

Box 2

LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS IN THE PERIOD FROM 11 FEBRUARY TO 12 MAY 2009

This box describes the ECB's liquidity management in the three reserve maintenance periods ending on 10 March, 7 April and 12 May 2009. In these periods the ECB continued to apply most of the measures that were 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 via tender procedures with a fixed rate (equal to the ECB's policy rate in the case of operations denominated in euro) and full allotment (i.e. all bids were satisfied), and a wider range of collateral continued to be accepted for these open market operations.

In March 2009 the ECB announced that the use of the fixed rate tender procedure with full allotment for all refinancing operations in euro would be prolonged again – this time until the end of 2009. It was originally announced in October 2008 that this procedure would be used for all main refinancing operations until at least 20 January 2009 and for all longer-term refinancing operations until March.

In May the ECB decided to proceed with its enhanced credit support approach and announced the introduction of liquidity-providing longer-term refinancing operations with a maturity of one year (in addition to the existing maturities of the length of a maintenance period, three months and six months); the first of these one-year operations is scheduled to take place in June. At the same time, the temporary expansion of the list of assets eligible as collateral, which was first announced in October 2008, was prolonged until the end of 2010. The Governing Council also decided in principle that the Eurosystem would engage in a programme of purchasing euro-denominated covered bonds issued in the euro area. Moreover, the European Investment Bank will become an eligible counterparty in the Eurosystem's monetary policy operations with effect from 8 July and under the same conditions as any other counterparty.

In April the ECB broadened its cooperation with other central banks by entering into a swap arrangement with the US Federal Reserve System, according to which the ECB will offer liquidity of up to €80 billion to the Federal Reserve System until 30 October 2009. The Federal Reserve System did not make use of this swap arrangement in the period under review. The ECB also extended its provision of Swiss francs to counterparties via swap operations until the end of July.

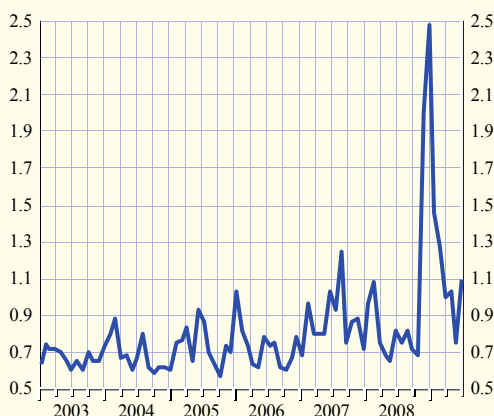
During the period under review the euro money market continued to show signs of improvement. For instance, the three-month spread between the EURIBOR and the EONIA swap rate, which captures the level of prevailing credit and liquidity risk, declined steadily and by the end of the period under review it was broadly the same as the level observed before the intensification of the turmoil in mid-September 2008.

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) – amounted to €612.0 billion, an increase of €18.1 billion compared with the average for the previous three maintenance periods.

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

(EUR billions; average level in each maintenance period)

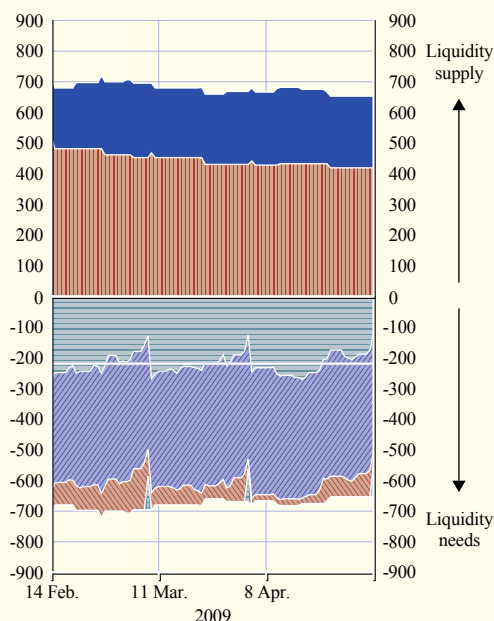


Source: ECB.

Chart B 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: €232.1 billion
- longer-term refinancing operations: €445.9 billion
- current account holdings: €220.4 billion (excess reserves: €1.0 billion)
- reserve requirements: €219.4 billion
- autonomous factors: €391.6 billion
- net recourse to deposit facility: €62.5 billion
- fine-tuning operations: €3.5 billion



Source: ECB.

This was primarily due to an increase of €18.6 billion in average autonomous factors, while average reserve requirements and excess reserves were respectively €0.1 billion and €0.3 billion lower than in the previous three maintenance periods (see Chart A). The increase in average autonomous factors mainly reflected higher levels of government deposits and, to a lesser extent, higher levels of banknotes in circulation. As in previous maintenance periods, autonomous factors included the effect, in terms of euro liquidity, of the foreign exchange swap operations that were conducted in cooperation with other central banks. In the three maintenance periods under review the average daily liquidity needs resulting from reserve requirements amounted to €219.4 billion, while average autonomous factors and average excess reserves made contributions of €391.6 billion and €1.0 billion respectively (see Chart B).

Since many banks continued to cover their liquidity needs via Eurosystem refinancing operations, the use of tender procedures with full allotment resulted in large, albeit declining, amounts of excess liquidity in the banking system overall. This led to significant use of the deposit facility. Net recourse to the deposit facility in the maintenance periods ending on 10 March, 7 April and 12 May averaged respectively €93.9 billion, €56.6 billion and €41.9 billion per day, down from the peak of €235.5 billion reached in the maintenance period ending on 20 January 2009.

Liquidity supply and interest rates

The volume of outstanding open market operations continued to decline in line with the trend which started at the beginning of 2009. In the maintenance period ending on 12 May the average volume of outstanding open market operations was €663 billion, which is much lower than the historical high of €857 billion observed around the end of 2008. This was mainly due to a decline in the volume of outstanding

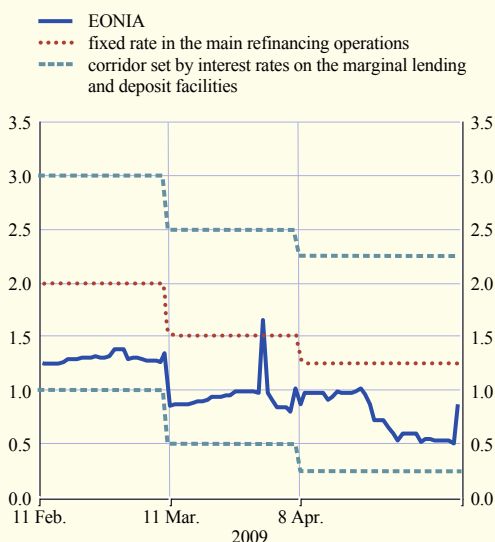
longer-term refinancing operations, while the volume of outstanding main refinancing operations was more stable and even increased slightly (see Chart B). Therefore, main refinancing operations accounted for 36% of total outstanding refinancing in the maintenance period ending on 12 May, which is a substantial increase from the 25% observed in the maintenance period which covered the end of 2008.

Reflecting the demand for excess liquidity on the part of counterparties (i.e. liquidity in excess of the amount needed to cover reserve requirements, autonomous factors and excess reserves), the EONIA remained between the rate on the main refinancing operations (i.e. the policy rate) and the rate on the deposit facility in the three maintenance periods under review (see Chart C), as has been the case since October 2008. At the same time, in parallel with the decline in the use of the deposit facility, the EONIA moved closer to the rate on the main refinancing operations. In the maintenance period ending on 12 May the EONIA averaged around 50 basis points below the rate on the main refinancing operations, compared with around 70 basis points in the maintenance period ending on 10 March.

Moreover, the EONIA displayed calendar effects throughout the period under review, being higher on the last day of each month (in particular at the end of the quarter) and on the last day of each maintenance period when the ECB carried out its regular liquidity-absorbing fine-tuning operations. It was also at an elevated level in the period around Easter.

Chart C The EONIA and the ECB interest rates

(daily interest rates in percentages)



Source: ECB.