Box 3

MONEY MARKETS' REACTION TO ANNOUNCEMENTS REGARDING THE PHASING-OUT OF NON-STANDARD MEASURES

This box assesses the euro area money markets' reaction to the announcements made by the Governing Council with regard to the start of the gradual phasing-out of non-standard measures. In December 2009, in view of the improved financial market conditions, the Governing Council announced that the last twelve-month refinancing operation would be conducted in that month, while the last six-month operation would be conducted in March 2010. Three months later, in March 2010, the Governing Council also decided to return to variable rate tender procedures in its regular three-month operations as of the end of April 2010.

This assessment of markets' reaction to those announcements is based on market expectations for the EONIA, spreads between the EURIBOR and the OIS, and implied volatility derived from money market rates. Overall, money markets' reaction to the announcements made in December 2009 and March 2010 has been fairly muted. This is consistent with the gradual nature of the phasing-out of those measures and suggests that the money markets are expecting to make a gradual and orderly return to normal functioning.

Communication of the phasing-out of non-standard measures

On 3 December 2009, in view of the improved financial market conditions, the Governing Council announced that the last twelve-month refinancing operation would be conducted in December 2009 and the last six-month operation would be conducted in March 2010.[1] Three months later, on 4 March 2010, the Governing Council also decided to return to variable rate tender procedures in its regular three-month operations as of the end of April 2010. At the same time, the Governing Council announced that it would continue to conduct its main refinancing operations and special-term refinancing operations (i.e. operations with a maturity of one maintenance period) by means of fixed rate tender procedures with full allotment for as long as necessary, and at least until mid-October 2010. Given the continued uncertainty surrounding future developments in the euro area economy, gradualism remains an essential element of the phasing-out of the ECB's non-standard operational measures.

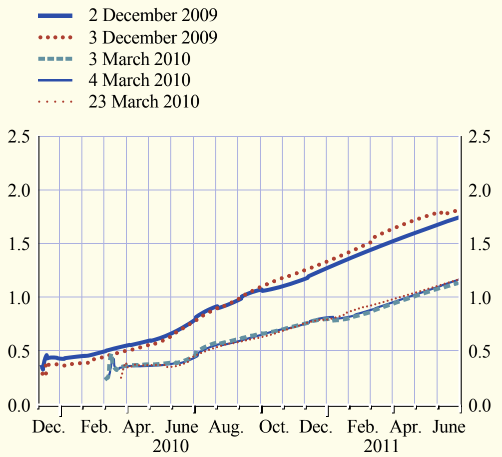
Money markets' reaction to the phasing-out of non-standard measures

Looking at the behaviour of very short-term money market rates, the immediate impact of these announcements was fairly subdued. Indeed, expectations for the EONIA up to one year ahead – as shown by the EONIA forward curve – did not appear to change significantly as an immediate result of these announcements. The immediate reaction to the announcements made on 3 December and 4 March was very small in both cases. This suggests that markets consider that the support provided to the financial system remains adequate, despite the gradual phasing-out of non-standard measures. It could also suggest that the decisions taken in this respect were in line with market expectations (see Chart A).

Furthermore, the spread between the three-month EURIBOR and the three-month OIS and the forward EURIBOR-OIS spreads derived from forward rate agreements on the EURIBOR were also broadly unaffected by the announcements. Indeed, since December these spreads have remained at relatively low levels consistent with the notion of a "new normality".

Chart A EONIA forward curves at different points in time

(percentages; forward rates; smoothed)



Sources: Reuters and ECB calculations.
Note: The smoothing technique used in the chart is based on the calculation of the splines of the logarithms of zero coupon prices.

1 For a detailed account of the decisions taken, see the ECB's press release of 3 December 2009, entitled "ECB announces details of refinancing operations up to 7 April 2010", or the December 2009 issue of the Monthly Bulletin.

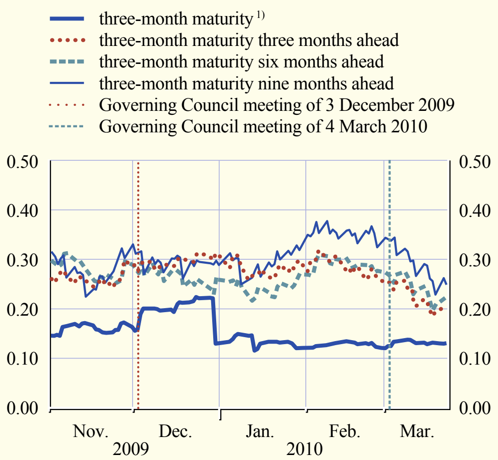
In other words, uncertainty is likely to remain at elevated levels as a lasting consequence of the financial turmoil. The fact that the spread between the three-month EURIBOR and the three-month OIS has been smaller since the beginning of January is more likely to be associated with the easing of tensions related to the end of the year, which gradually accumulated towards the end of 2009. Since then, this spread has remained relatively stable. There do not appear to have been any major changes as an immediate response to the March announcement. This would suggest that the message regarding the gradual phasing-out of non-standard measures was delivered in a fairly smooth manner and was perceived by the money markets as being in line with their orderly return to normal functioning (see Chart B).

Finally, these announcements have not caused tensions in the longer-term segments of the money market, which are relevant for the monetary policy transmission mechanism. Indeed, implied volatilities with constant maturities derived from options on three-month EURIBOR futures contracts suggest that the announcements have not triggered any tensions in this money market segment either. Volatility appeared to decline following the December announcement and has generally remained broadly unchanged since then. Similarly, there was no significant effect on volatilities in March (see Chart C).

All in all, the announcements made in relation to the phasing-out of non-standard measures appear to have been well received by the markets, without any major impact. The markets' reaction suggests that both in December 2009 and in March 2010 the decisions taken by the Governing Council were perceived to be an appropriate response in line with financial and economic developments.

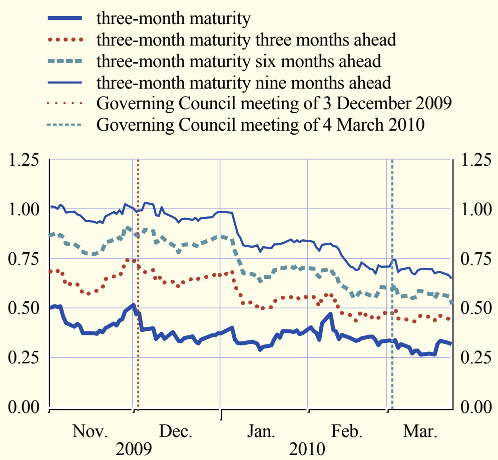
Chart B Spreads between the EURIBOR and the OIS

(percentage points)



Sources: Reuters and ECB calculations.
Note: Forward spreads have been calculated on the basis of EURIBOR forward rate agreements.
1) The three-month spread has been calculated using the three-month unsecured deposit rate.

Chart C Implied volatilities



Sources: Reuters and ECB calculations.
Note: Volatilities have been converted from the market convention in use for EURIBOR options to the market convention in use for Bund options.