

## 2 TARGET balances and the asset purchase programme

**TARGET balances have seen renewed increases since the launch of the Eurosystem’s asset purchase programme (APP; see Chart A).**<sup>1</sup> TARGET balances are the claims and liabilities of euro area national central banks (NCBs) vis-à-vis the ECB that result from cross-border payments settled in central bank money.<sup>2</sup> Each NCB has either a positive balance (i.e. a claim in TARGET) or a negative balance (i.e. a liability in TARGET). When a country’s banking sector receives a cross-border inflow of central bank money, its claim increases or its liability decreases; cross-border outflows have the opposite effect. The total TARGET balance, which is the sum of all positive balances,<sup>3</sup> is only affected when central bank money flows between countries with positive and negative balances.<sup>4</sup> The launch of the APP has led to a rise in cross-border payments by purchasing central banks, which has caused renewed increases in the total TARGET balance.

**Chart A**  
Total TARGET balance



Source: ECB.

Notes: The total TARGET balance is the sum of all positive TARGET balances. The red and yellow vertical lines denote the commencement of purchases under the APP and the PSPP respectively.

<sup>1</sup> “TARGET” stands for “Trans-European Automated Real-time Gross settlement Express Transfer system”. In May 2008, TARGET2 fully replaced the original TARGET system as the real-time gross settlement system owned and operated by the Eurosystem. In the interests of readability, however, the term “TARGET balances” is used here to describe the balances accumulated by central banks in both of those systems, and the TARGET2 payment system is also referred to as “TARGET”.

<sup>2</sup> For more details, see the box entitled “Publication of TARGET balances”, *Economic Bulletin*, Issue 6, ECB, 2015.

<sup>3</sup> This is equal in magnitude to the sum of all negative balances. Total claims and liabilities sum to zero, since all obligations resulting from activity in TARGET are owed by and to participants in the system.

<sup>4</sup> The total TARGET balance increases if central bank money flows from a country with a liability to a country with a claim, and it decreases if that money flows in the opposite direction. By contrast, flows between two countries with claims (or two countries with liabilities) change the composition, but not the value, of the total TARGET balance.

**Cross-border APP transactions are common owing to the integrated nature of euro area financial markets and give rise to changes in TARGET balances.**

Securities transactions are not limited by national borders under the APP, with central banks purchasing securities from a wide range of counterparties located across the euro area and beyond. When a central bank purchases securities, it makes a payment in central bank money to the selling counterparty at the time of settlement, receiving the security in exchange.<sup>5</sup> In the case of a cross-border transaction,<sup>6</sup> that liquidity flow affects the TARGET balances of the sending and receiving NCBs and may potentially alter the total TARGET balance. Consequently, the location of the TARGET accounts used by APP counterparties to receive payment for securities determines the impact that asset purchases have on TARGET balances immediately following the purchase.<sup>7</sup>

**Asset purchases from counterparties located in a different country from the purchasing central bank can directly affect TARGET balances.**

Counterparties whose NCBs are connected to TARGET use their accounts at those NCBs,<sup>8</sup> while counterparties located elsewhere can use an account at a correspondent bank with access to TARGET.<sup>9</sup> Banks based outside the euro area tend to make payments in TARGET via branches or correspondent banks in countries with claims in TARGET, such as Germany or the Netherlands.<sup>10</sup> It follows that when an NCB purchases securities from a non-domestic counterparty, whether it is located in another euro area country or outside the euro area, the purchase is likely to give rise to cross-border flows of central bank money.<sup>11</sup>

**A very large majority of APP purchases involve counterparties located in a different country from the purchasing central bank.**

In volume terms, around 80% of all APP purchases have involved non-domestic counterparties.<sup>12</sup> Furthermore, around 50% of APP purchases have involved sellers resident outside the euro area. This has given rise to substantial cross-border flows of central bank money, affecting national TARGET balances and leading to structural inflows of

<sup>5</sup> The selling counterparty may not necessarily be the legal owner of the security. Counterparties can also act as intermediaries, holding securities and managing transactions on behalf of owners.

<sup>6</sup> This is defined as a transaction where money is credited to an account held by the seller at a central bank other than the purchasing NCB.

<sup>7</sup> Settlement can take place in the TARGET account used by the selling counterparty or the TARGET account of a custodian bank or central securities depository. The analysis in this box is based on the assumption that liquidity from APP purchases flows to the TARGET account used by the counterparty. This is a simplifying hypothesis adopted in order to simulate liquidity distribution resulting directly from purchases.

<sup>8</sup> This includes euro area-resident branches of banking groups headquartered outside the euro area. Furthermore, five non-euro area countries currently participate in TARGET: Bulgaria, Denmark, Croatia, Poland and Romania.

<sup>9</sup> Banks with branches that are in the European Economic Area, but outside the euro area, can also hold an account at a Eurosystem NCB as a direct participant in TARGET.

<sup>10</sup> For a more detailed discussion on the subject of non-euro area banks with accounts at Eurosystem NCBs, see "The impact of Eurosystem securities purchases on the TARGET2 balances", *Monthly Report*, Deutsche Bundesbank, March 2016. The locations of participation in TARGET by non-euro area banks typically reflect historical relationships with euro area branches or correspondent banks, and have remained largely unchanged since the TARGET2 payment system was set up in 2007/08.

<sup>11</sup> The ECB also purchases securities under the APP, which are recorded as flows from the ECB to the sellers' NCBs. As a result, the ECB's liability in TARGET has increased since the launch of the APP.

<sup>12</sup> In this context, "non-domestic" refers to a counterparty that is located in a country which is different from that of the purchasing NCB. This includes counterparties located in other euro area countries.

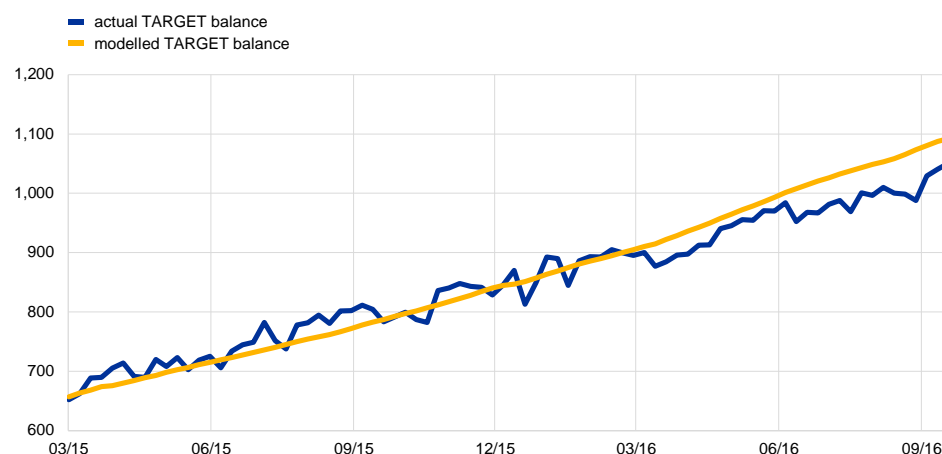
central bank money in countries hosting large numbers of non-resident counterparties (such as Germany).

**Analysis of data on individual APP transactions indicates that the upward trend observed in TARGET balances largely reflects cross-border liquidity flows arising from the settlement of APP purchases.** Chart B shows the evolution of the total TARGET balance since the launch of the public sector purchase programme (PSPP) in March 2015, which has led to a sizeable increase in the amount of liquidity being injected via the APP. It also reports a modelled balance, showing how the total TARGET balance would have evolved if the only cross-border payments in the system were the liquidity flows from central banks to counterparties' TARGET accounts resulting from APP purchases. The total TARGET balance has risen in line with the modelled balance. Although subsequent flows of APP liquidity can further affect TARGET balances, the first-round liquidity flows have provided a good approximation to date of the impact of the APP on the total TARGET balance. An analysis of subsequent liquidity flows falls outside the scope of this box.

### Chart B

#### Total TARGET balance since the launch of the PSPP and a modelled balance

(EUR billions; weekly data)



Sources: ECB, TARGET2 and ECB staff calculations.

Notes: The modelled TARGET balance is calculated using APP transaction data and information on the location of APP counterparties' TARGET accounts. The modelled balance shows how the total TARGET balance would have evolved since March 2015 if the only cross-border payments in the system were the liquidity flows from central banks to counterparties' TARGET accounts resulting from APP purchases.

**In contrast to previous periods of rising TARGET balances, changes in the TARGET balances immediately after APP purchases are a direct consequence of the implementation of monetary policy decisions, rather than a symptom of renewed stress in financial markets.** TARGET balances increased from mid-2007 to late 2008, and again from mid-2011 to mid-2012. The increases in TARGET balances during those periods were rooted in the market stress and fragmentation that resulted from the financial and sovereign debt crises.<sup>13</sup> As banks lost access to

<sup>13</sup> For more information on the evolution of TARGET balances and the implementation of monetary policy during different phases of the financial crisis, see Peter Praet's remarks at BNY Mellon's 20th anniversary dinner in Brussels on 15 September 2016.

market-based funding, they replaced private sources of funding with central bank liquidity obtained from their NCBs through repurchase operations.<sup>14</sup> Those repurchase operations had no immediate impact on TARGET balances, as they were settled domestically,<sup>15</sup> but the subsequent redistribution of liquidity, influenced by market stress and fragmentation, did have an impact. The link between the implementation of monetary policy decisions and TARGET balances was therefore indirect. With the APP, however, there is a direct link, since central banks are initiating cross-border payments in order to pay for securities purchased under the programme. The ensuing upward trend in TARGET balances largely reflects the settlement of these cross-border transactions by central banks and, therefore, does not signal renewed stress in financial markets.

---

<sup>14</sup> For a more detailed discussion on this subject, see the article entitled "TARGET balances and monetary policy operations", *Monthly Bulletin*, ECB, May 2013.

<sup>15</sup> When reserves are injected via repurchase agreements, the NCB records a liability in the form of an increase in current accounts of commercial banks and records an asset in the form of lending operations.