

Box 2

LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS IN THE PERIOD FROM 15 MAY TO 7 AUGUST 2007

This box describes the ECB's liquidity management during the three reserve maintenance periods ending on 12 June, 10 July and 7 August 2007 respectively.

Liquidity needs of the banking system

During the period under review banks' liquidity needs increased by €16.7 billion. This was a result of autonomous factors rising by €9.7 billion and reserve requirements increasing by €7 billion. Reserve requirements and autonomous factors averaged €188.3 billion and €254.5 billion respectively over that period. On 3 August banknotes in circulation, the most prominent autonomous factor, reached the highest level observed since the start of Stage Three of EMU (€645 billion).

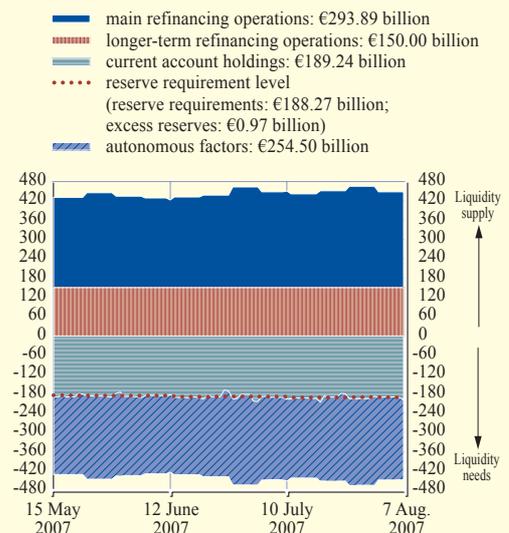
Over the period under review the level of daily average excess reserves (i.e. the daily average of current account holdings in excess of reserve requirements) was somewhat higher than usual. Excess reserves averaged €0.92 billion in the reserve maintenance period ending on 12 June and €1.2 billion in the reserve maintenance period ending on 10 July. They declined, however, to an average level of €0.74 billion in the reserve maintenance period ending on 7 August (see Chart B).

Liquidity supply and interest rates

Reflecting the increase in liquidity needs, the volume of open market operations increased during the period under review (see Chart A). Liquidity provided via the main refinancing operations (MROs) averaged €293.9 billion. The ratio between bids submitted by counterparties and satisfied bids (the bid-cover ratio) in the MROs ranged between 1.08 and 1.31, with an average of 1.23 over the review period.

Chart A Liquidity needs of the banking system and liquidity supply

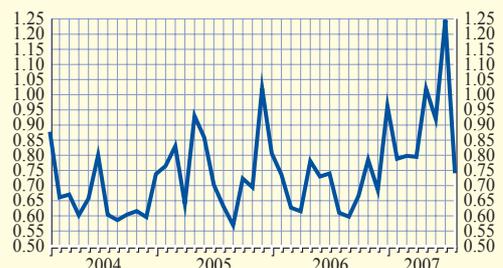
(EUR billions; daily averages for the whole period are shown next to each item)



Source: ECB.

Chart B Excess reserves ¹⁾

(EUR billions; average level in each maintenance period)



Source: ECB.

¹⁾ Banks' current account holdings in excess of reserve requirements.

Liquidity provided through longer-term refinancing operations remained unchanged at €150 billion in the period under review.

Reserve maintenance period ending on 12 June

The ECB allotted €1 billion above the benchmark amount in all four MROs of the reserve maintenance period. The average spread between the EONIA (euro overnight index average) and the MRO minimum bid rate was 5 basis points, thus slightly lower than the historical average. The first two MROs of the period produced marginal and weighted average MRO rates of 3.82%, with the EONIA remaining stable at 3.83%. In the third tender, the marginal MRO rate remained unchanged, whereas the weighted average MRO rate increased to 3.83%. The EONIA rose slightly to 3.85% on 31 May owing to the usual end-of-month effect. In the following days the EONIA gradually declined to a level slightly below the minimum bid rate. Also in the light of this development, the final MRO of the reserve maintenance period produced marginal and weighted average rates of 3.75% and 3.77% respectively.

The EONIA fell to 3.68% following the allotment of the last MRO of the reserve maintenance period, before stabilising at around 3.80% before the end of the reserve maintenance period.

On the last day of the reserve maintenance period the ECB absorbed an expected liquidity surplus of €6 billion by means of a fine-tuning operation. The reserve maintenance period ended with net recourse to the marginal lending facility totalling €0.7 billion and the EONIA standing at 3.79%.

Reserve maintenance period ending on 10 July

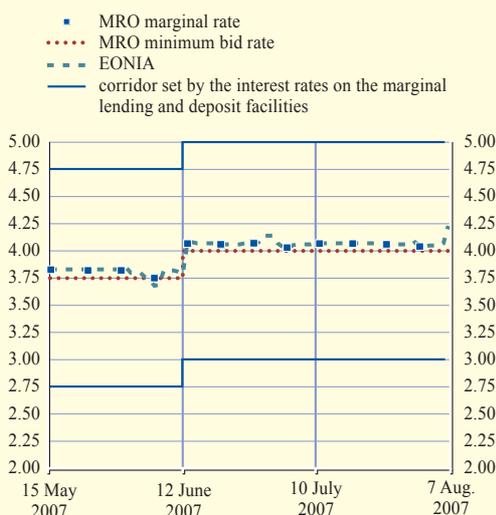
On 6 June the Governing Council of the ECB decided to increase the key ECB interest rates (the minimum bid rate and the rates on the deposit and marginal lending facilities), raising them by 25 basis points to 4%, 3% and 5% respectively. This change was effective as of 13 June, the first day of the subsequent reserve maintenance period.

The policy of allotting €1 billion above the benchmark amount was maintained for all four MROs of this reserve maintenance period. The spread between the EONIA and the MRO minimum bid rate averaged 7 basis points across the reserve maintenance period as a whole.

The first two weeks of that period saw the weighted average rate in the MROs standing at 4.07%, with the marginal rate standing at 4.06%. The EONIA remained stable between 4.06%

Chart C The EONIA and the ECB interest rates

(daily interest rates in percentages)



Source: ECB.

and 4.08% during those first two weeks. In the following MRO both the weighted average rate and the marginal rate increased by 1 basis point, to 4.08% and 4.07% respectively. On 29 June the EONIA peaked at 4.14% for this reserve maintenance period on account of the usual end-of-month effect. The marginal and weighted average rates were lower for the final MRO of the reserve maintenance period, at 4.03% and 4.05% respectively. The EONIA declined in the days following that allotment and reached 4.01%, before stabilising at 4.06% on 6 July. The ECB conducted a fine-tuning operation to withdraw €2.5 billion of liquidity on the last day of the reserve maintenance period. The fine-tuning operation was oversubscribed (with bids totalling €17.4 billion from 18 counterparties), and the reserve maintenance period ended with net recourse to the marginal lending facility totalling €0.4 billion and the EONIA standing at 4.07%.

Reserve maintenance period ending on 7 August

As in the previous maintenance period, the ECB allotted €1 billion above the benchmark amount in all MROs, and the average spread between the EONIA and the MRO minimum bid rate stood at 7 basis points. The first two weeks of that period saw marginal and weighted average MRO rates of 4.06% and the EONIA stable at 4.07%, while in the third week the weighted average MRO rate rose to 4.07%. The EONIA increased to 4.08% on 31 July owing to the usual end-of-month effect. The marginal and weighted average rates stood at 4.04% and 4.06% respectively in the last MRO of the reserve maintenance period, while the EONIA declined slightly to 4.05%, before returning to its previous level of 4.07% on the penultimate day of the maintenance period. A fine-tuning operation was not necessary on the last day of the reserve maintenance period, given that net recourse to the marginal lending facility totalled €0.4 billion and the EONIA stood at 4.23%.