Box 2

LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS IN THE PERIOD FROM 12 NOVEMBER 2008 TO 10 FEBRUARY 2009

This box describes the ECB's liquidity management during the three reserve maintenance periods ending on 9 December 2008, 20 January 2009 and 10 February 2009. During this period the ECB continued to apply most of the measures introduced in October 2008 in response to the intensification of the financial market turmoil.

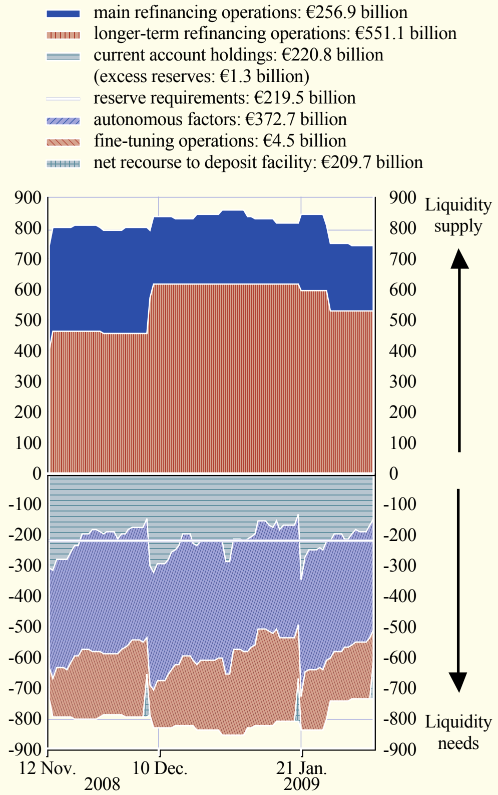
In particular, all refinancing operations in euro and US dollars continued to be conducted with a fixed rate (equal to the ECB's policy rate in the case of operations in euro) and full allotment (i.e. all bids were satisfied). In addition, a broader range of collateral was accepted, on a temporary basis, for Eurosystem open market operations. Until the end of 2009 the expanded list of eligible collateral will include, for example, a number of debt instruments denominated in foreign currency and will be based on a rating threshold of BBB+ instead of A-. In December 2008, in cooperation with other central banks, the ECB extended its provision of US dollars to counterparties through the US Federal Reserve's Term Auction Facility (initially via both repos and swaps) until the end of the first quarter of 2009. The ECB also extended its provision of Swiss francs (via swap operations) until the end of April 2009. Owing to low levels of demand, the US dollar swap operations were discontinued at the end of January 2009, with US dollar refinancing offered only through repo operations thereafter.

In October 2008, when the money market was particularly impaired, the Governing Council of the ECB temporarily reduced the width of the standing facilities corridor around the main policy rate to 100 basis points. In December 2008, seeking primarily to revive the interbank market, the Governing Council decided to widen the corridor again, returning it to 200 basis points as of 21 January 2009.

The euro money market showed some signs of improvement during the period under review. This is evident, for instance, from the steady declines observed in the spreads between unsecured (e.g. EURIBOR) and secured (e.g. EUREPO) lending rates.

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)



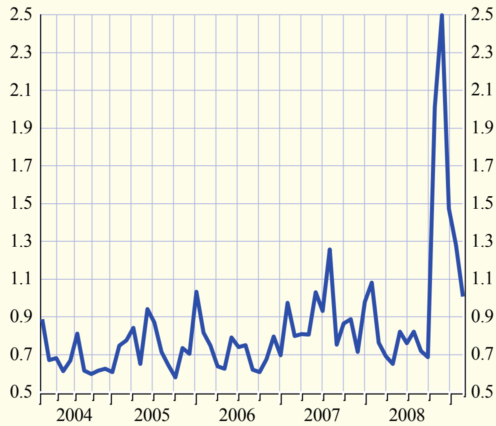
Source: ECB.

Liquidity needs of the banking system

In the three maintenance periods under review banks' average daily liquidity needs – defined as the sum of autonomous factors, reserve requirements and excess reserves (i.e. current account holdings in excess of reserve requirements) – were €593.5 billion, an increase of €97.8 billion by comparison with the average for the previous three periods. Between 12 November 2008 and 10 February 2009 average daily liquidity needs resulting from reserve requirements totalled €219.5 billion and those resulting from autonomous factors totalled €372.7 billion (see Chart A). As in previous maintenance periods, autonomous factors also included the euro liquidity effect of the foreign exchange swap operations being conducted in cooperation with other central banks. Average autonomous factors were €93.6 billion higher than in the previous three maintenance periods, mainly reflecting increases in government deposits and banknotes in circulation, while average reserve requirements were €4.7 billion higher and average excess reserves were €0.5 billion lower at €1.3 billion (see Chart B).

Chart B Banks' current account holdings in excess of reserve requirements

(EUR billions; average level in each maintenance period)



Source: ECB.

Despite the signs of improvement in the money market, many banks continued to have difficulty obtaining funding in the interbank market during the three reserve maintenance periods under review. As a result, they continued to cover their liquidity needs via Eurosystem refinancing operations. The policy of full allotment led to large amounts of excess liquidity in the banking system at the aggregate level, resulting in significant use of the deposit facility. Average daily net recourse to the deposit facility stood at €220.6 billion during the maintenance periods ending on 9 December 2008 and 20 January 2009, considerably higher than in any other period. In the maintenance period beginning on 21 January 2009, when the standing facilities corridor was widened again, the use of the deposit facility declined somewhat, averaging €173.4 billion per day (see Chart A).

Liquidity supply and interest rates

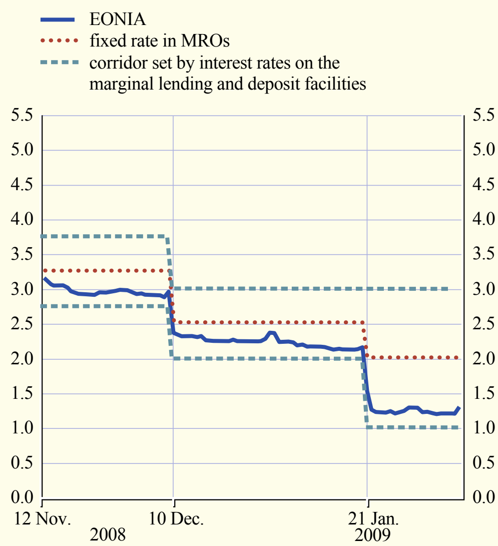
As a result of the exceptional measures adopted in October 2008, the volume of outstanding open market operations continued to rise until early January 2009 and then declined slightly. The total amount of outstanding refinancing peaked at the end of the year, reaching a historic high of €857 billion. In the maintenance period ending on 20 January 2009 main refinancing operations accounted for 25% of total outstanding refinancing, a marked decline from the 40% observed between August and November 2008. Once the standing facilities corridor had been widened again on 21 January 2009, the level of outstanding longer-term refinancing operations decreased somewhat, leaving total outstanding open market operations averaging around €770 billion during the maintenance period ending on 10 February 2009 (see Chart A).

As a result of the significant amounts of liquidity being demanded by counterparties on account of the dysfunctional state of the money market, the EONIA remained between the main refinancing rate (i.e. the policy rate) and the rate on the deposit facility in the three maintenance periods under review (see Chart C). Once the remuneration rate on the deposit facility had been reduced to 100 basis points below the main refinancing rate, the spread between the EONIA and the rate on the deposit facility stabilised at around 20 basis points, in line with the average for the preceding maintenance period.

The EONIA displayed seasonal effects throughout the period under review. It stood at an elevated level on the last day of each month and around the end of the year. It was also higher at the beginning of each maintenance period, as well as on the last day of the maintenance period, when the ECB carried out liquidity-absorbing fine-tuning operations.

Chart C The EONIA and the ECB interest rates

(daily interest rates in percentages)



Source: ECB.