Box 3

LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS IN THE PERIOD FROM 13 MAY TO 11 AUGUST 2009

This box describes the ECB's liquidity management during the three reserve maintenance periods ending on 9 June, 7 July and 11 August 2009 respectively. Those maintenance periods saw the ECB continue to apply the enhanced credit support measures introduced in October 2008 in response to the intensification of the financial market turmoil. In particular, refinancing operations in euro were carried out at a fixed rate with full allotment against an extended range of collateral and for a wider variety of maturities, including maturities of one maintenance period, three months and six months. In addition, the first one-year longer-term refinancing operation was conducted on 24 June, and in early July the Eurosystem made its first purchases under its covered bond purchase programme.

With regard to the provision of liquidity in foreign currencies, the Governing Council of the ECB decided to continue its US dollar liquidity-providing open market operations until at least the end of September 2009. The ECB's provision of Swiss francs to counterparties via open market operations was also extended until the end of October 2009. Finally, in June the ECB carried out a transaction under a pre-existing swap agreement with Sveriges Riksbank.

The one-year longer-term refinancing operation saw very strong demand by counterparties and resulted in the allotment of €442 billion. Consequently, the EONIA fell to a level around 10 basis points above the deposit rate of 0.25%, which remained unchanged over the period under review. On 3 July the EONIA reached a record low of 0.328%. The spread between the three-month EURIBOR and the three-month EONIA swap rate – which indicates the level of credit and liquidity risk – also declined steadily in the period under review, averaging around 48 basis points, broadly the same as that observed prior to the severe pressures experienced by various large banking groups in early 2008.

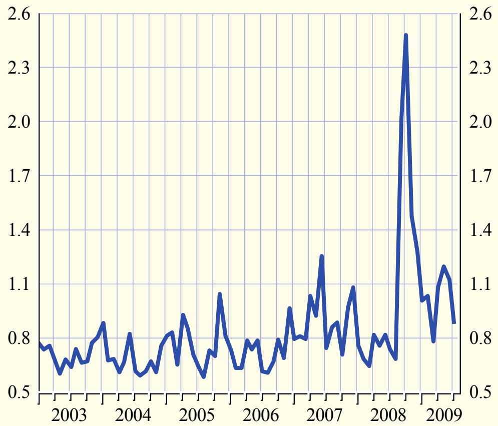
Liquidity needs of the banking system

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) – totalled €598 billion, €14 billion less than the average for the previous three maintenance periods.

Average excess reserves were marginally lower than they had been in the previous three maintenance periods, recording a decline of €0.1 billion (see Chart A). Average autonomous factors fell to €380.2 billion (see Chart B), down from €391.6 billion in the previous three maintenance periods,

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

(EUR billions; average level in each maintenance period)



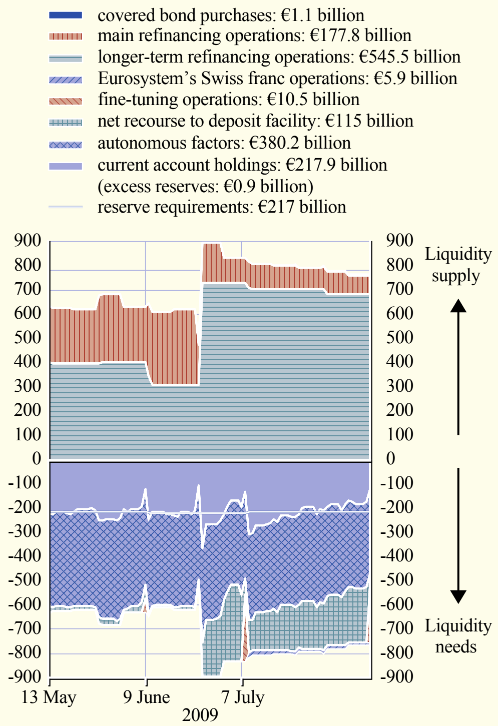
Source: ECB.

reflecting the technical reclassification of the Eurosystem's Swiss franc operations, which as of 6 July 2009 were regarded as open market operations rather than autonomous factors. The resulting decline in autonomous factors was partly offset by an increase in banknotes in circulation and, to a lesser extent, increased government deposits. Finally, average reserve requirements fell by €2.4 billion to stand at €217 billion.

As a result of the very strong demand in the first one-year longer-term refinancing operation, daily average recourse to the deposit facility increased significantly to stand at €115 billion in the period under review. This was 81% higher than the average for the previous three maintenance periods, which had seen average recourse to the deposit facility decline gradually further following its peak of €235.5 billion in the maintenance period ending on 20 January 2009. Looking at the situation in more detail, daily recourse to the deposit facility in the maintenance periods ending on 9 June, 7 July and 11 August averaged €22.3 billion, €119.7 billion and €185.1 billion respectively.

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)



Source: ECB.

Moreover, in July and August the level of participation in the Eurosystem's liquidity-absorbing fine-tuning operation carried out on the last day of the maintenance period was significantly higher (see Chart B). These two operations saw the absorption of an average of €264 billion, compared with an average of €89 billion in the previous three maintenance periods. The use of the marginal lending facility averaged €0.8 billion in the period under review.

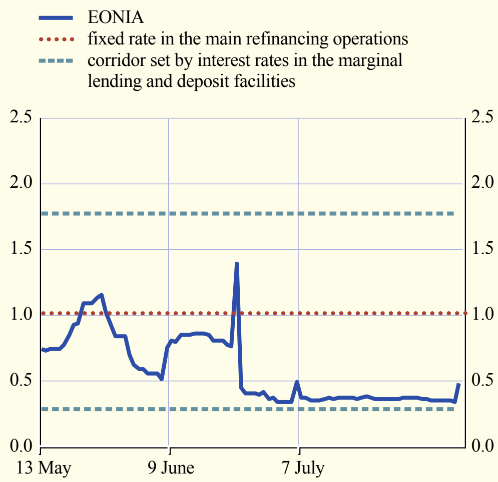
Liquidity supply and interest rates

Initially, the volume of outstanding open market operations declined further, continuing the trend observed since the beginning of 2009. However, this came to a halt on 25 June, when the first one-year longer-term refinancing operation was settled. This operation brought the volume of outstanding refinancing operations in euro to a new record high of €896.5 billion, €40 billion more than the previous peak at the end of 2008. In addition, given that around two-thirds of the amounts maturing in other longer-term refinancing operations have been renewed since 25 June, longer-term refinancing operations represented around 90% of all outstanding Eurosystem open market operations at the end of the period under review (see Chart B), with the one-week main refinancing operations only accounting for around 10%. Indeed, given the significant liquidity surplus, the allotment volumes in those weekly main refinancing operations declined considerably, averaging €94.1 billion in the maintenance period ending on 11 August, 60% lower than the average for the two previous maintenance periods.

The first purchases under the Eurosystem's covered bond purchase programme were conducted on 6 July. Under this programme, a daily average of €220 million worth of covered bonds were purchased during the period under review, and the total value of settled purchases stood at €5.9 billion on 11 August. By 2 September (the cut-off date for this issue of the Monthly Bulletin) the total value of purchases had reached €9.6 billion. Further information on the covered bond purchase programme is available on the ECB's website.

Chart C The EONIA and the ECB interest rates

(daily interest rates in percentages)



Source: ECB.

The ECB's key interest rates have been left unchanged since 13 May 2009, with the rate on the main refinancing operations standing at 1%, the marginal lending rate standing at 1.75% and the deposit rate standing at 0.25%. With the use of the deposit facility declining, the EONIA remained volatile in the first half of the period under review, averaging 0.82% (see Chart C). However, since the end of June, following the settlement of the first one-year longer-term refinancing operation, the EONIA has hovered around the 0.35% level as a result of the ample supply of liquidity.

Throughout the period under review, the EONIA was higher on the last day of the maintenance period, when the ECB carried out its regular liquidity-absorbing fine-tuning operation. However, it did not increase at the end of the month, as had been the case in previous maintenance periods.