

EURO AREA MONEY GROWTH AND THE “SECURITIES MARKETS PROGRAMME”

The “Securities Markets Programme” (SMP), which was announced by the Governing Council on 10 May 2010, is intended to ensure depth and liquidity in malfunctioning segments of the debt securities markets and to restore an appropriate functioning of the monetary policy transmission mechanism.¹ As the purchases of debt securities conducted in the context of the SMP are sterilised, they do not change central bank liquidity. Importantly, the SMP does not alter the stance of monetary policy as determined by the Governing Council. This box discusses different concepts of liquidity and, in particular, explains to what extent there could be direct or indirect effects of the programme on monetary liquidity as measured in broad monetary aggregates.

Different concepts of liquidity

A key consideration behind the setting-up of the SMP was the inability of certain financial market segments to absorb transactions without much effect on prices. It is this notion of liquidity, commonly referred to as *financial market liquidity*,² that the SMP is intended to restore. By contrast, the SMP is not intended to alter banks’ holdings of *central bank liquidity*, a concept that centres on the ability of banks to pay their obligations with deposits held with the central bank. At the same time, the SMP should not alter the *monetary liquidity* of the euro area either, which relates to the ability of the money-holding sector to make payments and is commonly measured by a broad monetary aggregate – such as M3 in the case of the euro area.

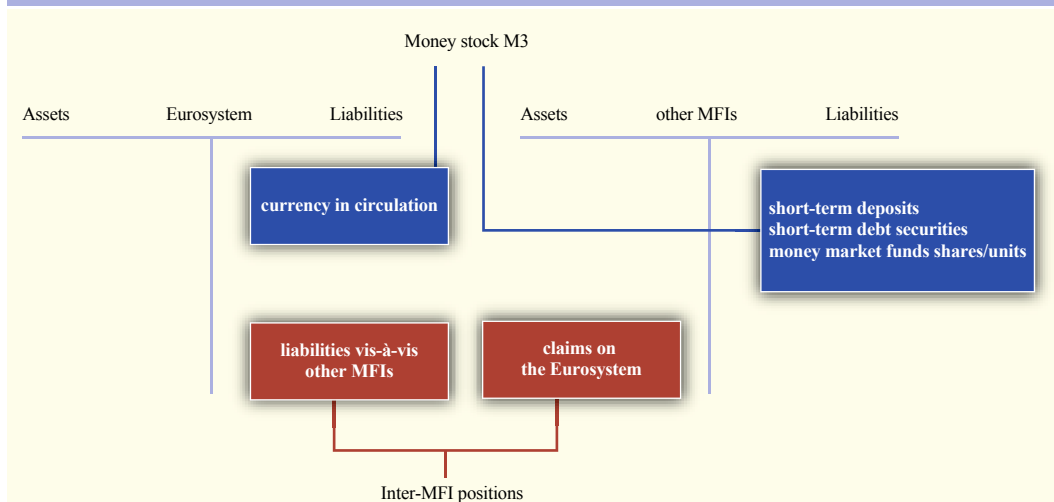
Direct effects on central bank liquidity and M3 are precluded

The SMP involves the purchase of debt securities by the Eurosystem from its counterparts. In the first instance, these purchases are settled by increases in the current account holdings of the MFI sector with the Eurosystem. A key element of the SMP is the re-absorption of these highly liquid deposits through fine-tuning operations into fixed-term deposits. This so-called sterilisation intends to keep banks’ holdings of central bank liquidity unchanged at the aggregate level.

1 See the box entitled “Additional measures decided by the Governing Council” in the May 2010 issue of the Monthly Bulletin.

2 Financial market liquidity is normally defined as the ability to undertake transactions in such a way as to adjust portfolios and risk profiles without disturbing underlying prices (see A. Crockett, “Market liquidity and financial stability”, in Banque de France, *Financial Stability Review*, Special issue on liquidity, No 11, February 2008).

MFIs' monetary liabilities and inter-MFI positions



Source: ECB.

Note: This stylised representation focuses solely on balance sheet items that are relevant for the issues discussed in this box.

Moreover, the SMP has no mechanical effects on euro area monetary aggregates (the items contained in the blue boxes in the chart), given that they are compiled on the basis of the consolidated MFI balance sheet, i.e. net of all transactions that take place between the Eurosystem and other MFIs (the items contained in the red boxes in the chart). Therefore, transactions of the Eurosystem with credit institutions, viewed from an accounting perspective, cannot have any impact on M3, irrespective of their volume.

Can an indirect impact on money arise through portfolio composition effects?

An orderly functioning of financial markets is necessary for the appropriate transmission of the monetary policy stance, as determined by the Governing Council, to the economy. In the case of malfunctioning markets, however, excessive liquidity premia render the financing of banks more costly (e.g. via the benchmark role of government bond yields for bank debt securities) and ultimately increase the cost of credit to non-financial corporations and households in an inappropriate manner. By restoring more orderly market conditions, the SMP fosters a risk and return configuration of financial assets in dislocated markets that is more in line with what a normal transmission of the monetary policy stance would imply. Thus, compared with a situation in which market dislocation was allowed to proliferate, the SMP will lead to a shift in the composition of financial market participants' portfolios. Through this shift, the SMP makes the yield configuration more compatible with what would prevail in a situation of orderly functioning financial markets, and thus limits any effect from disorderly markets on the economy and, thereby, on monetary aggregates.³

³ While all purchases are settled through euro area credit institutions, the securities may have originally been held by non-MFIs. In this respect, it may be helpful to distinguish between resident and non-resident holders. Purchases of securities originally held by the euro area money holding sector could lead to higher money holdings if the sellers alter their portfolio behaviour toward holding more liquid monetary assets. However, to the extent that orderly market conditions are re-established, any such changes in portfolio behaviour would not seem warranted. Purchases of securities originally held by non-residents are neutral with regard to monetary aggregates as they are balanced by a decline in the net external asset position.

Monetary liquidity is what matters for inflation dynamics

From a medium to longer-term perspective, inflation moves in line with broad monetary aggregates. This relationship holds true across countries and monetary policy regimes, suggesting that it is “hardwired” into the deep structure of the economy. Empirical evidence confirms this relationship for the euro area and underpins the prominent role assigned to money in the ECB’s monetary policy strategy. It also suggests that inflation is not linked to short-term fluctuations in monetary aggregates. To the extent that the SMP restores the orderly functioning of financial markets, and thereby establishes an appropriate yield configuration, and the purchases are sterilised, there is every reason to believe that the medium to longer-term dynamics of broad money will be unaffected. Thus, the SMP should not give rise to risks to price stability, in particular those stemming from developments in monetary liquidity.

Concluding remarks

Overall, there are clear and important differences between the SMP and asset purchase programmes intended to provide additional monetary stimulus to the economy, as the SMP is designed to be neutral with respect to the supply of money, while the latter are intended to boost the money supply.

The ECB’s monetary policy strategy ensures the regular monitoring of developments in euro area money and credit and that these developments are taken into account in the formulation of monetary policy. This, in turn, provides a safeguard against any unintended effects on risks to price stability that result from monetary developments.