



## GOVERNING COUNCIL DECISIONS ON NON-STANDARD MEASURES

On 7 May 2009 the Governing Council of the ECB decided to make a further cut in the rate on the main refinancing operations and the rate on the marginal lending facility, to 1.00% and 1.75% respectively, while keeping the rate on the deposit facility unchanged at 0.25%. This means that since October 2008 the interest rates on the main refinancing operations have been cut by a total of 325 basis points. On 4 June 2009 the Governing Council decided to leave the key ECB interest rates unchanged.

In addition to the reduction in interest rates, on 7 May the Governing Council also decided to proceed with its enhanced credit support. In line with the operations undertaken since October 2008, and in recognition of the central role played by the banking system in financing the euro area economy, the Eurosystem will conduct liquidity-providing longer-term refinancing operations with a maturity of 12 months via fixed rate tender procedures with full allotment. Furthermore, the Governing Council decided that the European Investment Bank (EIB) will become an eligible counterparty in the Eurosystem's monetary policy operations with effect from 8 July 2009 and under the same conditions as any other counterparty. Finally, the Governing Council decided in principle that the Eurosystem will purchase euro-denominated covered bonds issued in the euro area. Further details of this measure were announced following its meeting on 4 June.

### NON-STANDARD MEASURES IMPLEMENTED BETWEEN OCTOBER 2008 AND MAY 2009

Since the intensification of the financial crisis in September 2008, and against the background of rapidly receding inflationary pressures, the ECB has introduced monetary policy and liquidity management measures that are unprecedented in nature, scope and magnitude.

At the onset of the financial crisis the ECB implemented forceful liquidity measures, with a view to protecting the flow of credit to the euro area economy and ensuring that the Governing Council's decisions concerning the stance of monetary policy were reflected in money and

credit market conditions. A key element in this context was the Governing Council's decision in October 2008 to increase the frequency and size of its longer-term refinancing operations (with a maturity of up to six months) and to conduct all liquidity-providing operations through a fixed rate tender procedure with full allotment. In addition, the ECB offered funding in US dollars and Swiss francs through foreign exchange swaps. Given that these changes to the ECB's operational framework are significant, they can be characterised as non-standard.

Overall, the abovementioned non-standard measures appear to have played a vital role in alleviating funding risk and providing financing support to the economy through banks.

As a result, the past few months have witnessed a sizeable fall in term money market and loan interest rates, which have declined even faster than the key policy interest rate. Consequently, the ECB's monetary policy decisions and liquidity measures have been effective in averting a dramatic contraction in credit volumes.

### FURTHER ENHANCEMENT OF NON-STANDARD MEASURES

At its meeting on 7 May the Governing Council decided to further enhance its set of non-standard measures.

First, the ECB will conduct liquidity-providing longer-term refinancing operations with a maturity of 12 months, at a quarterly frequency. This measure is designed to improve banks' liquidity positions on very favourable terms and to further promote the reduction in money market term spreads while encouraging banks to maintain and expand lending to their customers, which is such a central component of the euro area financial system. This measure is fully in line with those undertaken since October 2008, as it too operates through banks. The newly adopted operations will be conducted via fixed rate tender procedures with full allotment. The rate in the first of these operations, to be announced on 23 June 2009, will be the rate

on the main refinancing operations at that time. In subsequent longer-term refinancing operations the interest rate applied may include a spread in addition to the rate on the main refinancing operations, depending on the circumstances at the time. Together with the existing longer-term refinancing operations, the provision of funding, which is in principle unlimited, should contribute to keeping 12-month money market interest rates at low levels.

Second, the Eurosystem will purchase euro-denominated covered bonds issued in the euro area. This measure aims to improve liquidity in the private debt security markets and encourage a further easing of credit conditions given that the deleveraging process in the banking sector, which has recently accelerated, is likely to continue for some time. Specifically, covered bond purchases in both primary and secondary markets should improve the funding conditions for financial institutions that issue covered bonds in the primary market. Covered bond purchases in the secondary market should contribute to improving the depth and liquidity of the market and should further narrow the spreads of covered bond yields over those on government bonds. This should improve the risk profile of institutions holding covered bonds and thereby help to spur credit growth. Furthermore, covered bond purchases could encourage new issuances in the primary market and contribute to activity in the secondary market, which has remained subdued.

This will complement and reinforce the ECB's support to the banking system.

Details of the covered bond purchases were decided at the Governing Council's meeting on 4 June 2009. Direct purchases, for an amount of €60 billion, will be conducted in both the primary and secondary markets. They will include covered bonds compliant with the Directive on undertakings for collective investment in transferable securities (UCITS) and non-UCITS-compliant structured covered bonds that are eligible for use in monetary operations and which are considered to offer similar

safeguards as UCITS-compliant covered bonds. The pool of eligible covered bonds will contain exposures to private and public entities, subject to compliance with the restrictions stipulated in Article 101 of the Treaty establishing the European Community. The minimum size of eligible covered bonds will, as a rule, be about €500 million and, in any case, not less than €100 million. The minimum rating will, as a rule, be AA or equivalent, as given by at least one of the major rating agencies (Fitch, Moody's, S&P or DBRS) and, in any case, not lower than BBB-/Baa3 for covered bonds issued in the euro area by euro area institutions. Monetary policy counterparties and counterparties accepted by Eurosystem members for the purposes of their euro-denominated portfolio investments will be eligible as counterparties accepted for covered bond purchases. The purchases will start in July 2009 and are expected to be concluded by the end of June 2010.

Third, the EIB will become an eligible counterparty in the Eurosystem's monetary policy operations with effect from 8 July 2009 and under the same conditions as any other counterparty. By widening the range of eligible counterparties in Eurosystem operations, the ECB has supplemented its measures to support lending in the euro area. This will further enhance the contribution of the EIB, a key European credit institution that is particularly active in lending to small and medium-sized businesses in the euro area.

## CONCLUSION

All non-standard measures adopted by the Governing Council seek to maintain price stability over the medium term and to ensure that inflation expectations remain firmly anchored in line with price stability. The measures support financing conditions above and beyond what could be achieved through reductions in key ECB interest rates alone.

As there are lags in the transmission of these measures, and the transmission channel has increasingly been affected by the strains in the financial sector, it will take some time for them to feed through to the economy in full.