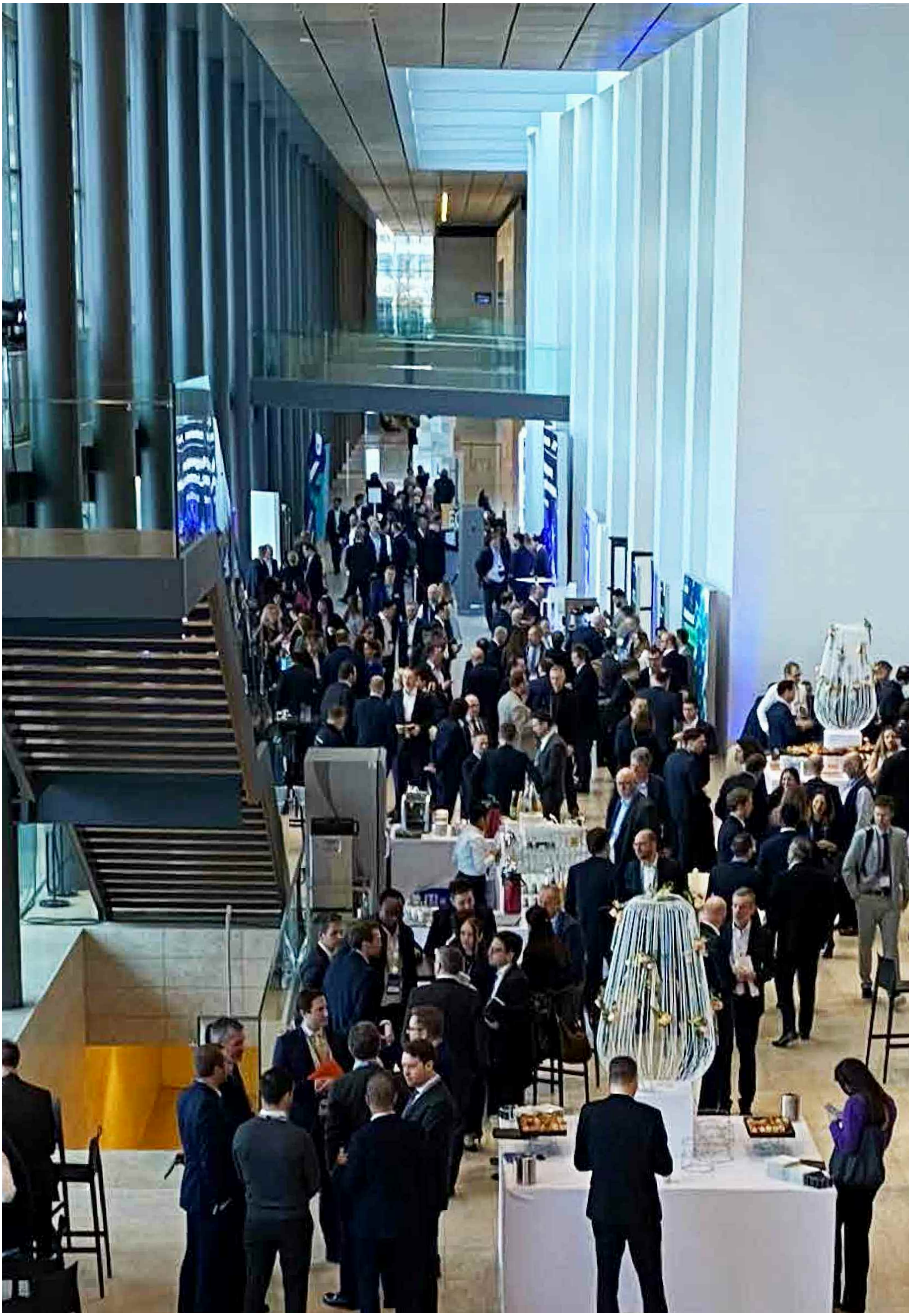
clearstream EUREX DEUTSCHE BÖRSE GROUP

Global Funding and Financing Summit 2025

Navigating uncertainty: geopolitics and market dynamics

Whitepaper
Summary and key findings



Foreword

We are just over two months into 2025 and already experiencing significant geopolitical uncertainty. Decades-old paradigms are shifting and the contours of a new framework for world governance remain ill-defined.

In Europe, these issues are as pertinent as in any corner of the globe. EU member states are reckoning with a historic change in defense spending needs that is set to significantly increase issuance of government bonds in the continent.

The implications this new fiscal stance will have for funding markets are significant and come at a time when market participants are still readjusting to a complex monetary environment. While the ECB seeks to cut rates, national central banks are still trying to reduce the size of their balance sheets through quantitative tightening. Taken together, these conditions are pushing funding markets from an era of collateral scarcity to one of abundance.

Against this backdrop, market participants must re-assess their business models to adapt to these new conditions. As specialness evaporates from repo markets, trading desks are already considering collateral optimization and clearing – routes that offer significant capital and operational efficiencies.

In this landscape, innovation has taken on central importance. Not only to gain a competitive edge, but to ensure compliance too. Even as Europe's firms prepare to implement T+1 settlement, the prospect of T+0 is already being discussed – a transition that will be impossible without further harmonization efforts in the post-trade segment and the widescale adoption of a DLT.

Innovation takes many forms, and Europe has long shown that it can innovate in market structure and efficiency through cooperation between institutions. While the importance of competition remains paramount, there are many ways in which infrastructure providers and even regulatory bodies can and do foster innovation through cooperation.

Clearstream and Eurex have proudly played a key role throughout their history in both bringing market participants together and providing them with the technology to help improve performance.

These themes, and more, were discussed in depth at the recent Clearstream and Eurex Global Funding and Financing Summit, held in Luxembourg in January this year. In this whitepaper, we provide attendees with a summary and analysis of the event and its key findings.

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1.

The European Repo market in 2025

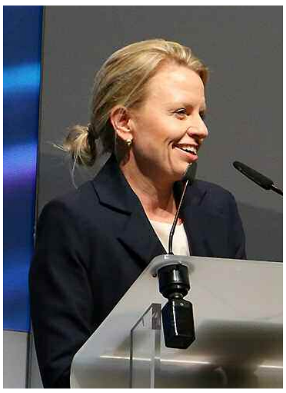
At a time when geopolitical uncertainty is ratcheting up, the current era of European monetary policy is also raising an increasing number of questions.

The continent's central banks are firmly pulling away from the near decade of quantitative easing programs that dominated government bond market conditions.

Yet at the same time, a lackluster economic outlook for the continent has created pressure to push rates down after a two-year run of aggressive hiking. This is throwing up new dynamics for the funding market to contend with.

"In repo and securities lending markets, 2024 was marked by a shift in buy-side repositioning, increased financing demand and abundant collateral," says Stephanie Eckermann, Member of the Executive Board at Deutsche Börse AG and Clearstream chairwoman.

This situation is expected to persist until interest rates normalize around more neutral rates."



Stephanie Eckermann

The ECB is now well into a rate-cutting cycle, with its last five decisions reducing interest rates on the continent. However, for the EU's national central banks the task is very different. As the enforcers of QE, these institutions have accumulated large amounts of low yielding government bonds on their balance sheets over the past decade.

With the ECB deposit rate currently at 2.50%, following another 25 basis point cut in March, the cost of financing these holdings is well above the earnings they generate. Consequently, national central banks are now in a position where they are incurring significant losses.

Excess reserves in the system are still substantial though, with Europe's national central banks sitting on almost €3tr of excess reserves that must be remunerated. The weight of these assets on balance sheets means that focus on disposing them is unlikely to be altered by ECB loosening efforts.

"You are pushing the accelerator, while at the same time hitting the brakes, which is a difficult way of conducting monetary policy," says Christian Kopf, Head of Fixed Income and FX at Union Investment. "But at the same time, it will continue because the national central banks cannot tolerate such heavy losses on their balance sheets."

The effects of this need to shrink balance sheets are already spilling out into funding markets. Since the Eurosystem shifted to quantitative tightening in 2023, market participants have begun to adapt from a period of collateral scarcity to the collateral abundance described by Eckermann.

National central banks' switch from hoover to hose has had tangible consequences already. Prime among these has been the reduced specialness of Bunds and increasing volumes in cash-driven repo. This is already forcing repo desks to reevaluate business models and how they generate PnL (see 'Innovation in 2025').

The distortionary effect has extended across debt markets, with some corporate names trading inside sovereign curves. Louis Vuitton's tightening beyond French government bonds was one notable recent example that drew much attention.

Balance sheet reduction will be a long journey, and more distortions can be expected. Since the beginning of the year, the ECB has stopped reinvesting its bond holdings, which has resulted in a run-off rate of c. €40bn a month.

Even though this will result in a c. €500bn smaller balance sheet by the end of the year, excess liquidity in the Eurosystem will be about c. €2.4tr by the end of 2025. This significant level of excess liquidity indicates that further shifts in market dynamics are likely as the central banks continue to shrink their bond holdings.

During the period of loose monetary policy and collateral scarcity, Southern European and French banks often used additional credit claims as collateral for ECB cash, while German banks focused on retained covered bonds as a funding source. As more government bonds return to the market, such divergences can be expected to melt into a more unified funding model among the continent's banks.

Absorbing supply

While the ECB's rate cutting is compressing the short-end of the euro yield curve, the increasing net supply of collateral into the market is already pushing up yields at the longer end of the curve. Net supply will be added to by government new issues, with increased defense spending needs set to bring sovereigns to the debt markets at a regular clip.

Germany, Belgium and Italy are expected to be key sources of supply to the euro market in the near future. The net supply of Bunds alone is by some estimates expected to hit €40bn for 2025, without taking into account issuance stemming from the removal of the German debt brake.

In a sign of these market conditions, the spread between interest rate swaps and European government bonds has widened since collateral abundance began, as high-quality government bonds became significantly cheaper than swaps at the equivalent maturity.

While GFF Summit panelists agreed that the swap spread had probably hit a floor at the front-end of the curve, at the longer end there is still scope for further widening as more bonds are sold into the markets.

The question then becomes who will absorb this supply?

Banks are scooping up some of the new stream of government bonds through their liquidity reserves.

"The share of government bonds in banks' HQLA liquidity reserves has increased since Europe moved into a rising rates regime, from around 25% in 2022 to around 40% by the end of 2024," says Andreas Bohn, Partner at McKinsey & Co. "However, there is a limit for this to continue due to internal and regulatory liquidity risk considerations."

With national central banks becoming suppliers to the market and banks restricted in their buying capacity by regulatory ratios, significant expectations are being put on the leveraged community.

How much capacity these market participants have to buy bonds is hard to discern however, given the difficulties of collating data on many firms' holdings. Estimates given on one GFF Summit panel, based on e-trading platform data, indicate that between 2018–2024, leveraged players have roughly doubled the volume of government bonds that they are trading. However, e-trading data doesn't represent a full picture of activity.

German Financing Agency statistics show that hedge funds account for about 15% of Bund purchases. At the primary market level alone, their participation seems much lower, however. Syndication statistics show that hedge funds only accounted for 1% of the primary allocation of France's latest 10-year bond.

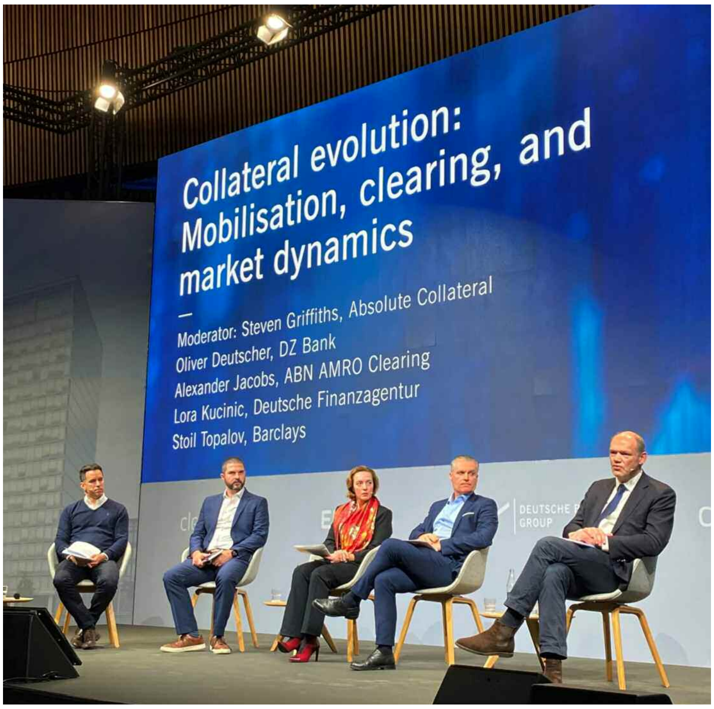
This indicates that any increase in hedge funds participation is more likely to take place via the secondary, rather than primary, markets. This will elevate the importance of asset swap trades, future basis trades, curve trades and country spread trades in 2025, which effectively allow hedge funds to buy off-the-run bonds from sellers who can then invest their proceeds into primary issuance.

Bank balance sheets

For this to work however, the leveraged community needs access to balance sheet. Banks' ability to provide this and even take advantage of trading opportunities themselves, has been constrained by RWA and liquidity requirements. Another potential constraint is emerging with the lapsing of the relief European regulators had given banks operating under the Net Stable Funding Ratio. A relaxation of RSF requirements from 10% to 0% for reverse repo financing backed by Level 1 high quality liquid assets (HQLA), will revert back to 10% in June 2025, absent any action from regulators. As central banks deleverage their balance sheets and banks seek to re-leverage so as to facilitate repo as a greater contributor to Europe's funding needs, these restrictions could put strain on their ability to do so.

Another route to easing funding routes for hedge funds and other non-bank market participants would be access to central bank facilities, in line with the US Fed's opening up of the reverse repo facility to money market funds.

However, GFF Summit panelists mostly did not see this as likely to happen in Europe. The ECB is keen to establish €STR as a benchmark for unsecured lending between banks. Opening access to its deposit facility to non-banks risks reducing the pool of eligible transactions in scope for the calculation of the €STR benchmark, and eroding a vital market mechanism for determining the front end of the yield curve.



Clearer solutions

Amid the many contradictions currently riddling European monetary policy and funding markets, one solution proposed on multiple GFF Summit panels was expanding access to clearing.

While a regulatory mandate is set to increase repo clearing in the US even further, the use of the sponsored clearing model in that market has already provided considerable support for dealer balance sheets and the broader market. Custodians have added around $1tr of US Treasury financing liquidity to the system through their netting and custodial capabilities, helping to support both leveraged and real money participation in the market.

As Europe confronts a future of further quantitative tightening and new issue supply, the capacity of dealers to act as effective intermediaries for that supply looks challenging. In the absence of a central bank backstop for non-bank repo participation, recent clearing models that facilitate buy-side access could ease those pressures.

2.

Innovation in 2025

The dwindling of specialness in repo markets, a trend that has emerged as Europe's national central banks push forward with balance sheet reduction and return large amounts of government bonds to market, is expected to change the dynamics of the repo business in 2025.

Banks earned substantial revenues from the period when specialness was valued. With collateral abundance now the dominant trend in funding markets, firms are having to explore other ways to pump up their bottom line.

One key route to achieving this is collateral optimization, and at a broader level, innovation. For repo desks, the imperative now is to explore all funding channels – be they bilateral repo, cleared repo, tri-party repo or GC pooling – to discover how each can increase the productivity of assets. With greater efficiency, repo desks can open an avenue to more competitive pricing for clients and subsequently, improved PnL.

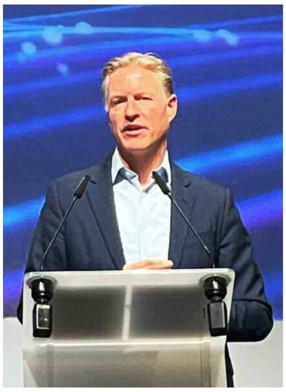
At the same time, the increased volume of repo transactions, as the market re-asserts itself as a funding channel that compensates for central banks' retreat from the space, will test the existing front and back-office systems of many firms.

Innovation will be key to overcoming these obstacles. However, it can take many forms. Many internal projects are currently focused on AI and DLT adoption, and their abilities to drive efficiency in areas such as reconciliation and settlement.

However, broader initiatives are also aiming to innovate the infrastructure of European funding markets. In these projects, central banks and other regulatory entities play an important role. In short, the imperative to innovate is an industry-wide one, and one in which regulatory entities and infrastructure providers can play as important a role as individual firms.

This point is proven by the success of the Eurosystem's Target2 system and the advances it has made for the continent's settlement infrastructure.

"Leveraging our technology is important," says Robbert Booij, CEO at Eurex Frankfurt. "We need to stay at the forefront. If we don't innovate. We stand still. We're not doing our job. We're not helping our clients to become more efficient and control risks better."



Robbert Booij

Another recent example of regulatory-driven innovation is the move to T+1 settlement in the US, a policy that the EU, UK and Switzerland are aiming to implement in October 2027.

Experience from the transition in North America (Canada, Mexico and the US made the switch in May 2024), is that a regulatory initiative on the scale of T+1 can open the door to internal discussion of a wider range of other initiatives. Some firms that implemented T+1 now have the objective of continuous processing as an open topic of discussion internally, as market participants start to contemplate a move to T+0.

That move will not be possible without DLT – a technology that banks have been trying to harness for some years now. This includes the ECB, which has made recent advances in its efforts to create settlement of transactions in central bank money on DLT. The process has involved input from more than 60 market participants from 11 nations, as the central bank makes further efforts to improve the infrastructure that innovation takes place upon. On the back of a successful first phase, the ECB has recently announced its intention to expand the scope of this project.

While settlement has long been flagged as the most obvious area for DLT to make a difference, its use cases are expanding beyond just that. Using DLT to facilitate corporate actions and intraday liquidity management was cited by GFF Summit panelists as spaces where real efficiencies could be brought to bear. Work to facilitate intraday liquidity management with dollar and euro digital repos is already underway.

However, while DLT offers significant efficiencies, there are risks that the current model of development could create new fragmentations. Many banks have until now pursued their own DLT projects, with little tangible interbank cooperation. In order to fully harness the benefits of the technology, greater efforts to establish interoperability and scale are needed.

“The true impact of blockchain, digital asset and custody is more than just automation, efficiency and speed,” says Steven Griffiths, CEO and Founder at Absolute Collateral, “it is redefining how assets interact with the financial ecosystem, with trust being the central theme.

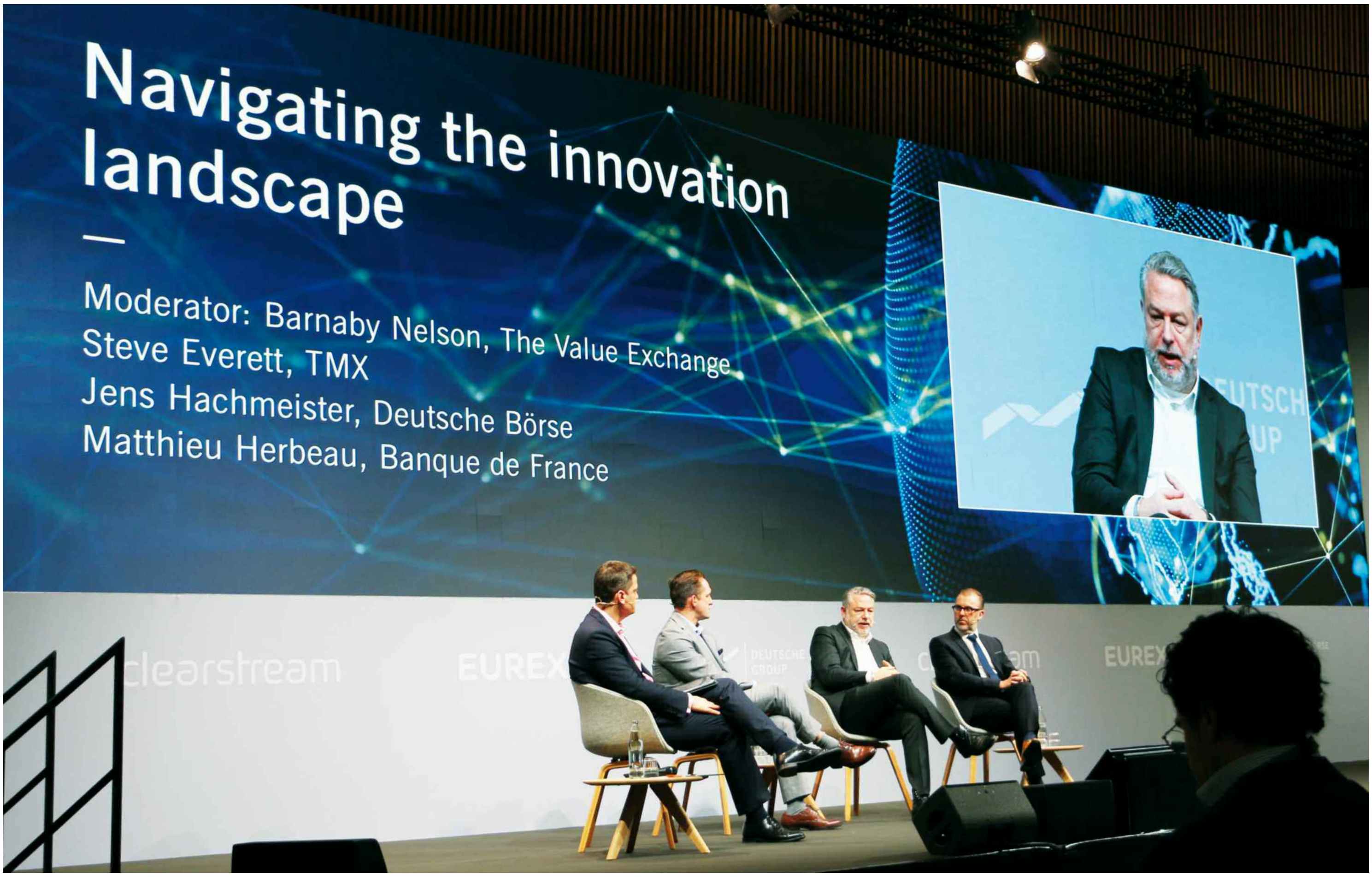
Technological advancement not backed by such a central ethos, only leads to shallow and superficial developments.”

Industry cooperation is also needed for the fundamentally important work of improving Europe’s trading infrastructure. This has historically been fragmented, with bilateral and cleared repo transactions settling in different CSDs.

GFF Summit panel members stressed that unifying settlement will build much more solid foundations for implementing T+1 and the expansion of cleared and sponsored repo models, with or without a regulatory mandate.

Clearing as an innovation

While the US mandate to clear Treasury cash and repo transactions is consuming much of the industry’s focus at present, in Europe market-driven efforts to broaden the range of cleared repo are also gaining traction.



Cleared repo is not commercially viable for all. By the estimate of one clearing expert at the GFF Summit, it makes sense for market participants with liquidity management requirements above €200m on an average daily basis. According to his estimate, there are more than 4,000 banks, 3,000 asset managers and 3,000 insurance companies in the EU – a huge potential pool for a market in which Eurex Clearing currently has 180 members.

While the costs and timelines of full clearing membership make this route to clearing an unviable one for many market participants, other models such as Eurex's ISA Direct, ISA Direct Indemnified and ISA Direct Light have introduced less onerous structures for buy-side access.

At a time when regulation continues to exert significant pressure on trading firms, not just in the form of clearing mandates, but Basel III, Uncleared Margin Rules and NSFR, the need to be capital efficient and optimize collateral and liquidity management as much as possible is as pressing as it has ever been. Clearing is a well-established solution for this challenge.

Engaging internally, as well as externally

While industry cooperation is an essential building block to the success of innovation, a key message from the GFF Summit was the importance of improving internal procedure to facilitate innovation.

While the benefits of innovation are clear, creating the internal momentum for projects can often be hard. GFF Summit panelists emphasized the importance of a well-developed business case and bringing in operations, treasury and compliance teams – traditionally the least engaged in innovation – at an early stage.

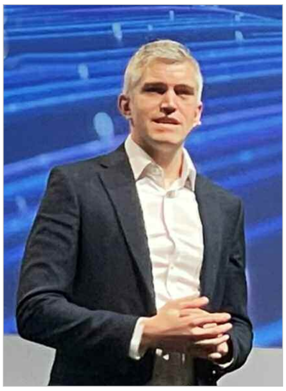
3.

Securities Lending in 2025

The securities lending industry faces a dual challenge in 2025. Market participants must stay abreast of geopolitics and the sudden shifts they can provoke across markets, while also grappling with a regulatory burden that is imposing considerable costs on the industry.

At a macro level, the rise of protectionism and trade tariffs represent the most immediate risk factor for market participants. But given the heightened level of geopolitical tension around the world and rapid pace of technological change, the potential for other risks to spring surprises in 2025 is very high.

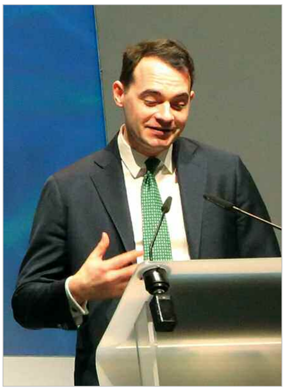
"So many different things can happen during the course of 2025 in terms of geopolitics, markets and domestic policy change" says James Pomeroy, Global Economist at HSBC. "That creates an enormous amount of uncertainty for markets, for economists and for everyone trying to think about how to set up their business or their trades for the course of this year."



James Pomeroy

GFF Summit panelists largely agreed that this will likely be a year characterized by sell-offs and relief rallies that move to the tune of tariff announcements. However, in many ways this uncertainty does not represent a dramatic parameter shift, given that global instability has been a constant feature of market conditions for some time now.

"We have been dealing with geopolitical risk for about 10 years," says Charles Litchfield, Deputy Director at the Atlantic Council. "There were two big political shocks in 2016, which crystallized that trend. But its beginnings go back even earlier, with the sovereign debt crisis. We have already been dealing with this world for a while and in a way, it's something we're now used to."



Charles Litchfield

While the last decade of turbulence has created some stressful moments in risk management, for some market participants shock events have also provided long-lasting lessons around managing exposures.

Russia's 2022 invasion of Ukraine was one such example, causing round the clock repositioning for many, but ultimately resulting in greater caution over where assets are held and slightly more niche issues such as monitoring exposure to local indexes.

Securities lending experts at the GFF Summit highlighted diversification as a key strategy to deal with the market's vulnerability to volatility in 2025 and the sudden dashes for cash that can afflict the financing side.

While geopolitical risk has been a long-term feature in securities lending markets, participants have also had to deal with the recent monetary policy shifts that repo traders are also adapting to. As interest rates continue to search for a neutral level, buy-side repositioning and financing demand are likely to remain elevated.

Trades that were popular during the preceding period of loose monetary policy are now fading. For example, during 2015–2022 when the need for cash was low, short basis trades by hedge funds drove the short-side of the market. Banks needed to source securities to lend to those funds, driving up specialness – a dynamic that has now reversed.

As in repo markets, these reversals are now also increasingly driving a focus on collateral optimization. Especially for those participating in highly efficient and liquid markets, alpha has become increasingly hard to capture. This is raising interest, including from the front-office, in other methods for boosting profitability.

However, opportunities still exist. For those market participants with cheap access to balance sheet, including beneficial owners, spread opportunities have been plentiful in recent months – a trend that some GFF Summit panelists expect to continue over the coming 12 months. One securities finance banker speaking at the event reported that these players are providing liquidity to the market – a positive development for the overall ecosystem.

Indeed, the opportunities for expansion are multiple. More banks are being asked to provide capacity for crypto ETFs, and the rise of delta one trading desks on the buy-side is also putting demands on dealer capacity.

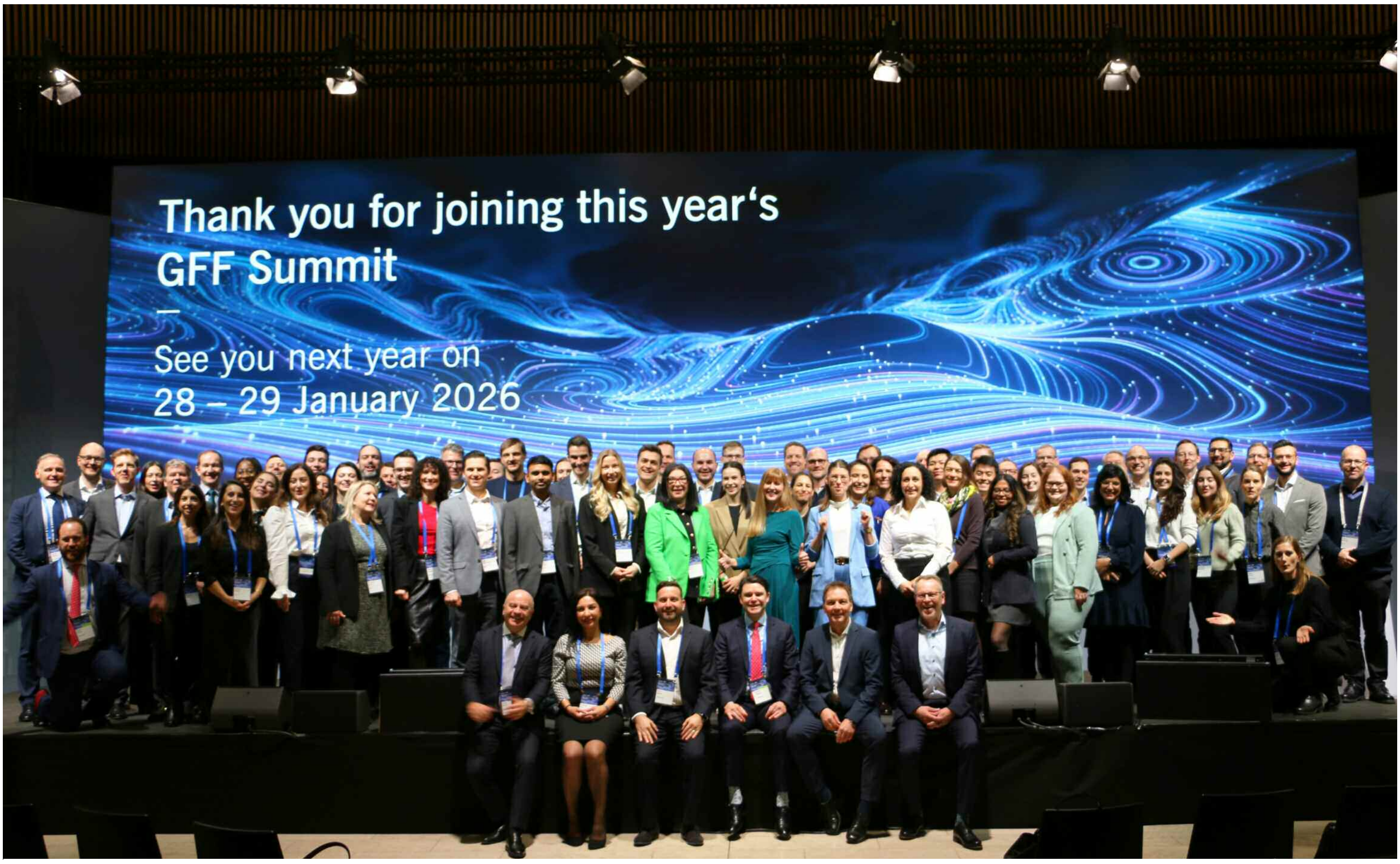
Regionally, enthusiasm is also high about the growth offered by the Middle East, with Saudi Arabia, Abu Dhabi and Dubai all presenting opportunities to expand.

Regulatory restrictions

While GFF Summit panelists agreed that opportunities for growth in the market were plentiful, there still remain substantial challenges.

Principal among these is regulation, with the industry still dealing with complex web of regulation that banks, the crucial intermediaries for the market, continue to grapple with. Basel III is exerting what amounts to a heavy tax on the industry, with the costs that it is imposing on pledge and excess margin structures. In the case of pledging specifically, the prohibition of regulated funds and US banks from participating in this model has significantly restricted the scope of the structure as a beneficial tool for the industry.

As the industry prepares for T+1 settlement in Europe and looks beyond that implementation to the possibility of T+0, the issue of well-structured regulation is becoming increasingly urgent. Without greater standardization of contracts and reporting inputs, the resiliency of the market and its ability to make innovative changes such as digital settlement will be a significant challenge.



GFF

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