



**EUROPEAN CENTRAL BANK**  
EUROSYSTEM

**ECB-PUBLIC**

*COURTESY TRANSLATION*

Mario DRAGHI  
President

Mr Marco Zanni  
Member of the European Parliament  
European Parliament  
60, rue Wiertz  
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Frankfurt, 11 May 2017

L/MD/17/165

**Re: Your letter (QZ-018)**

Honourable Member of the European Parliament, dear Mr Zanni,

Thank you for your letter, which was passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 1 March 2017.

TARGET2 is the infrastructure that settles payments in central bank money related to monetary policy operations, interbank and customer payments, and payments relating to the operations of other settlement systems. The settlement of cross-border payments between TARGET2 participants results in intra-Eurosystem balances. In terms of accounting, at the close of business, all bilateral positions among national central banks (NCBs) are netted and aggregated, leaving each NCB with a TARGET2 claim or liability vis-à-vis the ECB as the central counterparty.<sup>1</sup>

A divergence in macroeconomic conditions across countries does not in itself give rise to increases in TARGET2 balances. In fact, differences in macroeconomic conditions also existed prior to the crisis, while TARGET2 balances remained relatively small. An increase in TARGET2 balances can arise in the context of the decentralised implementation of monetary policy in the euro area. For example, in the case of the Eurosystem's asset purchases, the securities acquired are funded by the creation of liquidity, or "reserves", by the purchasing NCB. The acquired security is recorded as an asset and the reserves are recorded as a liability on the balance sheet of that NCB. Cross-border flows of reserves must be recorded on the balance

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<sup>1</sup> For more details, see "[TARGET balances and monetary policy operations](#)", *Monthly Bulletin*, ECB, May 2013.

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sheets of the sending and receiving NCBs.<sup>2</sup> Therefore, cross-border payments by NCBs for securities purchased under the asset purchase programme (APP) can give rise to changes in TARGET2 balances in the course of the implementation of monetary policy. A significant number of large APP counterparties are domiciled in financial centres located in a few countries, while most of the non-euro area counterparties access the TARGET2 payment system via the Deutsche Bundesbank.<sup>3</sup> As a result of this financial structure, very large net cross-border flows of central bank money to accounts held at the Deutsche Bundesbank occur during the implementation of the APP, leading to changes in TARGET2 balances.<sup>4</sup>

The APP encourages the owners of assets purchased under the programme to rebalance their portfolios, which means that the owners make other forms of investment or purchase other securities. For instance, there has been a broad-based rebalancing across euro area countries towards non-euro area debt securities,<sup>5</sup> although the specific characteristics of the rebalancing can differ, for example owing to heterogeneity in the ownership structure and net issuance of new securities. The rebalancing can also lead to payment flows to euro area financial centres and thereby keep TARGET balances elevated. Evidence from a range of financial market and banking statistics does not indicate a general increase in stress. With respect to the balance of payments, euro area countries with large current account deficits before the global financial crisis have seen a significant correction over recent years and, in most cases, have turned these deficits into surpluses. The current increase in TARGET2 balances is therefore inherently different from the dynamics observed during previous episodes of rising balances. The eventual normalisation of central bank balance sheets and liquidity conditions can also be expected to bring about a reduction in the TARGET2 balances.

Yours sincerely,

[signed]

Mario Draghi

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<sup>2</sup> If the sending NCB has a TARGET2 claim (liability), the outflow of reserves will be offset by a reduction (increase) in its claim (liability). The receiving NCB will record an increase in reserves. This increase is balanced by either an increase in its TARGET2 claim or a reduction in its TARGET2 liability.

<sup>3</sup> The concentration of counterparties in euro area financial centres has a long history that pre-dates the financial and sovereign debt crises. The locations of participation in TARGET2 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>4</sup> See the box entitled "TARGET balances and the asset purchase programme", *Economic Bulletin*, Issue 7, ECB, 2016, available at <http://www.ecb.europa.eu/pub/pdf/ecbu/eb201607.en.pdf>, and the box entitled "The impact of Eurosystem securities purchases on the TARGET2 balances", *Monthly Report*, Vol. 68, No 3, Deutsche Bundesbank, March 2016, [https://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Monthly\\_Report/2016/2016\\_03\\_monthly\\_report.pdf?blob=publicationFile](https://www.bundesbank.de/Redaktion/EN/Downloads/Publications/Monthly_Report/2016/2016_03_monthly_report.pdf?blob=publicationFile).

<sup>5</sup> See the box entitled "Analysing euro area net portfolio investment outflows", *Economic Bulletin*, Issue 2, ECB, 2017.

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