

LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS IN THE PERIOD FROM 13 FEBRUARY 2008 TO 13 MAY 2008

This box describes the ECB's liquidity management during the three reserve maintenance periods ending on 11 March, 15 April and 13 May 2008. During these periods the ECB's liquidity management continued to respond in various ways to the tensions seen in the euro money market since August 2007. First, the ECB continued to pursue its policy of "frontloading" liquidity, a policy which consists of facilitating the fulfilment of counterparties' reserve requirements early in the maintenance period. This is achieved by allotting more than the benchmark amount in main refinancing operations (MROs) at the beginning of the maintenance period (the benchmark amount being the allotment amount that allows counterparties to fulfil their reserve requirements evenly in the course of a reserve maintenance period), while absorbing the resulting surplus liquidity towards the end of the maintenance period so that the average supply of liquidity in any maintenance period remains unchanged. Second, around the end of the first quarter of 2008 the ECB conducted two liquidity-providing fine-tuning operations in order to alleviate tensions in the euro money market. Third, the two supplementary three-month longer-term refinancing operations (LTROs), which were first carried out in August and September 2007, were rolled over for the second time when they matured in February and March 2008. Moreover, in March 2008 the Eurosystem announced that it would renew these operations again in May and June 2008 and that it would conduct two supplementary LTROs with a six-month maturity, one in April and one in July, with the aim of supporting the normalisation of the functioning of the euro money market. Finally, over the period under review the ECB resumed the conduct of term auction facilities providing US dollar liquidity to euro area banks in cooperation with the Federal Reserve System, with that liquidity secured using collateral eligible in the Eurosystem. These operations did not affect the supply of euro liquidity.¹

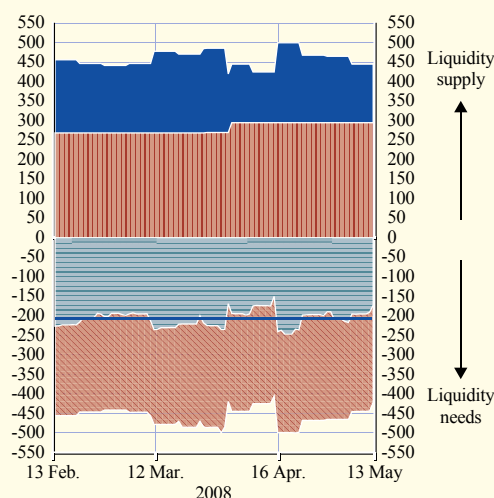
Liquidity needs of the banking system

In the three maintenance periods under review, banks' average liquidity needs rose by €10.4 billion by comparison with the preceding three periods. This can be explained by a €7.4 billion increase in required reserves and a €3.3 billion increase in autonomous factors, while excess reserves declined by €0.3 billion. Total liquidity needs resulting from reserve requirements stood at €206.5 billion, and those

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)

- main refinancing operations: €178.62 billion
- longer-term refinancing operations: €280.55 billion
- current account holdings: €207.17 billion
(reserve requirements: €206.47 billion;
excess reserves: €0.71 billion)
- reserve requirement level
- autonomous factors: €252.35 billion



Source: ECB.

¹ Please refer to <http://www.ecb.europa.eu/mopo/implement/omo/html/communication.en.html> for the statements communicated by the ECB.

resulting from autonomous factors averaged €252.4 billion (see Chart A).

The level of excess reserves (i.e. the daily average of current account holdings in excess of reserve requirements) decreased slightly in the three periods under review, averaging €0.71 billion (see Chart B), close to the average (€0.75 billion) seen since the changes to the monetary policy implementation framework in March 2004.

Liquidity supply and interest rates

The total volume of outstanding open market operations (denominated in euro) rose as a result of the increase in reserve requirements. The two supplementary three-month LTROs initially conducted in August and September 2007, which matured in February and March 2008, were rolled over for an amount of €50 billion each. In addition, on 2 April 2008 a supplementary LTRO was conducted with a six-month maturity and an amount of €25 billion. As a result, the average maturity of the outstanding open market operations increased slightly. The shares of LTROs and MROs in the total volume of outstanding open market operations remained broadly unchanged at around 60% and 40% respectively.

On 11 March 2008 the ECB announced that, in connection with the US dollar term auction facility offered by the Federal Reserve System, it would again offer US dollar funding to Eurosystem counterparties, as it had done in December 2007 and January 2008, with such funding secured using collateral eligible in the Eurosystem. It also announced that it intended to continue its provision of US dollar liquidity for as long as the Governing Council considered it to be necessary in view of the prevailing market conditions. On 2 May 2008 the amount offered through the ECB was increased from USD 15 billion to USD 25 billion. These operations did not affect the supply of euro liquidity.

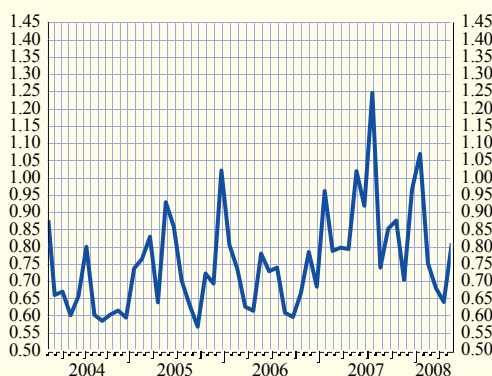
During the maintenance period ending in March the EONIA was remarkably stable, with the exception of a modest increase on the last day of the month. However, in the following two maintenance periods (ending in April and May) the EONIA exhibited greater volatility, particularly prior to the end of the quarter (see Chart C). Reflecting counterparties' aggressive bidding in the MROs, the spread between the minimum bid rate and the marginal rate (i.e. the lowest rate at which bidders receive liquidity) was occasionally substantial.

Reserve maintenance period ending on 11 March 2008

In this maintenance period the ECB continued its policy of “frontloading” liquidity and gradually reduced the amount it allotted in excess of the benchmark in the course of the maintenance period. Specifically, it allotted €20 billion, €15 billion and €10 billion in excess of the benchmark amount in the first three MROs. During these three weeks the EONIA stood only very slightly above the minimum bid rate. €4 billion was allotted in excess of the benchmark in the fourth and final MRO of the maintenance period. That week saw some unexpected and unusually strong tightening of liquidity conditions, which placed some upward pressure on the EONIA. On the last day of the

Chart B Excess reserves ¹⁾

(EUR billions; average level in each maintenance period)

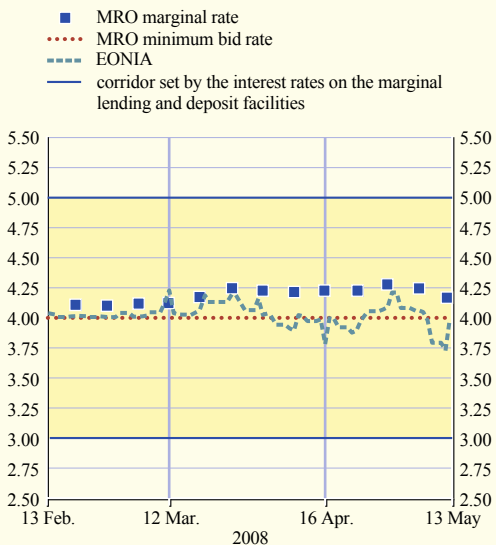


Source: ECB.

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.

maintenance period the ECB conducted a liquidity-providing fine-tuning operation for an amount of €9 billion. The maintenance period ended with net recourse to the marginal lending facility of €321 million and the EONIA at 4.229%.

Reserve maintenance period ending on 15 April 2008

On 11 March, in the first MRO of this maintenance period, the ECB allotted €25 billion in excess of the benchmark amount. During that week the EONIA stood slightly above the minimum bid rate and tended to increase slightly.

In the second MRO, which was allotted on 18 March, in the light of some signs of increased tensions in the euro money market, the ECB did not reduce its allotment in excess of the benchmark and continued instead to

provide €25 billion in excess of that amount. The EONIA rose further to 4.188% the day after the allotment of the MRO, and on 20 March the ECB launched a liquidity-providing fine-tuning operation with an allotment amount of €15 billion. The EONIA stood at 4.133% on that day.

On 25 March, in the third MRO of the reserve maintenance period, an operation which covered the end of the quarter, the ECB allotted €50 billion in excess of the benchmark in view of further increases in tensions in the euro money market. In that operation the marginal rate and the weighted average rate increased to 4.23% and 4.28% respectively. Notwithstanding the ample allotment in the MRO, the overnight rate remained elevated on the morning of 31 March, the last day of the quarter, and the ECB conducted a liquidity-providing fine-tuning operation in which it allotted €15 billion. The EONIA stood at 4.159% on that day.

In the fourth MRO of the reserve maintenance period the ECB allotted €35 billion in excess of the benchmark amount, and the EONIA subsequently fell to levels slightly below the minimum bid rate.

In the last MRO of the period the ECB allotted €5 billion in excess of the benchmark, and the EONIA stood close to the minimum bid rate in the last week of the maintenance period. On the last day of the maintenance period the ECB launched a liquidity-absorbing fine-tuning operation for an amount of €21 billion. However, counterparties only submitted bids for a total of €14.9 billion. As a result, the maintenance period ended with net recourse to the deposit facility of €4.6 billion. In line with that excess liquidity, the EONIA stood at 3.783% on that day.

Reserve maintenance period ending on 13 May 2008

On 15 April, in the light of the persistent tensions in the euro money market and consistent with its “frontloading” of liquidity, the ECB allotted €35 billion in excess of the benchmark in the

first MRO of the maintenance period. During that week the EONIA stood slightly below the minimum bid rate and tended to decline.

In the second MRO, which was allotted on 22 April, the ECB reduced its allotment in excess of the benchmark to €20 billion, thereby starting to reduce the liquidity surplus somewhat more quickly than usual. During that week the EONIA rose slightly above the minimum bid rate.

In the third MRO, which was allotted on 29 April and covered the end of the month, the ECB allotted €20 billion in excess of the benchmark amount. The EONIA stood at 4.090% on the day of the allotment, before rising to 4.210% on the following day, the last day of the month.

Following the allotment of €4 billion in excess of the benchmark in the fourth and final MRO of the maintenance period, the EONIA began to gradually decline. On 8 May it stood below the minimum bid rate at 3.979%. On the last day of the maintenance period the ECB launched a liquidity-absorbing fine-tuning operation and absorbed €23.5 billion. The maintenance period ended with limited net recourse to the deposit facility of €284 million, and the EONIA stood at 4.004% on that day.