

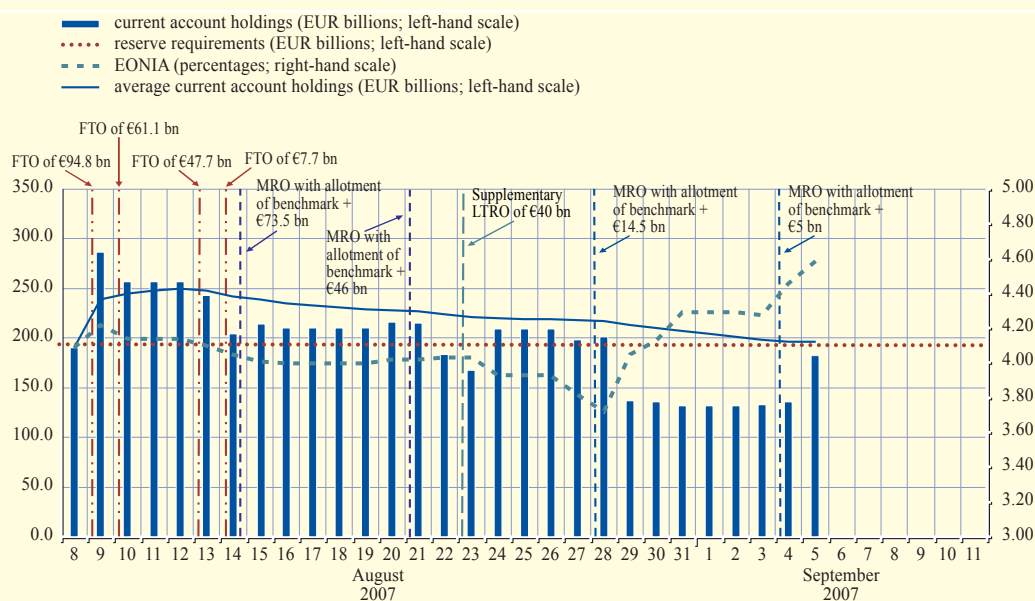
Box 3

THE ECB'S ADDITIONAL OPEN MARKET OPERATIONS IN THE PERIOD FROM 8 AUGUST TO 5 SEPTEMBER 2007

In order to reduce the tensions observed in the money market in the period from 8 August to 5 September, the ECB carried out additional liquidity-providing open market operations over and above the pre-scheduled operations. This box outlines the developments in the money market during that period and describes the ECB's operational actions (see table).

On the morning of 9 August a dislocation of the money market took place, characterised by a very small trading volume and a sudden increase in short-term money market rates. Banks' demand for current account holdings with the Eurosystem had temporarily increased as a result

Current account holdings and the EONIA in the maintenance period from 8 August to 11 September 2007



Source: ECB.

of tensions in some segments of the US dollar-denominated money market. In order to foster orderly conditions in the short-term money market, the ECB conducted a fine-tuning operation (FTO) with same-day settlement and overnight maturity. The operation was conducted as a fixed rate tender at 4.00% (the prevailing level of the minimum bid rate) and with pre-announced full allotment. This tender specification allowed the ECB to inject an amount of liquidity matching counterparties' demand, which the ECB could not easily quantify by means of its regular liquidity analysis. 49 banks submitted bids in this fine-tuning operation for a total amount of €94.8 billion.¹ The overnight rate normalised rapidly and was quoted at around 4.05% for the rest of the day (see chart). However, the bid-offer spread in the overnight market remained elevated at 10 basis points (by comparison with a normal spread of 5 basis points) in the context of continued subdued turnover.

On the morning of 10 August the ECB again conducted an overnight fine-tuning operation. This was conducted in accordance with the tender procedure normally used in the Eurosystem's MROs, namely a variable rate tender procedure with a minimum bid rate and without a pre-announced allotment amount. The change of tender procedure reflected the assessment that the operation on the previous day had had the intended impact on market tensions and that a demand schedule in which counterparties posted the rates they were willing to pay to obtain finance from the Eurosystem could reveal useful information on the banking system's demand for liquidity. 62 counterparties bid for a total amount of €110 billion at interest rates varying from 4.00% to 4.15%. The ECB decided to allot liquidity to all bids at or above 4.05%

¹ The fact that the additional operations of the Eurosystem were larger than those conducted by other central banks on these days mainly reflects the much larger size of the reserve requirements (together with the averaging provision) in the euro area. The larger the reserve requirements, the easier it is for banks to absorb temporary supply and demand shocks related to liquidity. However, this also implies that larger temporary liquidity injections are needed in order to have a certain effect on short-term interest rates.

Summary of the ECB's actions in the period from 8 August to 5 September 2007

Date	Time	Action	Communication	Operational details
9 Aug.	10.15 a.m.	Communication on news wire services	"The ECB notes that there are tensions in the euro money market, notwithstanding the normal supply of aggregate euro liquidity. The ECB is closely monitoring the situation and stands ready to act to assure orderly conditions in the euro money market."	
9 Aug.	12.30 p.m.	Announcement of fine-tuning operation at 4.00% with full allotment	"Following the communication given earlier this morning on the ECB page "Announcements on operational aspects", this liquidity-providing fine-tuning operation aims to assure orderly conditions in the euro money market. The ECB intends to allot 100% of the bids it receives."	Maturity: overnight Amount allotted: €94.8 billion Fixed rate: 4.00% Number of bidders: 49 Number of bids: 49 Bid-cover ratio: 1.00
10 Aug.	9.20 a.m.	Communication on news wire services	"The ECB continues to closely monitor the conditions in the euro money market."	
10 Aug.	10.15 a.m.	Announcement of fine-tuning operation, conducted as a variable rate tender with a minimum bid rate and without a pre-announced allotment amount	"This liquidity-providing fine-tuning operation follows up on yesterday's operation and aims to assure orderly conditions in the euro money market."	Maturity: overnight Amount allotted: €61.1 billion Marginal rate: 4.05% Weighted average rate: 4.08% Number of bidders: 62 Number of bids: 124 Bid-cover ratio: 1.80
13 Aug.	9.15 a.m.	Communication on news wire services	"The ECB continues to closely monitor the conditions in the euro money market."	
13 Aug.	9.30 a.m.	Announcement of fine-tuning operation, conducted as a variable rate tender with a minimum bid rate and without a pre-announced allotment amount	"The ECB notes that money market conditions are normalising and that the supply of aggregate liquidity is ample. With this fine-tuning operation, the ECB is further supporting the normalisation of conditions in the money market."	Maturity: overnight Amount allotted: €47.7 billion Marginal rate: 4.06% Weighted average rate: 4.07% Number of bidders: 59 Number of bids: 103 Bid-cover ratio: 1.77
13 Aug.	3.30 p.m.	Announcement of main refinancing operation ¹⁾	"In this refinancing operation, the ECB aims to ensure the continued normalisation of money market conditions. The allotment amount will be consistent with this aim and will not be bound by the published benchmark allotment amount."	Maturity: 1 week Amount allotted: €310 billion (above benchmark) (€73.5 billion) Marginal rate: 4.08% Weighted average rate: 4.10% Number of bidders: 344 Number of bids: 628 Bid-cover ratio: 1.38
14 Aug.	9.15 a.m.	Communication on news wire services	"The ECB continues to closely monitor the conditions in the euro money market."	
14 Aug.	9.30 a.m.	Announcement of fine-tuning operation, conducted as a variable rate tender with a minimum bid rate and without a pre-announced allotment amount	"The ECB notes that money market conditions are now close to normal. However, with this fine-tuning operation the ECB is still offering the opportunity to cover any remaining liquidity needs ahead of the settlement of this week's MRO tomorrow."	Maturity: overnight Amount allotted: €7.7 billion Marginal rate: 4.07% Weighted average rate: 4.07% Number of bidders: 41 Number of bids: 67 Bid-cover ratio: 5.97
20 Aug.	3.30 p.m.	Announcement of main refinancing operation ¹⁾	"Consistently with the normalisation of conditions on the shortest term of the money market, the ECB intends to gradually reduce the large reserve surplus which has accumulated in the first weeks of this reserve maintenance period. The allotment amount in this main refinancing operation will exceed the published benchmark of €227 billion by an amount which is consistent with this aim."	Maturity: 1 week Amount allotted: €275 billion (above benchmark) (€46 billion) Marginal rate: 4.08% Weighted average rate: 4.09% Number of bidders: 355 Number of bids: 635 Bid-cover ratio: 1.60

Summary of the ECB's actions in the period from 8 August to 5 September 2007 (cont'd)

Date	Time	Action	Communication	Operational details
22 Aug.	3.30 p.m.	Announcement of supplementary longer-term refinancing operation ²⁾	<p>“Today the European Central Bank’s Governing Council has decided to conduct a supplementary liquidity-providing longer-term refinancing operation with a maturity of three months for an amount of €40 billion.</p> <p>This operation is a technical measure aimed at supporting the normalisation of the functioning of the euro money market. It is conducted in addition to the regular monthly longer-term refinancing operations, which remain unaffected. The allotment amounts in the main refinancing operations will offset this provision of liquidity, taking into consideration the overall liquidity conditions. Today’s decision was taken by written procedure.</p> <p>The position of the Governing Council of the ECB on its monetary policy stance was expressed by its President on 2 August 2007.”</p>	<p>Maturity: 3 months Amount allotted: €40 billion Marginal rate: 4.49% Weighted average rate: 4.61% Number of bidders: 146 Number of bids: 411 Bid-cover ratio: 3.14</p>
27 Aug.	3.30 p.m.	Announcement of main refinancing operation ¹⁾	<p>“Consistently with the ongoing normalisation of conditions on the short term of the money market, the ECB continues to aim at gradually reducing the large reserve surplus which has accumulated in the last weeks. Accordingly, the allotment amount in this main refinancing operation will exceed the published benchmark of €194 billion by an amount which is consistent with this aim.”</p>	<p>Maturity: 1 week Amount allotted: €210 billion (above benchmark) Marginal rate: 4.08% Weighted average rate: 4.09% Number of bidders: 320 Number of bids: 578 Bid-cover ratio: 1.68</p>
3 Sep.	3.30 p.m.	Announcement of main refinancing operation ¹⁾	<p>“The ECB continues to aim at gradually reabsorbing the large reserve surplus which has accumulated in the last weeks. Accordingly, the allotment amount in this main refinancing operation will slightly exceed the published benchmark of €251 billion by an amount which is consistent with this aim.”</p>	<p>Maturity: 1 week Amount allotted: €256 billion (€5 billion above benchmark) Marginal rate: 4.15% Weighted average rate: 4.19% Number of bidders: 356 Number of bids: 746 Bid-cover ratio: 1.67</p>
5 Sep.	3.10 p.m.	Communication on news wire services	<p>“Volatility in the euro money market has increased and the ECB is closely monitoring the situation. Should this persist tomorrow, the ECB stands ready to contribute to orderly conditions in the euro money market.”</p>	

1) Main refinancing operations are conducted as variable rate tenders with a minimum bid rate.

2) Longer-term refinancing operations are conducted as pure variable rate tenders with a pre-announced allotment amount.

(€61.1 billion, roughly two-thirds of the value of the previous day’s operation), one basis point lower than the marginal MRO rate in the regular tender which had been settled on 8 August. The EONIA stood at 4.14% on that day.

On the morning of 13 August the overnight rate was quoted at a level 10 basis points above the minimum bid rate, but the money market was still characterised by elevated bid-offer spreads and subdued turnover. The ECB conducted another fine-tuning operation with a specification similar to that of the previous day. 59 counterparties bid for a total amount of €84 billion at interest rates varying from 4.00% to 4.10%. The ECB decided to allot liquidity to all bids at or above 4.06% (€47.7 billion), one basis point higher than in the previous operation. The fact that the EONIA stood at 4.10% on that day confirmed that conditions at the shortest end of the money market were, at that point in time, improving.

On the morning of 14 August the ECB decided to launch a further overnight fine-tuning operation to address additional liquidity needs possibly arising from the fact that the main refinancing operation allotted on the same day would not settle until the next day. The fine-tuning operation was once again conducted as a variable rate tender with a minimum bid rate and without a pre-announced allotment amount. 41 counterparties bid for a total amount of €46 billion, with bids ranging from 4.00% to 4.09%. The fact that the bid amount and bid rates were significantly lower showed that the demand for current account holdings with the Eurosystem was, at that point in time, normalising. The ECB decided to allot liquidity to all bids at or above 4.07% (€7.7 billion), one basis point higher than in the previous operation.

In addition to that fine-tuning operation, the ECB decided to allot €73.5 billion above the benchmark amount in the regular main refinancing operation on 14 August. This allotment sought to prevent the outflows in credit institutions' current account holdings which would have resulted from allotting the "mechanical" benchmark amount. By definition, allotting the benchmark amount would, within just one week, have led to the absorption of the large reserve surplus resulting from the fine-tuning operations and could possibly have increased market tensions. Following the allotment above the benchmark amount, the overnight rates in the euro area stood at around 4.00%, as also reflected in the EONIA, which stood between 4.00% and 4.02% over the next few days.

Given the temporary improvement at the shortest end of the money market, the ECB decided to progressively reduce the large reserve surpluses that had been accumulating in the first weeks of the maintenance period. Consequently, in the MROs on 21 and 28 August, it reduced the amount by which the allotment exceeded the "mechanical" benchmark to €46 billion and €14.5 billion respectively.

Notwithstanding the smooth functioning of the shortest end of the money market during that week, tensions continued to be observed at longer maturities, for which turnover remained very low. In order to support the normalisation also of the longer-term segment of the money market, the ECB decided on 22 August to conduct a supplementary longer-term refinancing operation (LTRO), in the form of a pure variable rate tender with a three-month maturity for an amount of €40 billion. 146 counterparties bid for a total amount of €126 billion, with bids ranging from 3.80% to 5.00%. Notwithstanding this operation, which was settled on 24 August, tensions remained in the longer-term segment of the money market.

On 30 August the overnight rate started to rise again, partly because of the usual tensions observed at the shortest end of the money market at the end of the month. The EONIA stood at 4.29% on 31 August and declined only slightly on the following business day. Given the continuing tensions in the overnight market, the ECB decided on 4 September to allot €5 billion above the "mechanical" benchmark in the last MRO of the maintenance period, even though the end of the maintenance period, at which point the ECB usually seeks to achieve balanced liquidity conditions, was approaching. Nevertheless, the EONIA stood at 4.458%² on that day.

² As of 3 September 2007 the EONIA will be published with three decimal places, following a decision by the European Banking Federation and Euribor ACI.