

Box 2

LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS IN THE PERIOD FROM 10 FEBRUARY 2010 TO 11 MAY 2010

This box describes the ECB's liquidity management during the three reserve maintenance periods that ended on 9 March, 13 April and 11 May 2010 respectively.

Over this period, the ECB continued to implement some of the non-standard measures it had introduced in response to the intensification of the financial crisis in October 2008 and, by the end of the third maintenance period, it had introduced additional measures amid the risk that renewed financial market tensions would hamper the transmission mechanism of monetary policy.

Specifically, on 4 March 2010, the Governing Council of the ECB announced that:

- (i) its main refinancing operations (MROs) would continue to be conducted as fixed rate tender procedures with full allotment for as long as needed – and at least until the end of this year's ninth maintenance period on 12 October 2010;
- (ii) special term refinancing operations with a maturity of one maintenance period would also continue to be conducted as fixed rate tender procedures – with the same fixed rate as that used in the respective MRO – at least until the end of the ninth maintenance period;
- (iii) an additional six-day fine-tuning operation with announcement, allotment and settlement on 1 July 2010 would be carried out in order to smoothen the liquidity effect of the 12-month long-term refinancing operation (LTRO) maturing on 1 July 2010. This fine-tuning operation would be conducted as fixed rate tender procedure with full allotment, with the same fixed rate as that used for the prevailing MRO;
- (iv) the rate in the six-month LTRO to be allotted on 31 March 2010 would be fixed at the average minimum bid rate of the MROs over the life of this operation.

On 4 March 2010, the Governing Council also announced that it would return to variable rate tender procedures in the regular three-month LTROs, starting with the operation to be allotted on 28 April 2010. Indicative allotment amounts in these operations would be pre-set in order to ensure smooth conditions in the money market and to avoid any significant spreads between bid rates and the prevailing MRO rate, which would be used as the minimum bid rate. On 10 May 2010, however, in order to address renewed severe tensions in financial markets, the Governing Council announced that the regular three-month LTROs to be allotted on 26 May and 30 June 2010 would instead be conducted as fixed rate tender procedures with full allotment.

Specifically, on 10 May 2010, the Governing Council also announced that:

- (i) interventions would be conducted in the euro area public and private debt securities markets (Securities Markets Programme) to address the malfunctioning that had arisen in certain security market segments and restore their depth and liquidity. The scope of these interventions would be determined by the Governing Council. To sterilise their impact, specific operations would be conducted to re-absorb the liquidity injected;

- (ii) a six-month LTRO would be carried out with full allotment on 12 May 2010, at a rate fixed at the average minimum bid rate of the MROs over the life of this operation;
- (iii) temporary swap lines with the Federal Reserve would be reactivated, in coordination with other central banks, and US dollar liquidity-providing operations with maturity periods of seven and 84 days would be resumed. These operations would take the form of repurchase operations against collateral fulfilling the ECB's eligible criteria and be carried out as fixed rate tenders with full allotment. The first operation would be conducted on 11 May 2010.

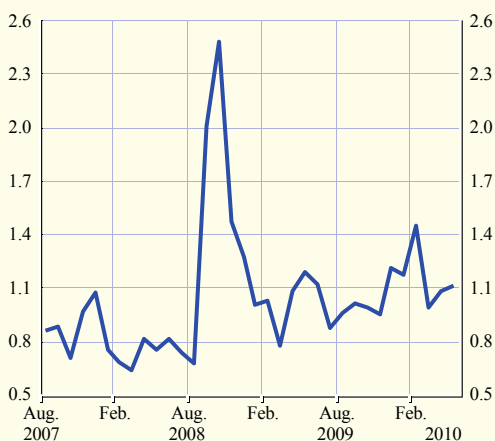
Liquidity needs of the banking system

In the three maintenance periods under review, the banking system's aggregate 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, see Chart A) – averaged €563.3 billion, which was €22.2 billion less than the average level registered in the previous three maintenance periods.

This was mainly due to a decrease of €23.3 billion in the average value of the autonomous factors, which stood at €351.1 billion (see Chart B). Instead, average reserve requirements rose by €1.2 billion to €211.2 billion. Daily excess reserves averaged €1.1 billion, thereby increasing by €0.2 billion in comparison with the three previous maintenance periods.

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

(EUR billions; average level in each maintenance period)

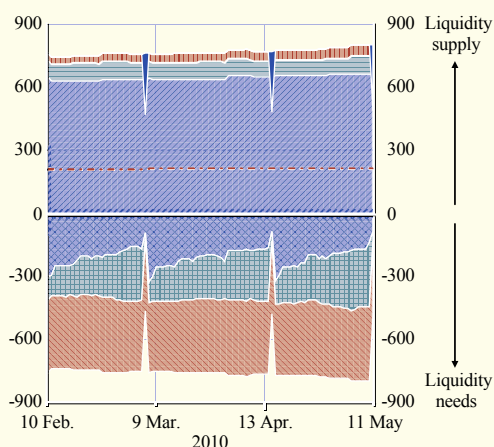


Source: ECB.

Chart B Liquidity needs of the banking system and liquidity supply

(EUR billions)

- fine-tuning operations: €302.2 billion on average
- covered bond purchases: €43.7 billion on average
- main refinancing operations: €78.2 billion on average
- longer-term refinancing operations: €652.5 billion on average
- autonomous factors: €351.1 billion on average
- net recourse to deposit facility: €201.0 billion on average
- current accounts: €212.3 billion on average
- reserve requirements: €211.2 billion on average



Source: ECB.

Liquidity supply

Over the three maintenance periods under review, the volume of refinancing operations outstanding averaged €721 billion, up from the average level of €686 billion recorded in the three previous maintenance periods.

The average size of the one-week MROs stood at €78.2 billion, registering an increase of €20.2 billion, while the size of special term refinancing operations with a maturity of one maintenance period averaged €9.3 billion, up from €3.4 billion in the previous three maintenance periods. At the same time, the total volume of three and six-month LTROs outstanding continued to decrease, totalling €29.5 billion on 11 May 2010, compared with €42.1 billion on 9 February 2010, as some of these operations matured and were not replaced.

The central banks of the Eurosystem continued their outright purchases of euro-denominated covered bonds as part of the covered bond purchase programme (CBPP), which began on 6 July 2009. During the period under review, average purchases per working day amounted to €255 million, so that total purchases rose to a cumulative value of €52.1 billion on 11 May 2010. The targeted amount of the CBPP is €60 billion, which is to be reached by late June 2010.

In the period from 10 February 2010 to 11 May 2010, the liquidity absorbed via fine-tuning operations on the last day of each maintenance period averaged €302.2 billion. This compares with an average of €219.4 billion in the previous three maintenance periods (see Chart B).

Use of standing facilities

As a result of the steady increase in the liquidity supply and the slight decline in the aggregate liquidity needs of the banking system, net recourse to the deposit facility¹ rose to a daily average² of €201.0 billion in the maintenance period ending on 11 May 2010, up from €149.1 billion in the maintenance period ending on 9 February 2010.

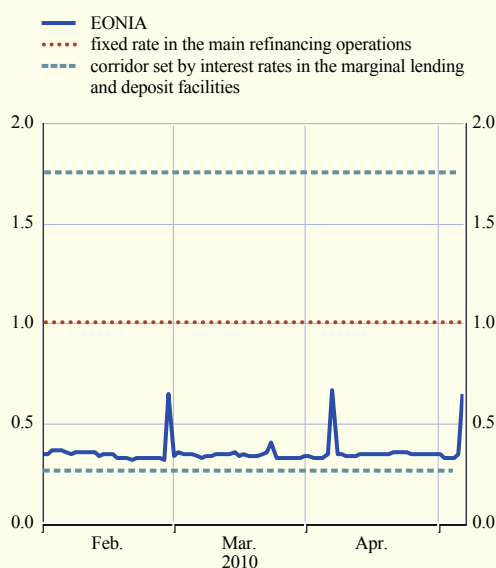
Interest rates

The ECB's key interest rates have remained unchanged since 13 May 2009, with the rate on the MROs standing at 1%, the marginal lending rate at 1.75% and the deposit rate at 0.25%.

As a result of the ample liquidity in the euro area, the EONIA continued to remain close to the rate on the deposit facility, averaging 0.346% in the period under review (see Chart C), which

Chart C The EONIA and the ECB interest rates

(daily interest rates in percentages)



Source: ECB.

1 Net recourse to the deposit facility = recourse to the deposit facility minus recourse to the marginal lending facility.

2 Average net recourse to the deposit facility includes weekends.

is almost identical to the average of 0.352% prevailing in the preceding three maintenance periods. On the last day of each of the three maintenance periods under review, the average EONIA rose to 0.649%, i.e. about 30 basis points above the level observed on the previous day, as a result of the absorption of liquidity on those days via fine-tuning operations.

In addition, in the period under review, the average spread between the three-month EURIBOR and the three-month EONIA swap rate – which indicates the level of credit and liquidity risk – declined slightly to 27 basis points, compared with an average level of 30 basis points in the three previous maintenance periods.