

LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM 8 NOVEMBER 2006 TO 13 FEBRUARY 2007

This box reviews the ECB's liquidity management during the three reserve maintenance periods ending on 12 December 2006, 16 January 2007 and 13 February 2007.

Liquidity needs of the banking system

During the period under review, banks' liquidity needs displayed the usual seasonal pattern (see Chart A), mainly resulting from the increase in banknotes in circulation towards the end of the year. Banknotes in circulation, the largest liquidity-absorbing autonomous factor, reached a historical high of €629.2 billion on 28 December 2006.

Overall, autonomous factors contributed an average of €259.3 billion to the liquidity deficit of the Eurosystem in the period under review. Reserve requirements, the other major source of liquidity needs, amounted to €174.1 billion on average over the same period.¹

Daily average excess reserves (i.e. the daily average of current account holdings in excess of reserve requirements) contributed €0.68 billion to the liquidity deficit of the Eurosystem in the reserve maintenance period ending on 12 December and €0.79 billion in the reserve maintenance period ending on 13 February.

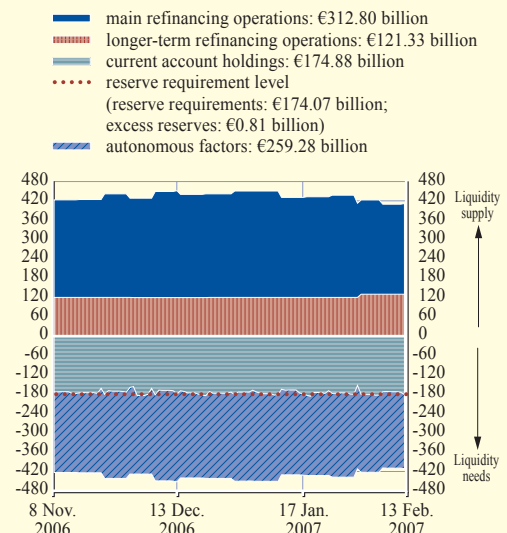
A somewhat higher average level of €0.96 billion was observed in the reserve maintenance period ending on 16 January, reflecting the usual higher demand for liquidity buffers around the Christmas and New Year holiday period (see Chart B).

Liquidity supply and interest rates

In parallel with the seasonal peak in the demand for liquidity, the volume of open market operations increased towards the end of the year, before declining again as the seasonal demand for banknotes receded (see Chart A). On average, the liquidity provided via the main refinancing operations (MROs) amounted to €312.8 billion. The ratio between bids submitted by counterparties and satisfied bids (the bid-cover ratio) varied between 1.14 and 1.37, with an average over the period of 1.25.

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)



¹ With the entry of Slovenia to the euro area on 1 January 2007, the daily reserve requirements increased by €0.3 billion and the liquidity needs stemming from autonomous factors decreased by €1.7 billion on average between 1 January and 13 February 2007. The latter figure included also monetary policy operations conducted by Banka Slovenije before 1 January 2007 and still outstanding after this date.

In line with the decision of the Governing Council to increase the allotment amount of the longer-term refinancing operations (LTROs) from €40 billion to €50 billion, the liquidity provided by LTROs increased from €120 billion to €130 billion in the period under review.

Maintenance period ending on 12 December

The ECB allotted €1 billion above benchmark in all MROs of this reserve maintenance period.

The first two weeks of the period saw marginal and weighted average MRO rates of 3.31% and 3.32%, respectively, and the EONIA (euro overnight index average) declining from 3.33% to 3.32%. In the subsequent tender, the marginal and weighted average MRO rates declined to 3.30% and 3.31%, respectively. With the exception of 30 November, when it stood at 3.34% due to the usual end-of-month effect, the EONIA remained at 3.32% until the last week of the reserve maintenance period. During this week, it first declined to 3.28% on 7 December, but started increasing again against the background of unexpectedly high autonomous factors. On the last day of the reserve maintenance period, the ECB provided €2.5 billion via a fine-tuning operation. The reserve maintenance period ended with a net recourse to the marginal lending facility of €0.5 billion and the EONIA at 3.36%, i.e. 11 basis points above the minimum bid rate. The average spread between the EONIA and the ECB's minimum bid rate in the reserve maintenance period amounted to 7 basis points.

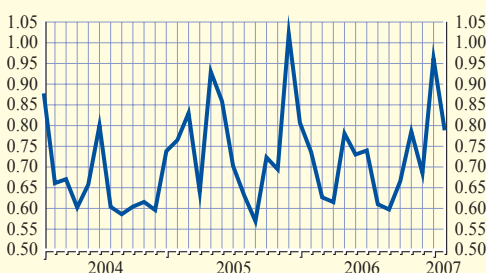
Maintenance period ending on 16 January

On 7 December the Governing Council decided to increase the key ECB interest rates (minimum bid rate and rates of the deposit and marginal lending facilities) by 25 basis points to 3.50%, 2.50% and 4.50%, respectively. The change became effective as of 13 December, the first day of the subsequent maintenance period.

The policy of allotting more than the benchmark amount followed in the previous reserve maintenance period was gradually stepped up in the period under review to foster smooth liquidity conditions in the money market around Christmas and the end of the year. In the first three MROs of the reserve maintenance period, the ECB allotted €2 billion, €4 billion and €5 billion above benchmark.

Chart B Excess reserves ¹⁾

(EUR billions, average level in each maintenance period)

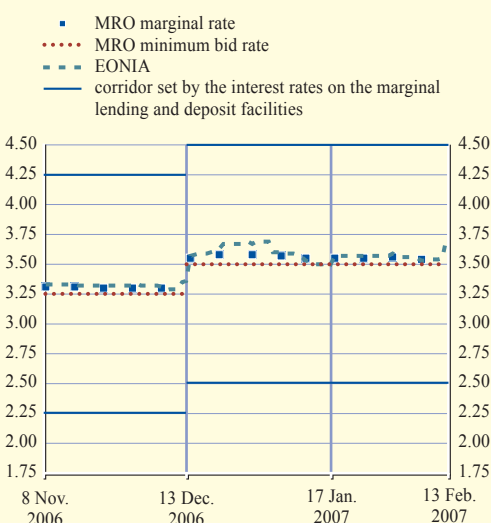


Source: ECB.

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

Chart C The EONIA and the ECB interest rates

(daily interest rates in percentages)



Source: ECB.

Notwithstanding the allotment above benchmark in the first and second MROs, the EONIA rose to 3.67% on 21 December and increased further to 3.69% on 27 December, possibly also reflecting an additional demand for liquidity around Christmas and the end of the year which seemed somewhat stronger than in the previous year. After the ECB had allotted €5 billion above benchmark in the last MRO of 2006, the EONIA briefly dropped to 3.67%, before rising again to 3.69% on 29 December, the last trading day of the year. The end-of-year spread between the EONIA and the minimum bid rate of 19 basis points was in line with the spread observed in previous years. At the beginning of 2007, the ECB reduced the amount allotted above benchmark to €2 billion in the penultimate MRO of the reserve maintenance period and further to €1 billion in the last one. Possibly also in connection with ample liquidity conditions due to lower than expected autonomous factors, the EONIA decreased with the start of the new year. It reached 3.56% on 9 January and declined further in the last week of the reserve maintenance period, notwithstanding liquidity-absorbing errors in the forecast of autonomous factors. The reserve maintenance period ended with a net recourse to the marginal lending facility of €0.9 billion and the EONIA at 3.50%. The average spread between the EONIA and the ECB's minimum bid rate in the reserve maintenance period amounted to 11 basis points, slightly higher than in the corresponding period one year earlier.

While the marginal and weighted average MRO rates stood at 3.55% and 3.56%, respectively, in the first and the last MRO of the reserve maintenance period, they ranged between 3.57% and 3.58% and between 3.58% and 3.68%, respectively, in the other three MROs.

Maintenance period ending on 13 February

In all MROs of this reserve maintenance period, the ECB continued allotting €1 billion above benchmark. The first two weeks of the period saw marginal and weighted average MRO rates at 3.55% and 3.56%, respectively, and the EONIA stable at 3.57%, i.e. 7 basis points above the minimum bid rate. The EONIA rose to 3.59% on 31 January, due to the usual end-of-month effect. Whereas the marginal MRO rate increased to 3.56% in the third week of the period, the EONIA started to decline, reaching 3.53% on 7 February. In line with this development, the marginal and weighted average MRO rates declined to 3.54% and 3.55%, respectively, in the last MRO of the period. However, the EONIA rose to 3.55% on 12 February against the background of liquidity-absorbing errors in the forecast of autonomous factors in the last week of the period. On 13 February, the last day of the reserve maintenance period, the ECB provided liquidity for an amount of €2 billion via a fine-tuning operation. The reserve maintenance period ended with a net recourse to the marginal lending facility of €0.4 billion and the EONIA at 3.71%, i.e. 21 basis points above the minimum bid rate. The average spread between the EONIA and the ECB's minimum bid rate amounted to 7 basis points during the period.