Box 1

LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM 10 AUGUST TO 8 NOVEMBER 2005

This box reviews the ECB's liquidity management during the three reserve maintenance periods ending on 6 September, 11 October and 8 November 2005.

Liquidity needs of the banking system

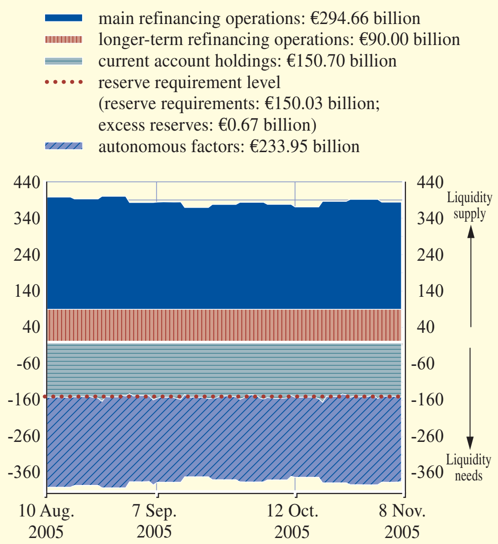
Banks' liquidity needs decreased slightly in the period under review (see Chart A), mainly owing to the evolution of government deposits. Banknotes, which represent the largest "autonomous factor" (i.e. a factor which does not normally stem from the use of monetary policy instruments), continued to increase, reaching a historical high of €539.7 billion on 4 November. Overall, autonomous factors contributed an average of €234 billion to the liquidity deficit of the Eurosystem in the period under review. Reserve requirements, which are the other major source of liquidity needs, increased to €150 billion over the same period. Daily average excess reserves (i.e. the daily average of current account holdings in excess of reserve requirements) contributed an average of €0.67 billion to the liquidity deficit of the Eurosystem over the period considered. In the reserve maintenance period ending on 6 September, average excess reserves were €0.57 billion, the lowest figure since 1999. In the following two maintenance periods, which ended on 11 October and 8 November, average excess reserves increased to €0.72 billion and €0.69 billion respectively (see Chart B). These higher levels might have been related to public holidays in some parts of the euro area during the last week of both maintenance periods.

Liquidity supply and interest rates

In line with the slight decrease observed in demand for liquidity, the volume of open market operations was reduced (see Chart A). On average, the liquidity provided via main refinancing operations (MROs) amounted to €294.7 billion. The ratio between bids submitted by counterparties and satisfied bids (the bid-cover ratio) increased at the beginning of the period under review, reaching values near 1.50, before decreasing afterwards to more usual levels. The average bid-cover ratio over the period under review was 1.38.

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)



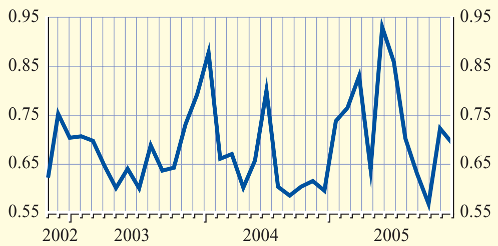
Source: ECB.

In the maintenance periods that ended on 6 September and 11 October, the ECB allotted the benchmark amount in all MROs. The difference between the marginal and the weighted average rates in the weekly tenders was either zero or one basis point, with the marginal rate, however, increasing slightly from 2.05% to 2.07% over this period. The EONIA (euro overnight index average) was relatively stable during these two maintenance periods, with its spread versus the minimum bid rate remaining at 8 basis points with the usual few exceptions, namely at month-ends and in the final days of the maintenance periods.

There was, in spite of the balanced liquidity conditions in the money market, some upward drift in September and October in the spread between, on the one hand, very short-term market rates and the tender rates and, on the other hand, the minimum bid rate. To address this upward drift, on 11 October the ECB communicated to market participants its uneasiness about the level of short-term spreads and started a slightly loose allotment policy in the maintenance period ending on 8 November. This policy did not, however, change the objective of aiming at balanced

Chart B Excess reserves[1)]

(EUR billions; average level in each maintenance period)

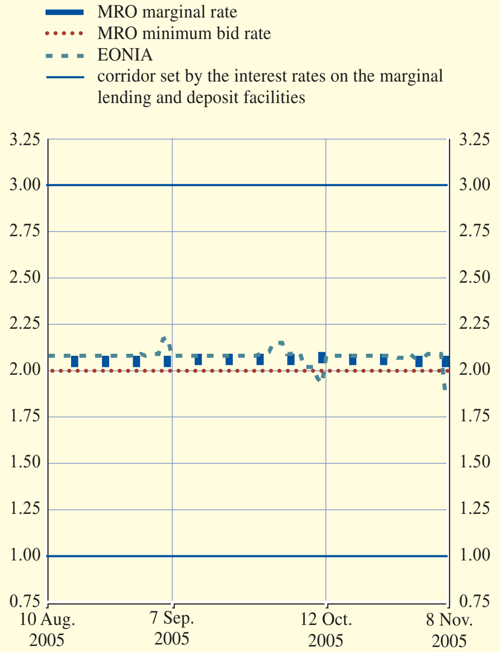


Source: ECB.
1) Banks' current account holdings in excess of reserve requirements.

liquidity conditions at the end of the reserve maintenance period. In this context, the ECB allotted €1 billion above the benchmark amount in all MROs, with the exception of the last operation in the maintenance period. The marginal and weighted average tender rates decreased by 2 and 1 basis points respectively over the maintenance period.

Chart C The EONIA and the ECB interest rates

(daily interest rates in percentages)



Source: ECB.

Liquidity conditions and the overnight interest rate in the final weeks of the three maintenance periods

As the end of the maintenance period ending on 6 September was approaching, market participants perceived liquidity conditions to be tight. As a result, the EONIA increased, reaching 2.17% on the penultimate day of the period. On the following day, the ECB conducted a fine-tuning operation in order to compensate for the expected €9.5 billion liquidity shortage. The bid amount was fairly high (€51 billion) and the marginal and weighted average rates in the fine-tuning operation were set at 2.09% and 2.10% respectively. By the end of the day, there was a net recourse to the deposit facility of €0.26 billion and the EONIA rose to 2.18%.

In the following maintenance period, which ended on 11 October, liquidity conditions loosened after the last MRO allotment. The EONIA declined to 2.02% on 7 October and to 1.96% on 10 October, the penultimate day of the maintenance period. On the last day of that period, a liquidity surplus of €8.5 billion was expected. To drain the excess liquidity, a fine-tuning operation was conducted, which attracted bids for an amount of €24 billion. The maintenance period ended with a net recourse to the deposit facility of €1.3 billion and the EONIA at 1.93%.

In the maintenance period ending on 8 November, market participants perceived liquidity conditions to be slightly tight following the last MRO. The EONIA rose to 2.09% on 4 November and remained at that level until the penultimate day of the maintenance period. However, on the last day of that period, liquidity conditions were fairly balanced and no fine-tuning operation was necessary. The maintenance period ended with only marginally loose liquidity conditions. There was a net recourse to the deposit facility of €1.4 billion and the EONIA declined to 1.87%.