

Box 2

LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM 12 MAY TO 10 AUGUST 2004

This box reviews the ECB's liquidity management during the three reserve maintenance periods ending on 8 June, 6 July and 10 August 2004.

Liquidity needs of the banking system

Banks' liquidity needs increased significantly in the period under review (see Chart A). The main contributing factor was the growth in net autonomous factors (i.e. liquidity factors which do not normally stem from the use of monetary policy instruments), which on average absorbed €178.7 billion, the highest level registered since January 1999. This increase was due to the sustained growth in banknotes in circulation, which reached a new historic high of €467.9 billion at the beginning of August. Government deposits were also unusually high during the period under review, reaching €87.5 billion at the end of June, the highest level seen since the beginning of Stage Three of EMU. During the period under review, reserve requirements increased by €4 billion, while excess reserves (i.e. banks' current account holdings in excess of reserve requirements) fluctuated to a limited extent around an average value of €0.68 billion.

Liquidity supply and interest rates

In line with growing liquidity demand, the volume of open market operations increased in the period under review (see Chart A). The allotment amount in the main refinancing operation (MRO) settled on 23 June was, at €260 billion, historically high. Counterparties' bid volumes

Chart A Liquidity needs of the banking system and liquidity supply

(EUR billions; daily averages for the whole period are shown next to each item)

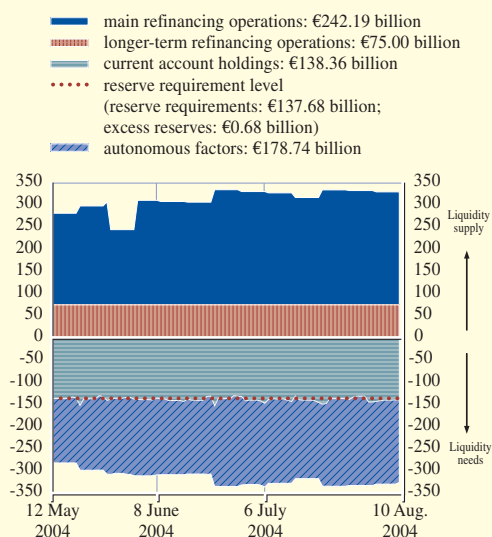
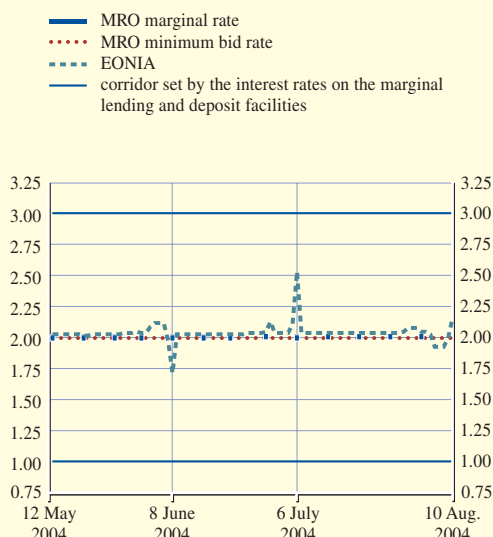


Chart B The EONIA and the ECB interest rates

(daily interest rates in percentages)



adapted smoothly to the increased allotment amounts and the ratio of submitted bids to satisfied bids (the bid-cover ratio) continued to hover around the level of 1.25, which had prevailed since March 2004, when the first MROs with a one-week maturity were carried out. For all the MROs settled during the review period, the difference between the minimum bid rate and the marginal rate and between the marginal rate and the weighted average rate was either zero or one basis point.

The EONIA (euro overnight index average) remained within a narrow range of between 2.03% and 2.05% (see Chart B), with the exception of those days falling at month-end or after the last MRO allotment of a maintenance period. After the last MRO allotments the EONIA was, as usual, more volatile, mainly fluctuating according to market participants' perceptions regarding the evolution of liquidity conditions. After the last MRO of the maintenance period ending on 8 June the EONIA temporarily increased to 2.12%, as market participants perceived the liquidity conditions to be somewhat tight. However, on the last day of that maintenance period the rate declined to 1.72%, as liquidity conditions turned out to be slightly loose, with a net recourse to the deposit facility of €2.1 billion. At the end of the subsequent maintenance period, the EONIA was relatively stable, starting to fluctuate only on the last two days of the period. During these two days the EONIA rose to 2.53% on account of tight liquidity conditions, the period ending with a net recourse to the marginal lending facility of €5.4 billion. Finally, after the last MRO allotment of the maintenance period ending on 10 August the EONIA declined to 1.93% on 6 August 2004, with market participants apparently expecting loose liquidity conditions at the end of the maintenance period. However, somewhat surprisingly, the EONIA rose to 2.16% on the last day of the maintenance period, despite the liquidity conditions actually being loose, with the period ending with a net recourse to the deposit facility of €4.0 billion.