

Box 3

**LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS IN THE PERIOD
FROM 11 NOVEMBER 2009 TO 9 FEBRUARY 2010**

This box describes the ECB's liquidity management during the three reserve maintenance periods ending on 7 December 2009, 19 January 2010 and 9 February 2010 respectively.

This period saw the ECB continue to implement some of the non-standard measures introduced since October 2008 in response to the intensification of the financial crisis, while gradually beginning to phase out those measures that were no longer needed given the improvements observed in financial market conditions.

More specifically, on 3 December 2009 the Governing Council of the ECB announced that:

- i) it would continue conducting its main refinancing operations (MROs) as fixed rate tender procedures with full allotment for as long as was needed – and at least until the third maintenance period of 2010 ended on 13 April;
- ii) special-term refinancing operations (i.e. operations with a maturity of one maintenance period) would continue to be conducted by means of this tender procedure for at least the first three maintenance periods of 2010;
- iii) regular three-month refinancing operations would continue to be carried out as fixed rate tender procedures with full allotment for at least the first three months of 2010 (including the three-month refinancing operation due to be settled on 1 April 2010);
- iv) the rate in the final 12-month refinancing operation, due to be allotted on 16 December 2009, would be fixed at the average minimum bid rate in the MROs over the life of this operation.

In addition, both the Swiss franc and US dollar open market operations conducted by the Eurosystem were discontinued at the end of January 2010. On 18 January the Governing Council of the ECB decided, in agreement with the Swiss National Bank, that the Eurosystem's one-week Swiss franc liquidity-providing swap operations would be discontinued on 31 January owing to declining demand and improving conditions in funding markets. Accordingly, the final one-week Swiss franc swap operation was allotted on 26 January. Similarly, on 27 January the ECB confirmed that its temporary swap lines with the Federal Reserve would end on 31 January in the light of the improvement seen in the functioning of the financial markets over the previous year. In addition, the Governing Council of the ECB decided, in agreement with the Federal Reserve, the Bank of England, the Bank of Japan and the Swiss National Bank, to stop conducting US dollar liquidity-providing operations on 31 January. Accordingly, the Eurosystem's last US dollar swap operation was allotted on 25 January.

Liquidity needs of the banking system

In the three maintenance periods under review, banks' 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) – averaged €585.5 billion, €1.9 billion less than the average for the previous three maintenance periods.

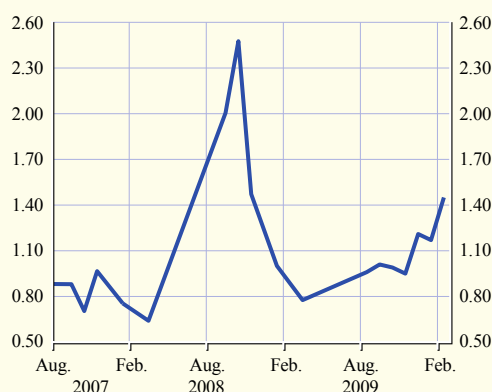
Average autonomous factors rose slightly to stand at €374.4 billion, an increase of €1.9 billion by comparison with the average for the previous three maintenance periods (see Chart B).

By contrast, average reserve requirements fell by €3.8 billion to stand at €210.0 billion.

Daily excess reserves averaged €1.28 billion during the period under review, compared with an average of €0.98 billion over the previous three maintenance periods (see Chart A).

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

(EUR billions; average level in each maintenance period)



Source: ECB.

Liquidity supply

The volume of outstanding refinancing operations averaged €686 billion over the three maintenance periods under review, up slightly from the €683 billion averaged in the previous three maintenance periods.

As in the previous three maintenance periods, the one-week MRO accounted for a limited share (i.e. around 8-10%) of total outstanding refinancing. Over the three maintenance periods under review, the volume of outstanding weekly MROs averaged €58.0 billion.

The volume of outstanding special-term refinancing operations declined significantly, averaging €3.3 billion over the three maintenance periods under review, down from an average of €15.9 billion over the previous three maintenance periods.

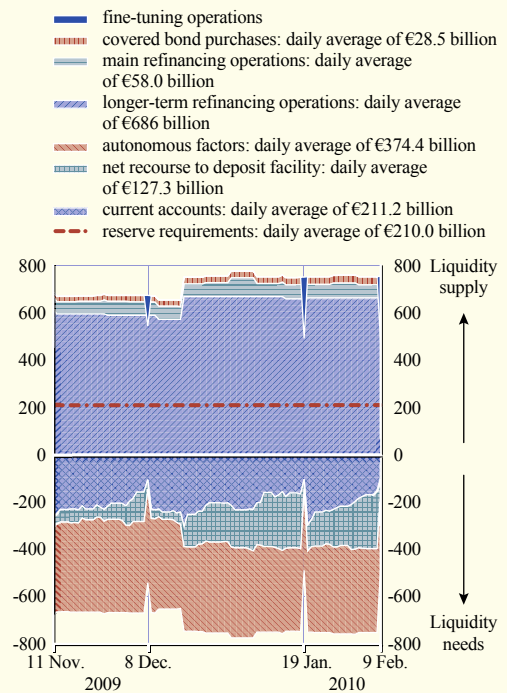
The volume of outstanding three and six-month LTROs declined further to stand at €42.1 billion on 9 February 2010, down from €97.6 billion on 11 November 2009, as some of these operations matured and were not replaced or were rolled over with an allotment amount lower than the maturing amount. The volume of outstanding three and six-month LTROs averaged €56.4 billion over the period under review. However, the decline in this outstanding amount was largely offset by the allotment of €96.9 billion in the third 12-month LTRO on 16 December 2009.

The period under review saw Eurosystem central banks continue their outright purchases of euro-denominated covered bonds as part of the covered bond purchase programme. This programme, which began on 6 July 2009, aims to purchase €60 billion worth of covered bonds by the end of June 2010. Bond purchases averaged €216 million per working day in the period under review, while the total cumulative value of bond purchases reached €35.4 billion on 9 February 2010 (up from €22.7 billion on 11 November 2009).

In the period under review, an average of €219.4 billion was absorbed in the three fine-tuning operations carried out on the last day of each maintenance period (see Chart B). By comparison, average liquidity absorption was €185 billion in the previous three maintenance periods. Recourse to the marginal lending facility averaged €0.45 billion in the period under review (€0.15 billion more than in the previous three maintenance periods).

Chart B Liquidity needs of the banking system and liquidity supply

(EUR billions)



Source: ECB.

Use of standing facilities

As a result of the increased liquidity supply and the largely unchanged liquidity needs of the banking system, average daily net recourse to the deposit facility¹ increased from €64.0 billion² in the maintenance period ending on 8 December 2009 to €149.1 billion in the maintenance period ending on 19 January 2010 and €168.1 billion in the maintenance period ending on 9 February 2010.

Interest rates

The ECB's key interest rates have remained 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%.

As a result of the ample liquidity in the euro area, the EONIA was stable over the period under review and remained close to the deposit facility rate, averaging 0.352% (see Chart C), almost unchanged from the 0.358% observed over the previous three maintenance periods. On the three days when liquidity-absorbing fine-tuning operations were conducted (i.e. the last day of each maintenance period), the EONIA averaged 0.623% – i.e. 30 basis points above the level observed the previous day.

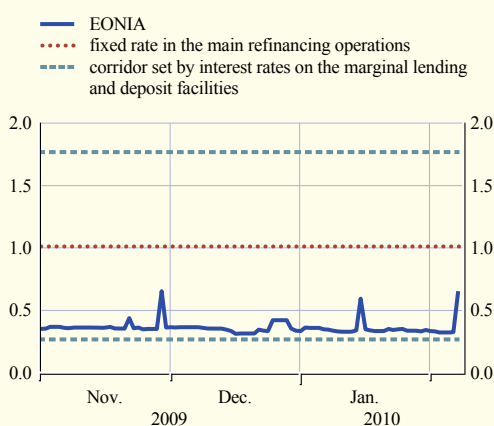
The period under review saw the spread between the three-month EURIBOR and the three-month EONIA swap rate – which indicates the level of credit and liquidity risk – decline to an average of 30 basis points, down from an average of 35 basis points in the previous three maintenance periods. By comparison, this spread averaged 64 basis points in the maintenance period prior to the collapse of Lehman Brothers in mid-September 2008 and peaked at 186 basis points on 12 October 2008 following Lehman Brothers' collapse.

1 Net recourse to the deposit facility is equal to recourse to the deposit facility minus recourse to the marginal lending facility.

2 Average daily net recourse to the deposit facility includes weekends.

Chart C The EONIA and the ECB interest rates

(daily interest rates in percentages)



Source: ECB.