

Box 3

LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM 14 FEBRUARY 2007 TO 14 MAY 2007

This box reviews the ECB's liquidity management during the three reserve maintenance periods ending on 13 March 2007, 17 April 2007 and 14 May 2007.

Liquidity needs of the banking system

During the period under review, banks' liquidity needs declined slightly (by €6.8 billion), mainly owing to a decline of €14.4 billion in the level of autonomous factors. The decline was offset, in part, by a €7.2 billion increase in reserve requirements, which amounted to €181.3 billion on average. Overall, autonomous factors contributed an average of €244.8 billion to the liquidity deficit of the Eurosystem in the period under review.

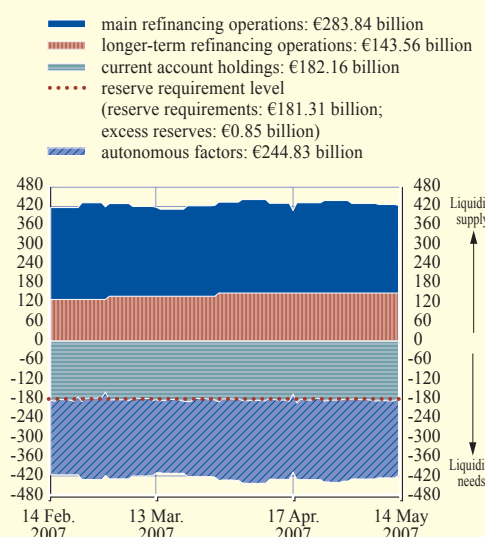
Over the review period daily average excess reserves (i.e. the daily average of current account holdings in excess of reserve requirements) were relatively high. They contributed €0.80 billion to the liquidity deficit of the Eurosystem in the reserve maintenance period ending on 13 March and €0.79 billion in the reserve maintenance period ending on 17 April. A somewhat higher average level of €0.99 billion was observed in the reserve maintenance period ending on 14 May. This was the second highest level of excess reserves since March 2004 (see Chart B).

Liquidity supply and interest rates

Reflecting the moderate decrease in liquidity needs, the volume of open market operations

Chart A Liquidity needs of the banking system and liquidity supply

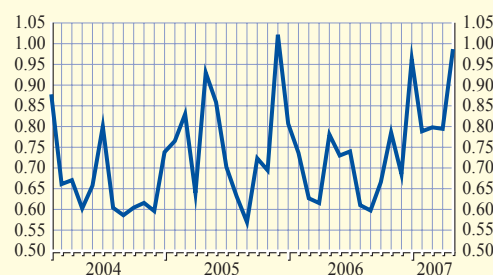
(EUR billions; daily averages for the whole period are shown next to each item)



Source: ECB.

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.

decreased during the period under review (see Chart A). On average, the liquidity provided via the main refinancing operations (MROs) amounted to €283.8 billion. The ratio between bids submitted by counterparties and satisfied bids (the bid-cover ratio) was in a range between 1.28 and 1.41, with an average of 1.34 for the period.

The liquidity provided through longer-term refinancing operations (LTROs) continued to increase in the period under review, from €130 billion to €150 billion, following the decision of the Governing Council to increase the allotment amount of each LTRO from €40 billion to €50 billion.

Maintenance period ending on 13 March

The ECB allotted €1 billion above benchmark in all four MROs of the reserve maintenance period. The average spread between the EONIA (euro overnight index average) and the MRO minimum bid rate was 4 basis points, thus slightly lower than its historical average. The first two weeks of the period saw the marginal and weighted average MRO rates at 3.55% and 3.56% respectively, with the EONIA stable at 3.57%. In the third tender, the marginal and weighted average MRO rates were both at 3.56%. The EONIA declined slightly, to 3.56%, on 27 February, before rising to 3.60% the next day on account of the usual end-of-month effect. On 1 March it returned to 3.57% and declined further to 3.56% on 5 March. After the allotment of the last MRO of the reserve maintenance period, the EONIA fell further to reach 3.52% on the penultimate day of the period. On the last day, the ECB intended to absorb an expected liquidity surplus of €10.5 billion via a fine-tuning operation. However, the operation attracted bids for only €2.3 billion, and the excess of liquidity on the final day of the reserve maintenance period put downward pressure on the overnight rate. The reserve maintenance period ended with a net recourse to the deposit facility of €7.3 billion and the EONIA at 3.11%. The negative EONIA spread to the MRO minimum bid rate on the last day was 39 basis points.

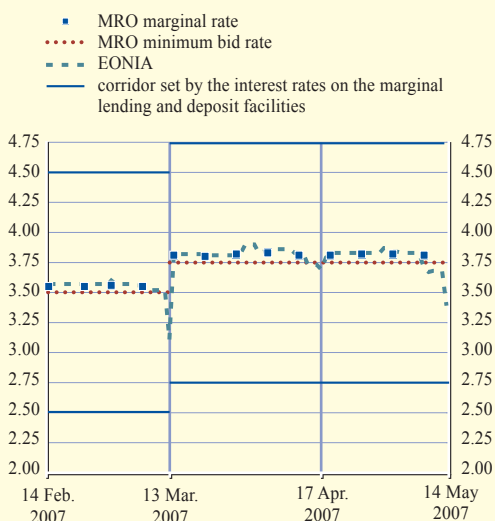
Maintenance period ending on 17 April

On 8 March the Governing Council decided to increase the key ECB interest rates (the minimum bid rate and the rates of the deposit and marginal lending facilities) by 25 basis points to 3.75%, 2.75% and 4.75% respectively. The change became effective as of 14 March, the first day of the subsequent reserve maintenance period.

The policy of allotting €1 billion more than the benchmark amount was applied in all five MROs of this reserve maintenance period. The average spread between the EONIA and the MRO minimum bid rate over the reserve maintenance period as a whole was 7 basis points. The first two weeks of the period saw the weighted average rate in the MROs at 3.81%, whereas

Chart C The EONIA and the ECB interest rates

(daily interest rates in percentages)



Source: ECB.

the marginal rate declined from 3.81% in the first operation to 3.80% in the second. The EONIA was stable at 3.82% during the first week and declined by 1 basis point in the second week. In the following two MROs, the weighted average rate increased to 3.83%, with the marginal rate increasing to this level for the MRO covering the Easter holiday period. The final MRO of the reserve maintenance period saw the marginal and the weighted average rates lower, at 3.82% and 3.83% respectively. The EONIA peaked at 3.90% on 30 March, the last business day of the quarter. On 2 April it returned to 3.83%, but increased temporarily to 3.86% on 5 April, ahead of the Easter weekend. In the days after the allotment of the last MRO of the reserve maintenance period, liquidity conditions were loose. The EONIA declined to 3.69% on the penultimate day of the period. The ECB conducted a fine-tuning operation to withdraw €22.5 billion of liquidity on the last day of the reserve maintenance period, which met high bidding from banks (bids totalling €42.2 billion from 35 counterparties). The reserve maintenance period ended with a net recourse to the marginal lending facility of €1.1 billion. The positive spread between the MRO minimum bid rate and the EONIA on the last day was 4 basis points.

Maintenance period ending on 14 May

In all four MROs of the reserve maintenance period, the ECB continued to allot €1 billion above benchmark. The average spread between the MRO minimum bid rate and the EONIA over the maintenance period as a whole was 4 basis points, thus slightly lower than its historical average; this masks some variability in the spread within the maintenance period. The first week of the period saw marginal and weighted average MRO rates of 3.81% and 3.82% respectively, and the EONIA stable at 3.83%, i.e. 8 basis points above the minimum bid rate. In the second and third weeks of the period, the marginal MRO rate was 3.82% and the weighted average rate 3.83%, while the EONIA rose to 3.87% on 30 April, on account of the usual end-of-month effect. The marginal and weighted average rates of the last MRO of the reserve maintenance period were 3.81% and 3.82% respectively, while the EONIA declined from 3.81% on 8 May to 3.68% on the penultimate day of the maintenance period, amid loose liquidity conditions. In order to absorb the excess liquidity in the market, the ECB announced a fine-tuning operation for the amount of €7.5 billion on 14 May, the last day of the reserve maintenance period. Seven counterparties participated in the tender, submitting bids for a total amount of €2.5 billion. The reserve maintenance period ended with a net recourse to the deposit facility of €5.5 billion, which can be attributed almost entirely to the underbidding (by €5.0 billion) observed in the fine-tuning operation. The negative spread between the EONIA and the MRO minimum bid rate on the last day was 36 basis points.