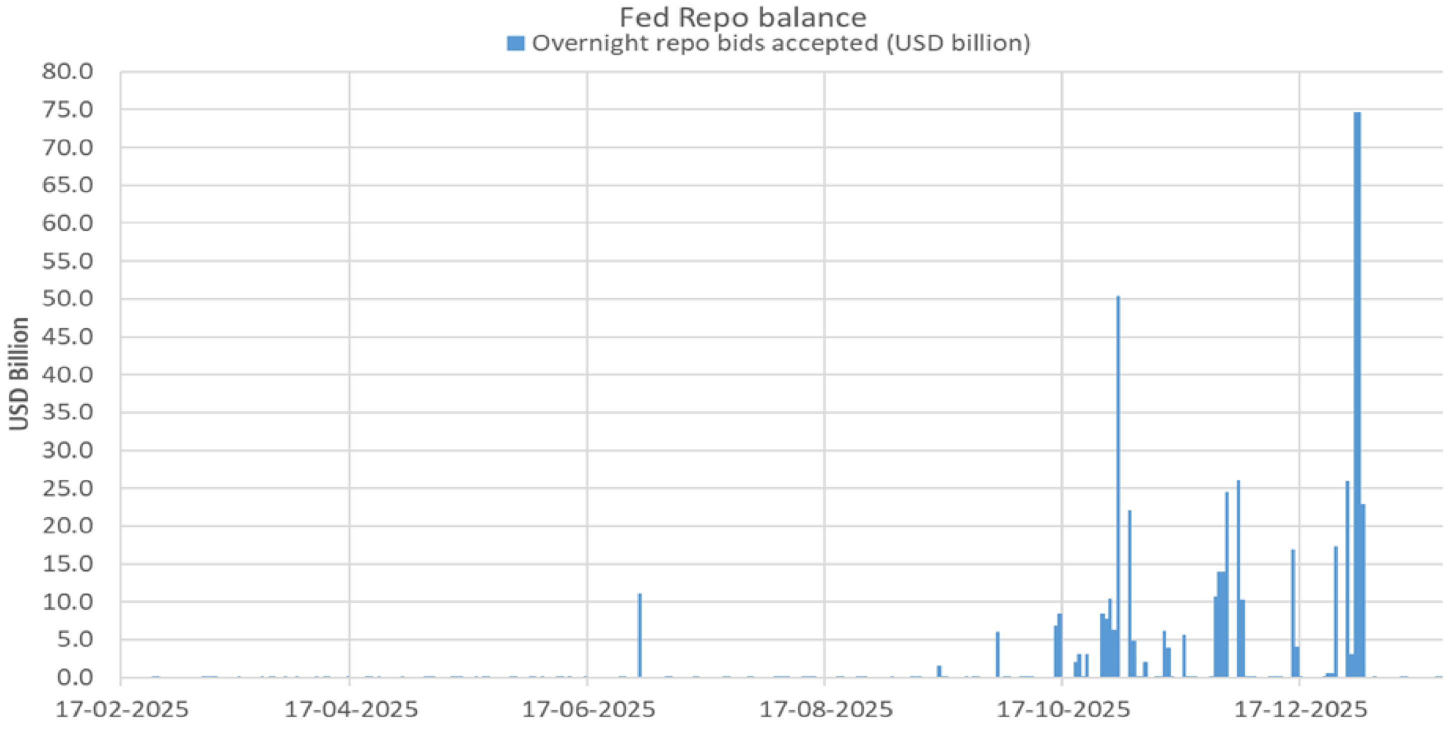
Quiet US money markets

- **It's difficult to find the smoking gun – the reason why the dollar flipped in the basis.** However, a confluence of events is dollar negative. You may have noticed that US money markets have become awfully quiet since December. Overnight rates are settling perfectly within the Fed's corridor:



Fed repo lending has dried up

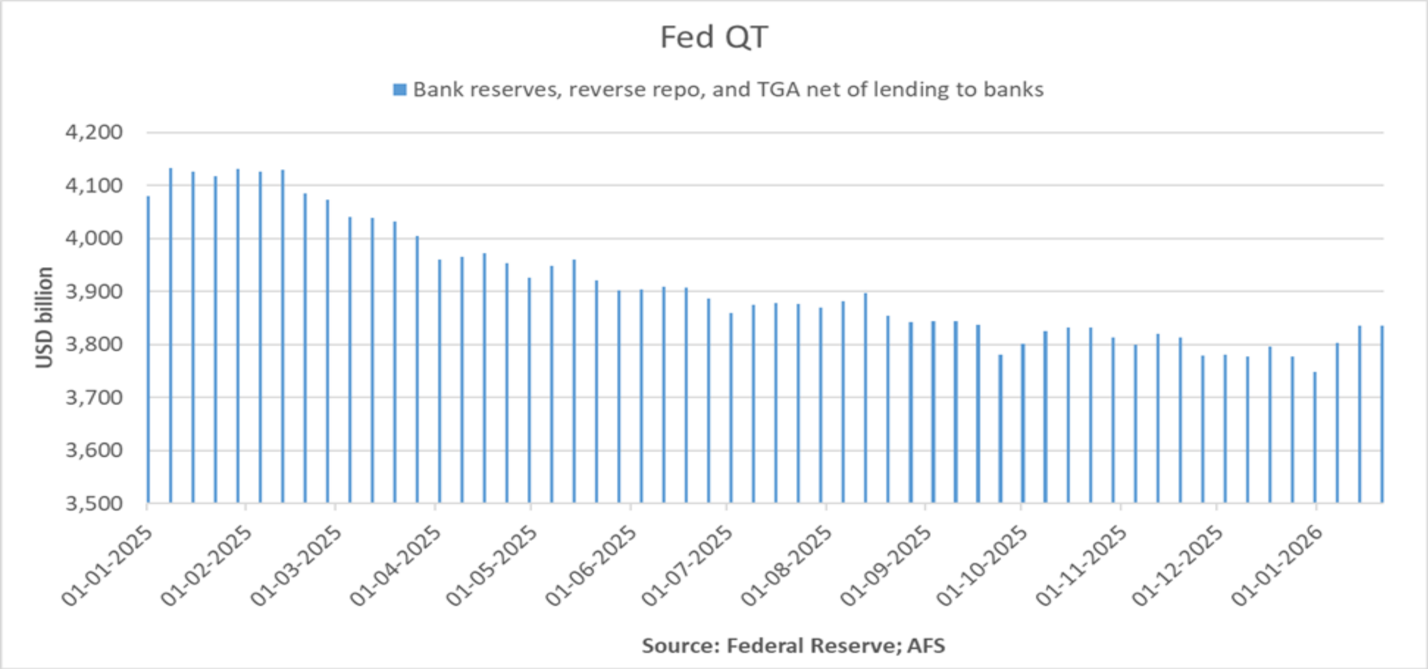
- **At the same time, repo borrowing from the New York Fed is back to being basically nonexistent.** Notice the spike in October, when we were in the midst of the record 41-day government shutdown;
- **During the shutdown, which lasted from October 1 to November 12, the Treasury balance at the Fed was persistently elevated at almost a trillion dollars**. Before the shutdown, the balance stood at 800 billion dollars. At the peak, the Treasury drained 200 billion dollars in reserves from the banking system. With ongoing Fed QT, bank reserves fell below 3 trillion dollars and were no longer ample.



Source: Bloomberg; AFS

Don’t call it QE

- **The Fed balance sheet is growing again, albeit at a modest pace, with the resumption of Treasury bill purchases.** In the December 17 – January 20 period, the New York Fed bought 57 billion dollars in bills;
- **The sum of unborrowed bank reserves and the Treasury balance of the Fed, the yardstick for measuring liquidity in the US money market, has started to increase gradually.** And while the amounts are still relatively small, what matters is the comparison with the ECB. While the Fed is slowly increasing bank reserves with bill purchases, the ECB balance sheet is shrinking. At the same time, the ECB wants banks to show up more often at the regular refinancing window (hence the press release). The Fed, on the other hand, prefers that recourse to the standing repo facility remains as low as possible (otherwise securities purchases would not have resumed).



The basis

- **Last year, we had a spike in the five-year EURUSD basis.** Bloomberg attributed the spike to heavy issuance of euro-denominated bonds by US entities. Issuers hedged with basis swaps, which richened the euro. There are no such stories this time around even though the euro has started to richen:

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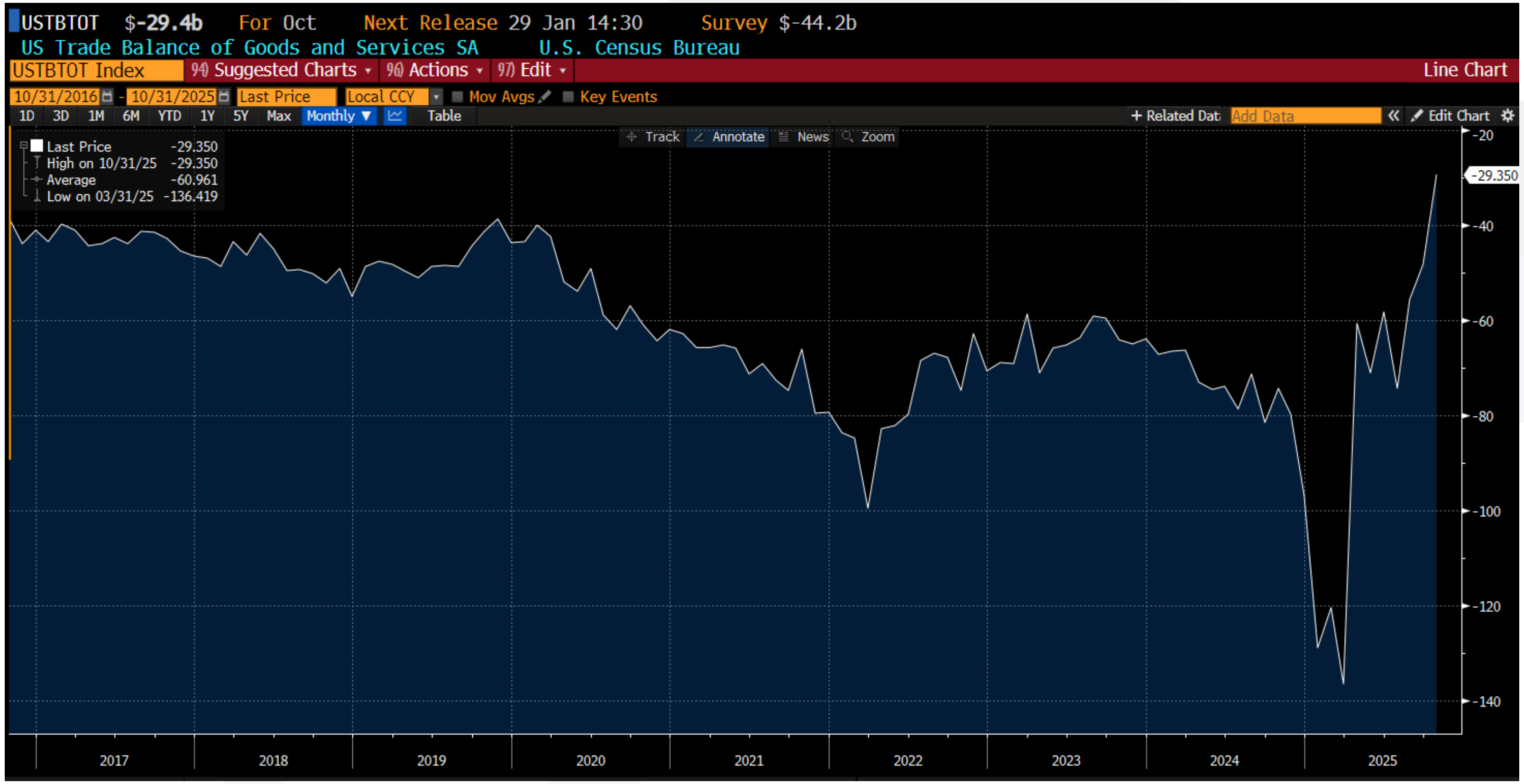
One word: tariffs

- **On a macro level, the US trade deficit has started to narrow rapidly.** Assuming no changes on the income balance (big if), the current account deficit will narrow. That means that the growth of the flow of dollars into the world economy will slow;
- **During Trump 1.0, the US started the trade war in 2018, which then escalated in 2019.** The trade war was dollar positive and narrowed the trade deficit somewhat.



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Wrecking the dollar

- **This time around, tariffs are dollar-negative.** However, it is perhaps unfair to single out tariffs as the cause of dollar weakness. President Trump's wrecking ball approach to pretty much everything – from the Federal Reserve's independence to the sovereignty of states – probably plays a role as big (or even bigger) in explaining greenback weakness. Compared to the post-election peak in late 2024, when the narrative was US exceptionalism, the dollar is down almost ten percent on a trade-weighted basis. And with nary a response from the White House.

Wrecking the dollar

- **I think it's best to explain dollar weakness (including the basis) with the financial account of the balance of payments.** On the balance of payments, the causality runs from the financial account to the current and not vice versa. That's because gross capital flows simply dwarf current account transactions. Furthermore, capital flows can change with the blink of an eye, but current account transactions are much slower to change;
- **The reserve currency status of the dollar forces the US to absorb the savings imbalance of the rest of the world.** Because of the unique status of the US – the size of its economy and its large, liquid, and open capital market – foreign demand for US financial assets has been voracious for decades. More importantly: the rest of the world needs dollars for trade, for payments, to borrow, and to transact in financial markets. Notice that I use dollars and US financial assets interchangeably. A dollar asset could be a simple bank deposit ('dollars'), US Treasuries, or whatever;
- **Foreign net capital outflows, the flipside of excess foreign savings and current account surpluses, force the US to run the corresponding current account deficit/financial account surplus.** Thus, the US must be net capital importer to accommodate the rest of the world;
- **With Trump unconstrained, demand for US financial assets is clearly on the wane.** 'US exceptionalism' has given way to 'sell America', or the 'quiet quitting' of US financial assets. We see these themes play out in US equities, which have started to underperform the rest of the world. But also in stuff like the basis, where cheapening of the dollar could reflect increased hedging of dollar exposures (i.e. short dollar);
- **If the demand for US financial assets is indeed falling, the US financial account surplus and the current account deficit must both shrink**. But I think the declines are self-limited *unless the dollar's reserve currency status is truly diminished or if global trade shrinks (because of protectionism) or if global capital flows are curtailed (because of capital controls)*. The rest of the world needs dollars for trade etc. If the growth in the supply of dollars slows because of the narrowing US current account deficit, global trade – economic activity – will slow too. Markets will figure this out in due time. And when that happens, we get the reflexive snap-back in the dollar like we had in 2018 and 2019. But, and I cannot stress this enough, this snap-back in the dollar is contingent on three things: the dollar's reserve currency status maintained; and no stalling or decline in global trade and capital flows. Not the stuff that is easy to forecast (if such a thing exists, an easy forecast).

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