Floor versus corridor systems in monetary policy regimes –
Overview of the euro area experience and forward-looking issues

13th ECB Central Banking Seminar
Policy panel on monetary policy implementation frameworks in constantly evolving financial markets
Federal Reserve favours a floor system with an ample supply of central bank reserves

January 2019 FOMC meeting minutes:

“Committee intends to continue to implement monetary policy in a regime in which an **ample supply of reserves** ensures that control over the level of the federal funds rate and other short-term interest rates is exercised primarily through the setting of the Fed’s administered rates and in which **active management of the supply of reserves is not required**.”

“… key advantages of the Fed’s current operating regime, incl. good control of the policy rate in a variety of conditions and good transmission to other money market rates and broader financial markets … level and variability of reserve demand and supply were likely to be much larger than in the period before the crisis, and stabilizing the policy rate in this environment would require large and frequent open market operations.”

March 2019 FOMC meeting minutes:

“… **longer-run level of reserves** and size of the balance sheet would ultimately be **determined by long-term demand for Federal Reserve liabilities** … eventual resumption of **purchases of securities** … would be a **normal part of operations to maintain the ample-reserves monetary policy implementation regime** and would not represent a change in the stance of monetary policy.”

“Some participants suggested that … the Committee should discuss the potential benefits and costs of tools that might reduce reserve demand or support interest rate control.”
Pre-crisis corridor system of the Eurosystem has evolved to a de facto floor system since late-2015

![Graph showing interest rates and monetary policy instruments over time](link-to-graph)
Experience of steering short-term interest rates in the euro area (II)

**Excess liquidity created by non-standard measures key factor behind de facto floor system**

The graph shows the evolution of excess liquidity created by non-standard measures and its impact on key interest rates and liquidity instruments in the euro area from 2007 to 2019. The excess liquidity (rhs) is a critical factor behind the de facto floor system, influencing the effective lower bound of short-term interest rates.

- **Excess liquidity (rhs)**: The blue line represents the excess liquidity created by non-standard measures, which has significantly increased over time, especially from 2014 onwards.
- **EONIA**: The black line shows the Effective Single-Market Average Rate (EONIA), which is a key interest rate in the euro area.
- **Deposit Facility**: The green line indicates the level of deposits in the deposit facility, which is another liquidity instrument.
- **Marginal Lending Facility**: The red line represents the marginal lending facility, providing an upper limit for the lending rate.
- **Main Refinancing Operation**: The orange dashed line indicates the main refinancing operation, another key instrument for liquidity provision.

The graph highlights the role of excess liquidity in shaping monetary policy and interest rate dynamics in the euro area.
Arbitrage involving banks and non-banks drives money market activity & rates in a floor system

Money market unsecured rates

Money market unsecured rate volumes

Is it a floor or a magnet?
Amount of liquidity required in corridor and floor systems depends on evolving liquidity demand

Stable or unstable liquidity demand?
Driven by exogenous or endogenous factors?

Minimum excess liquidity in a floor system
Required liquidity provision in a corridor system
Policy preferences and objectives will determine choice of monetary policy regime for the future

Pros of a floor system:
• better steering of the short-term interest rates due to potentially lower volatility of money market rates and less operational complexity
• robust to a further expansion of the balance sheet to serve monetary policy or other policy objectives

Cons of a floor system:
• larger financial market footprint of the Eurosystem
• lower (unsecured) interbank market activity
• could endogenously create additional liquidity demand due to incentives implied by the arbitrage mechanism and (short-term) interest rates below the floor

Alternative to a pure floor system in a world of uncertain demand for reserves: symmetric corridor system with fixed-rate full allotment MROs and a tiered/quota-based remuneration scheme for banks’ reserve holdings