LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM 9 AUGUST 2006 TO 7 NOVEMBER 2006

This box reviews the ECB’s liquidity management during the three reserve maintenance periods ending on 5 September, 10 October and 7 November 2006.

Liquidity needs of the banking system

Over the period under review, banks’ liquidity needs remained broadly unchanged (see Chart A), increasing by only €3 billion owing, in equal parts, to higher autonomous factors and a higher level of reserve requirements. Banknotes in circulation, which are the largest (liquidity-absorbing) autonomous factor, reached a historical high of €597 billion on 3 November.

Overall, autonomous factors contributed on average €264.5 billion to the liquidity deficit of the Eurosystem in the period under review, whereas reserve requirements – the other major source of liquidity needs – contributed on average €166.1 billion. Daily average excess reserves
(i.e. the daily average of current account holdings in excess of reserve requirements) contributed €0.68 billion on average to the liquidity deficit of the Eurosystem. Average excess reserves reached €0.60 and €0.67 billion in the reserve maintenance periods ending on 5 September and 10 October respectively and increased further to €0.79 billion in the maintenance period ending on 7 November (see Chart B).

Liquidity supply and interest rates

In parallel with the increase in the demand for liquidity, the volume of open market operations remained broadly unchanged (see Chart A). On average, the liquidity provided via main refinancing operations (MROs) amounted to €311.3 billion. The ratio between bids submitted by counterparties and satisfied bids (the bid-cover ratio) varied between 1.00 and 1.24, with an average bid-cover ratio over the period of 1.15.

The liquidity provided by longer-term refinancing operations remained constant at €120 billion in the period under review.

Maintenance period ending on 5 September

On 3 August, the Governing Council of the ECB decided to increase the minimum bid rate and the rates of the deposit and marginal lending facilities by 25 basis points to 3.00%, 2.00% and 4.00% respectively. The change became effective as of 9 August, i.e. at the start of the subsequent maintenance period.

During the whole reserve maintenance period, the ECB continued its allotment policy of the previous three maintenance periods by providing in all MROs €2 billion above the benchmark amount (i.e. the amount that balances the demand and supply of liquidity).

The first half of the period saw marginal and weighted average MRO rates at 3.05% and 3.06% respectively and the EONIA (euro overnight index average) at 3.07%, i.e. 7 basis points above the minimum bid rate. Whereas the two tender rates remained unchanged in
the third week, the EONIA started to decline during this week to 3.01%. Consequently, the following tender also saw the marginal and weighted average MRO rates decline to 3.00% and 3.02% respectively. The EONIA remained close to the minimum bid rate during the final week of the reserve maintenance period. On the last day of the maintenance period, the ECB absorbed an expected liquidity surplus of €11.5 billion via a fine-tuning operation. The maintenance period ended with a net recourse to the marginal lending facility of €0.6 billion and the EONIA at 3.04%.

**Maintenance period ending on 10 October**

On 5 September, the ECB issued a communication that, given the continued progress in countering the elevated spread between market rates and tender rates, on the one hand, and the minimum bid rate, on the other, which had been achieved by following the practice of allotting €2 billion above benchmark in all MROs, the allotment above the benchmark amount would be reduced to €1 billion.

During the first three weeks of the maintenance period, the marginal and weighted average MRO rates declined by 1 basis point to 3.03% and 3.04% respectively. The decline in the EONIA, however, gained momentum and the EONIA fell from 3.06% at the beginning of the period to 3.01% by the end of the third week. Therefore, on 26 September the ECB issued a statement that, given the results achieved in countering the spread between market rates and tender rates, on the one hand, and the minimum bid rate, on the other, it would allot the benchmark amount. The ECB also mentioned that, when deciding about future allotments, it would continue to closely monitor the spreads.

The marginal and weighted average MRO rates fell to 3.00% and 3.03% respectively in the penultimate tender of the maintenance period, before increasing to 3.02% and 3.04% in the final MRO. The EONIA drifted upwards to 3.10% during the penultimate week and reached 3.25% during the final week of the reserve maintenance period.

On the final day of the maintenance period, the ECB provided €9.5 billion of liquidity via a fine-tuning operation. The maintenance period ended with a net recourse to the deposit facility of €0.2 billion and the EONIA at 3.09%, i.e. 9 basis points above the minimum bid rate.

**Maintenance period ending on 7 November**

On 5 October, the Governing Council decided to further increase the key ECB interest rates by 25 basis points. The change became effective as of 11 October, i.e. the start of the subsequent
maintenance period. During the first three weeks of the period, the ECB allotted the benchmark amount.

During the first two weeks of the maintenance period, marginal and weighted average tender rates remained stable at 3.29% and 3.30%. The EONIA rose from 3.31% at the start of the period to 3.34% on 25 October. The tender rates increased by 1 basis point in the penultimate MRO, while the EONIA increased further to 3.38% on 31 October, i.e. 13 basis points above the minimum bid rate, although this partly reflected the usual end-of-the-month effect. Therefore, the ECB allotted €1 billion above benchmark in the final MRO of the maintenance period. The EONIA gradually declined in the course of the last week to 3.33% on 6 November, the penultimate day of the period. The maintenance period ended with a net recourse to the marginal lending facility of €2.0 billion and the EONIA at 3.32%.

Overall, the average spread between the EONIA and the ECB’s minimum bid rate increased from 4 basis points in the maintenance period ending on 5 September to 8 basis points in the two following maintenance periods.