



EUROPEAN CENTRAL BANK

EUROSYSTEM

Cornelia Holthausen
European Central Bank

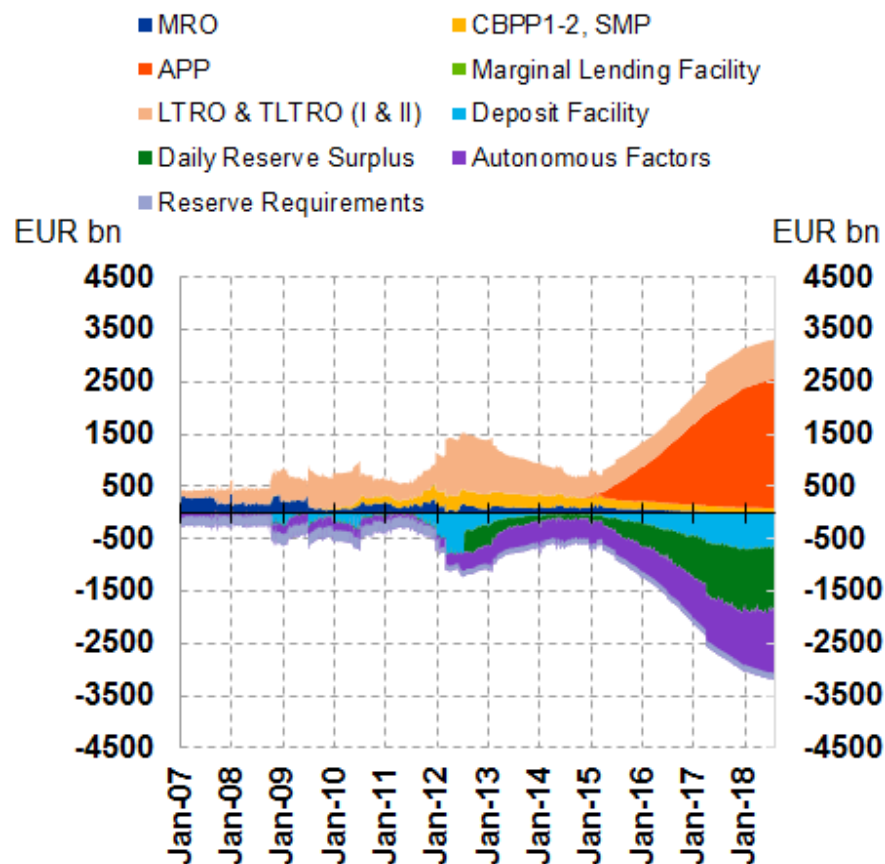
Impact of Reductions in Reserves in the euro area

Monetary Policy Implementation
Workshop

New York, 28 September 2018

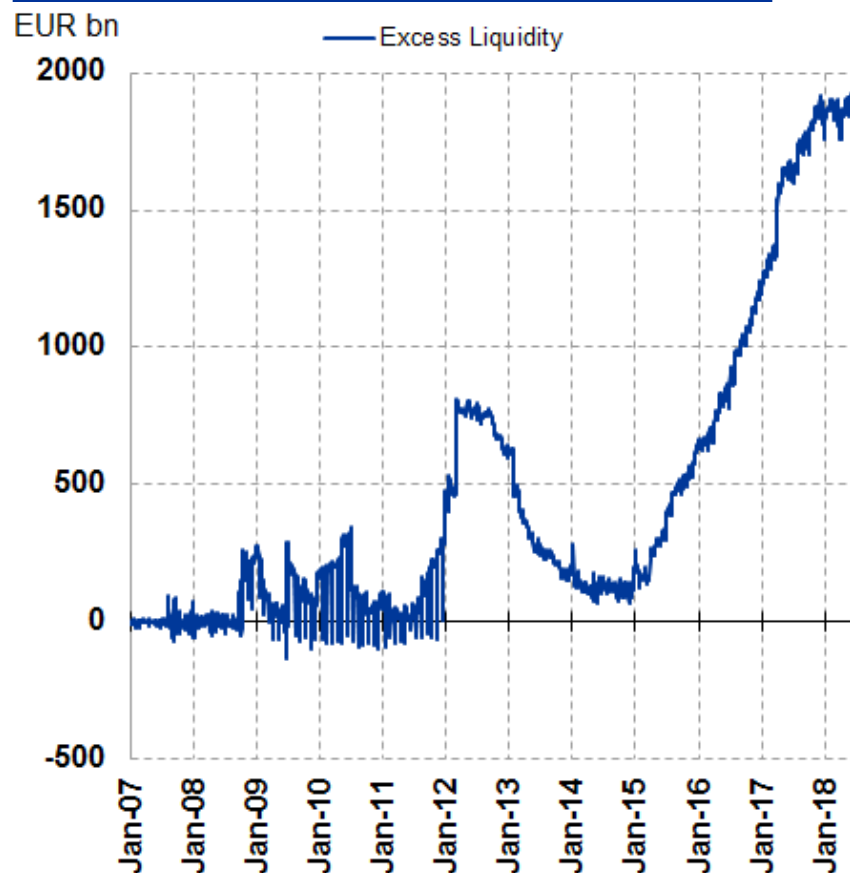
Bank reserves are still increasing in the euro area

Eurosystem balance sheet items



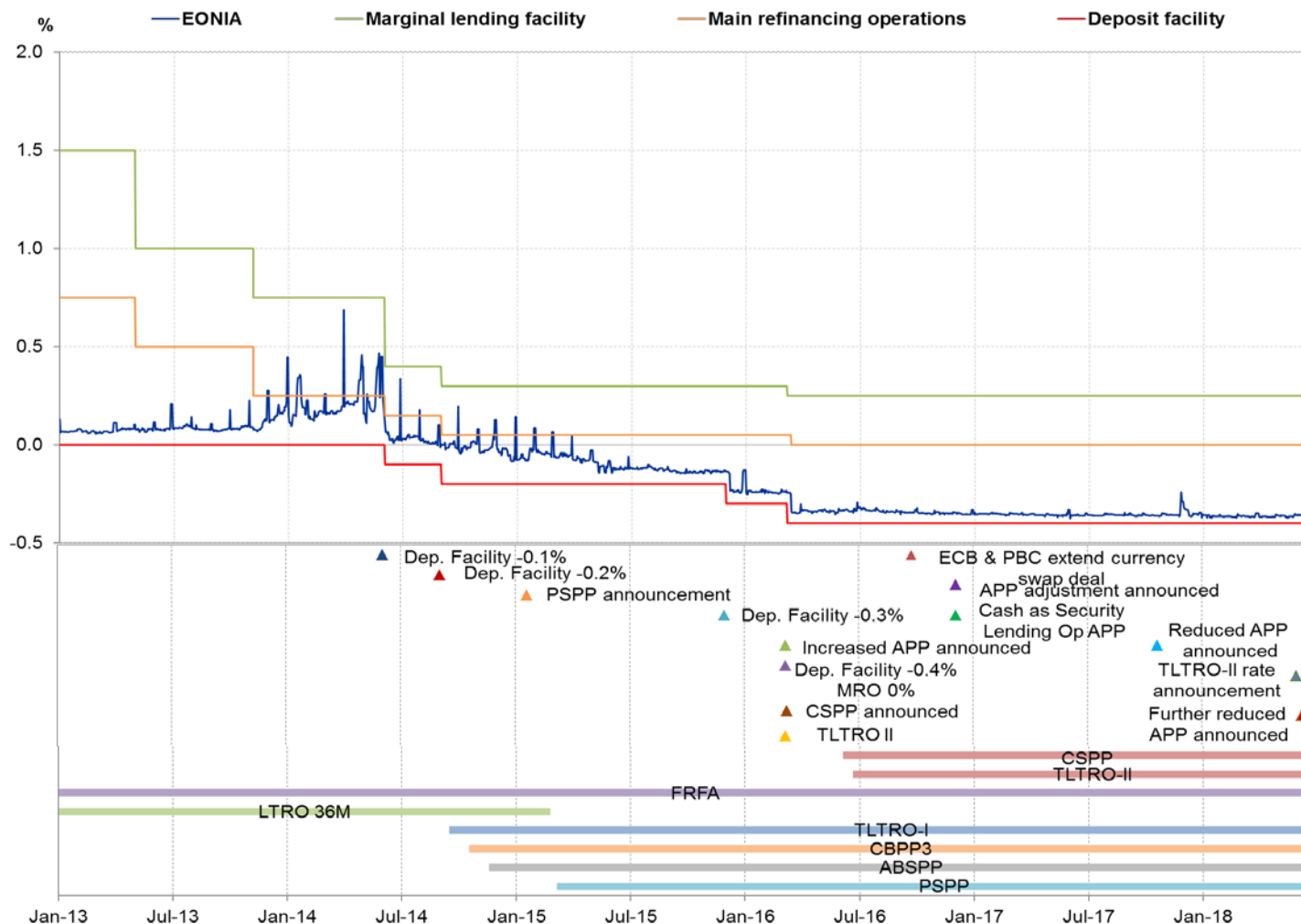
Note: Selected items from the assets (+) and (net) liabilities (-).
Source: ECB.

Excess liquidity



Note: excess liquidity is defined as the daily reserve surplus (i.e. holdings above reserve requirements) plus deposit facility holdings and minus reliance on the marginal lending facility.
Source: ECB.

EONIA very close to the deposit facility rate



Overview

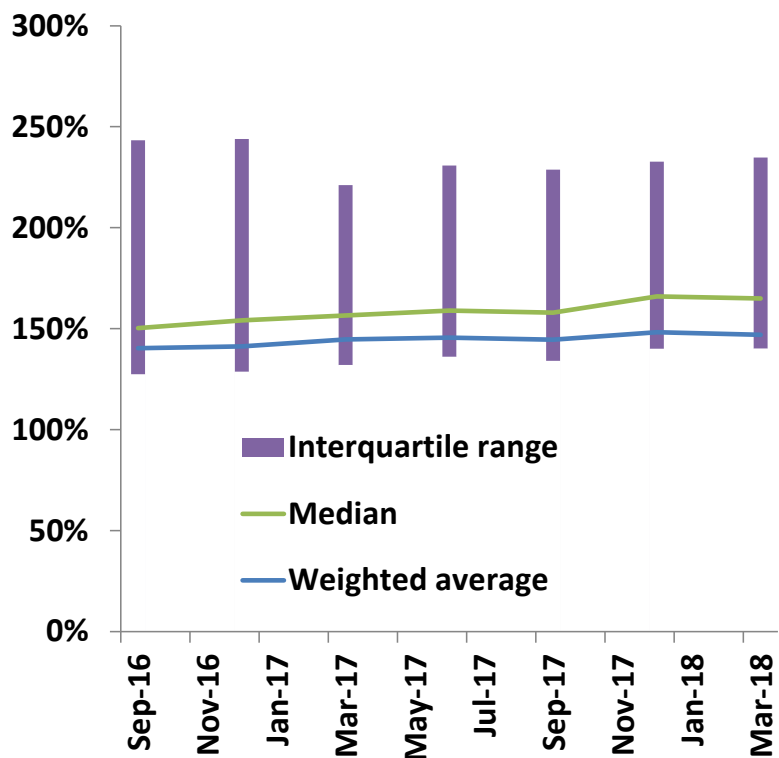
1 Interaction with HQLA supply and demand

2 Interaction with regulation

3 Interaction with market segmentation

Large LCR buffers and a large supply of high quality liquid securities

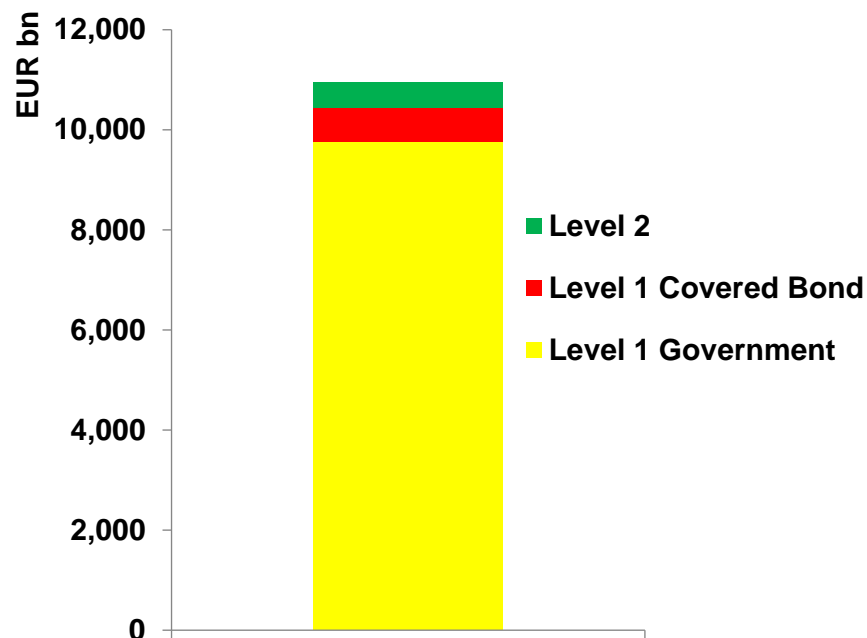
Liquidity coverage ratio of EU banks



Note: 25th and 75th percentiles, median and weighted average LCR.

Source: EBA Risk Dashboard for 190 banks.

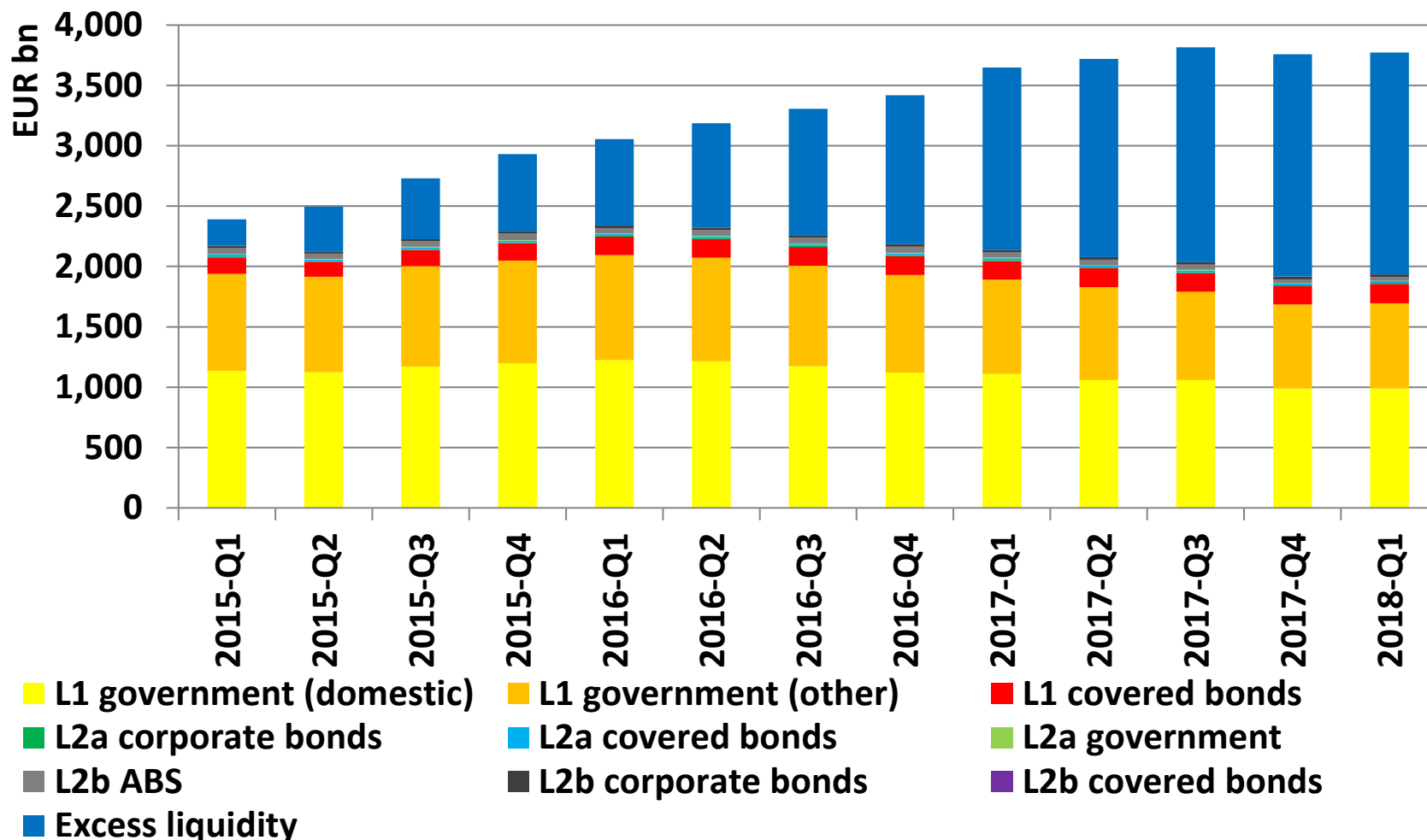
Stock of HQL securities



Notes: total of high quality liquid securities supplied by governments and private entities, market value after LCR haircuts and before ECB operations, as of 2017-Q3.

Source: Eurosystem calculations.

Euro area banks will want to replace part of the current reserve holdings with securities



Note: see also forthcoming ECB Occasional Paper.

Source: Eurosystem.

Redistribution of HQLA probably more relevant than the reduction

- Exit from unconventional policy has a fairly neutral effect on HQLA supply:
 - The maturity of the ECB securities portfolio and new bond issuance exchange L1-HQLA mainly for L1-HQLA
 - The maturity of TLTROs does not reduce the liquidity transformation opportunity for banks as long as the full allotment procedure applies
- Any upward pressure on government bond yields following the end of QE gets partly dampened if banks compete to hold more bonds
- Funding rates may experience upward pressure if banks see less liquidity inflows and compete for deposits and issue more
- HQLA demand could spill over to ECB refinancing operations

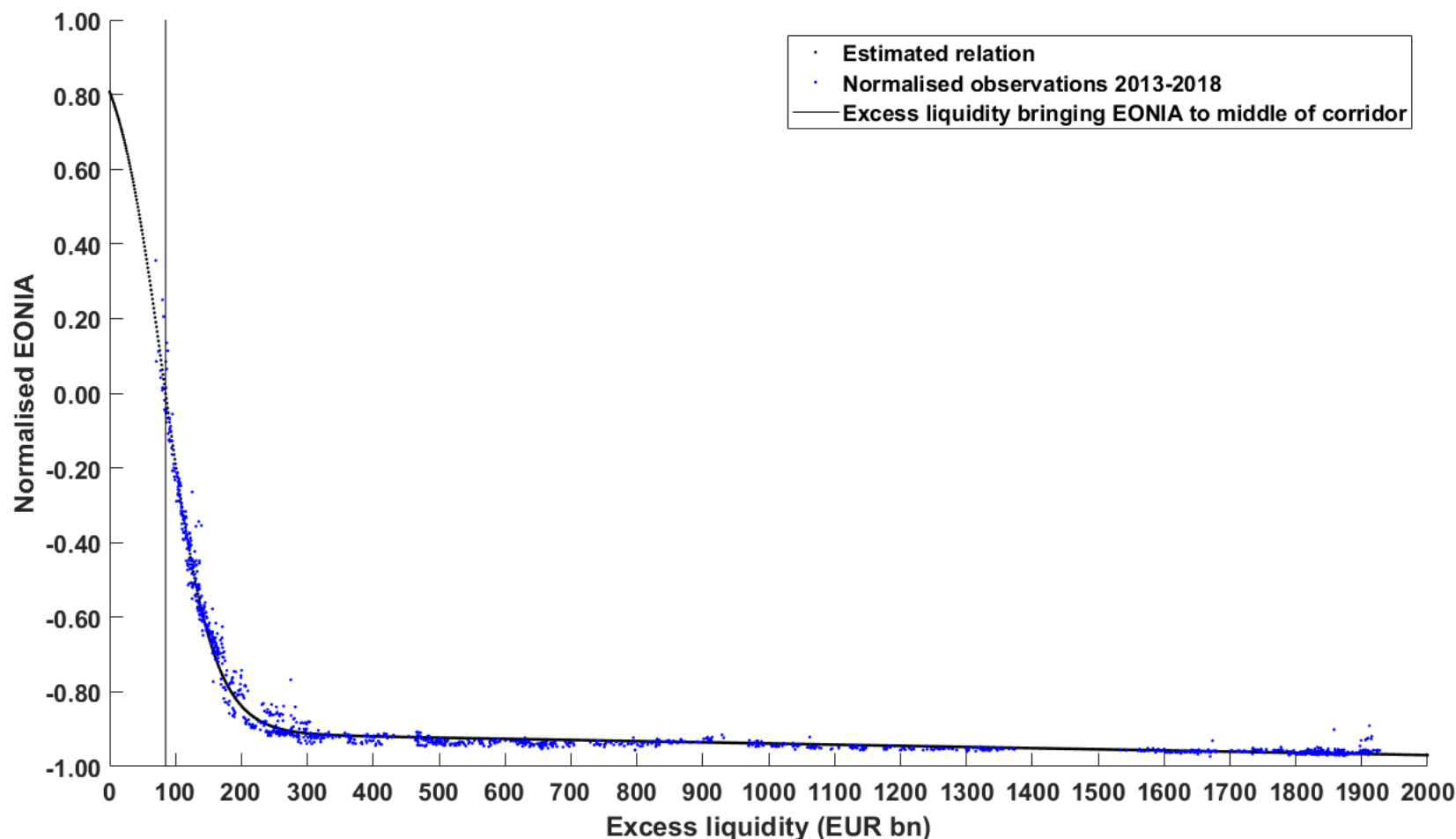
Overview

1 Interaction with HQLA supply and demand

2 Interaction with regulation

3 Interaction with market segmentation

A structural demand for excess liquidity may be present

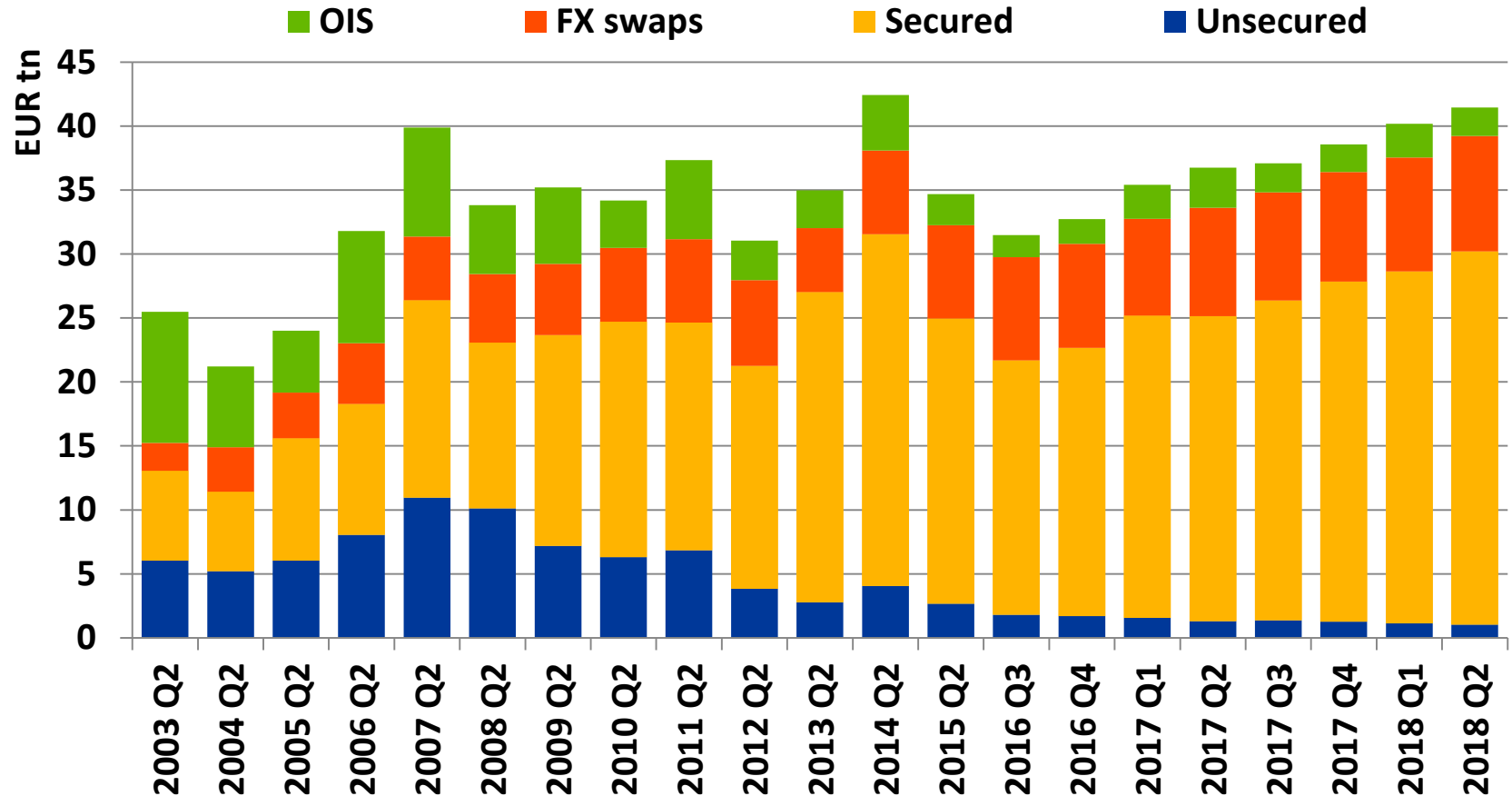


Notes: The sample period is 2013-2018, when new regulatory initiatives became relevant. The y-axis represents a stylised monetary policy corridor with $MLF=1$, $MRO=0$, $DFR=-1$. The vertical line indicates the excess liquidity level at which the expected market rate equals the MRO rate.

Source: EMMI, ECB, ECB calculations.

Unsecured money market unlikely to recover owing to regulation

Interbank cash lending and borrowing of 38 banks (quarterly total transaction volumes)

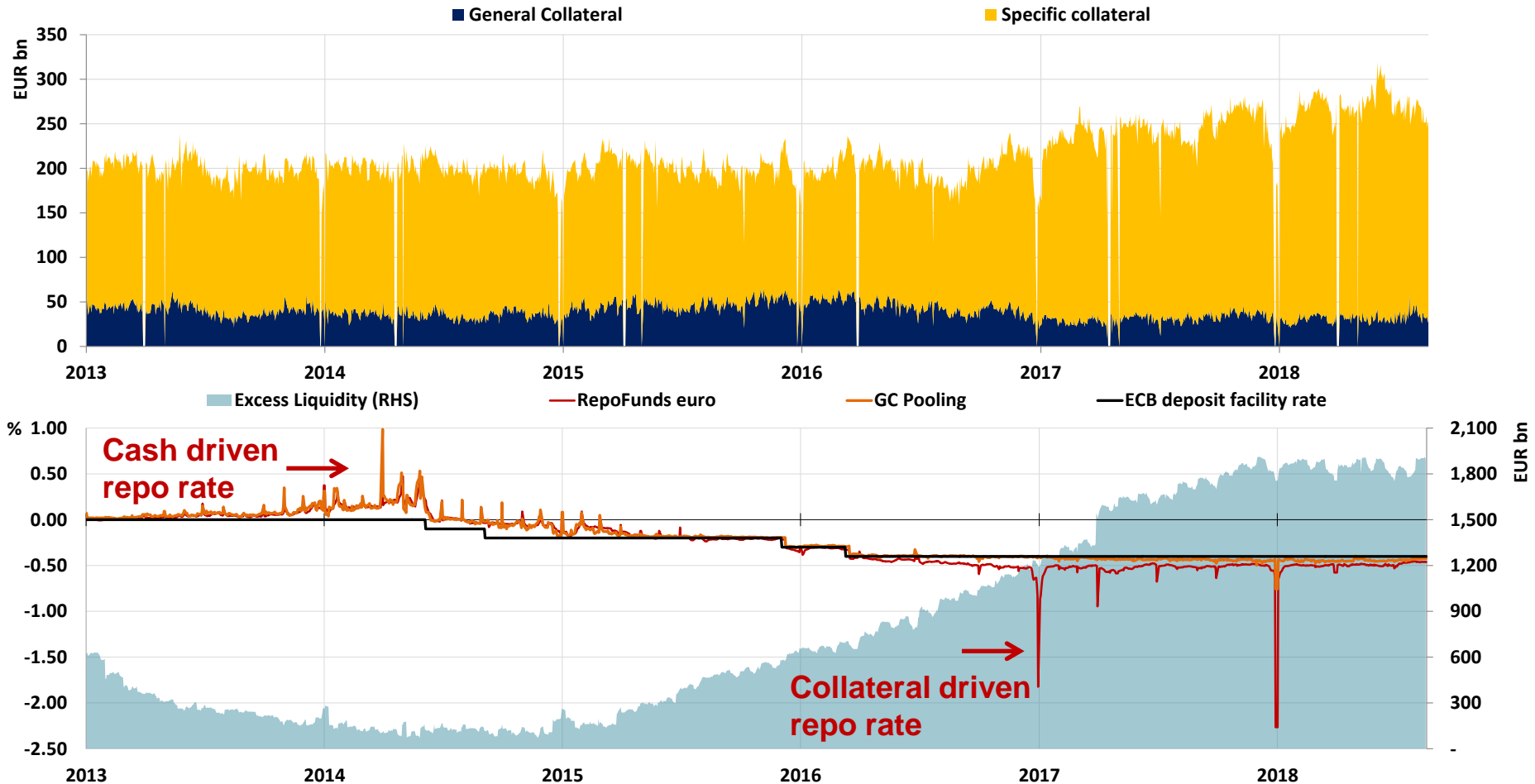


Notes: Sample of 38 banks reporting in both the Euro Money Market Survey until Q2 2015 and under the Money Market Statistical Reporting from Q3 2016 onwards.

Source: ECB.

A return of cash management driven repo, and rate spikes on reporting dates?

Short-term repo and excess liquidity conditions



Note: volumes as executed on the Brokertec and MTS platforms (top panel); RepoFunds index and STOXX GC Pooling ON index (bottom panel).

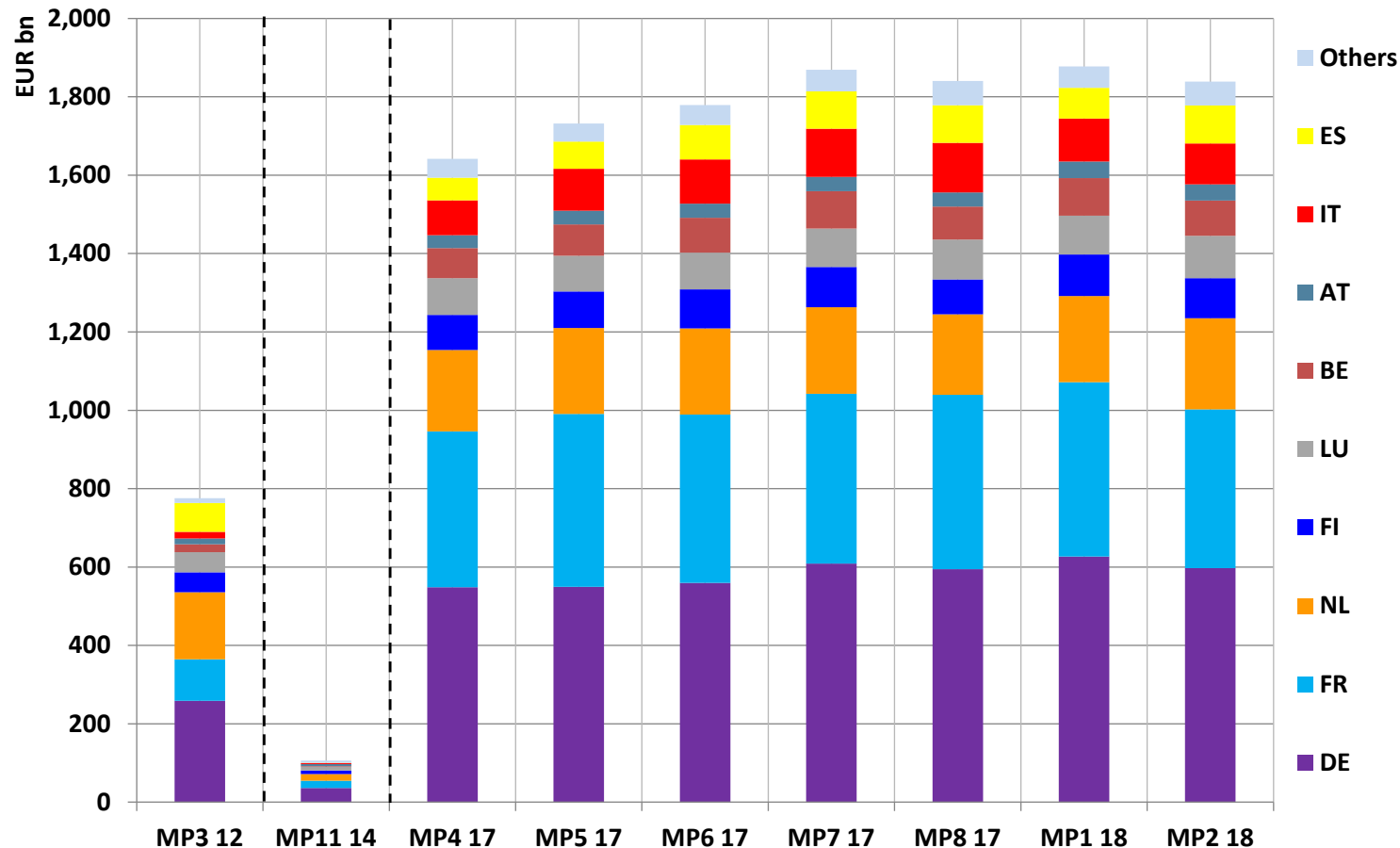
Source: Bloomberg, Brokertec, ECB, MTS.

Overview

- 1 Interaction with HQLA supply and demand
- 2 Interaction with regulation
- 3 Interaction with market segmentation**

Reserve reduction will concentrate on certain euro area countries

Excess liquidity held with national central banks (averages of reserve maintenance periods)

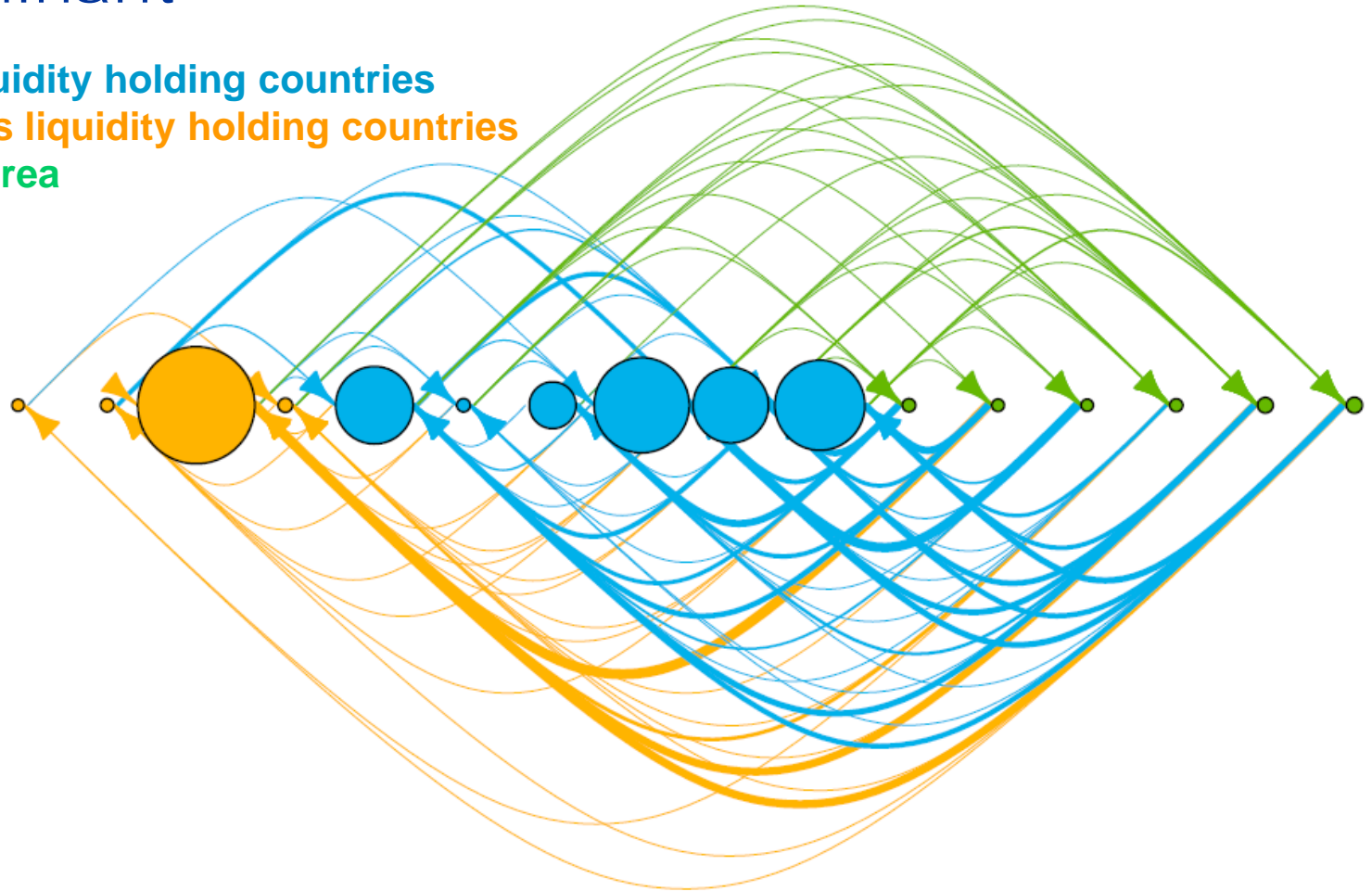


Notes: excess liquidity covers recourse to the deposit facility and current account holdings in excess of minimum reserve requirements. See also Baldo et al. (2017): "The distribution of excess liquidity in the euro area", ECB Occasional Paper, 200.

Source: ECB.

Excess liquidity driven deposit flows to become less dominant

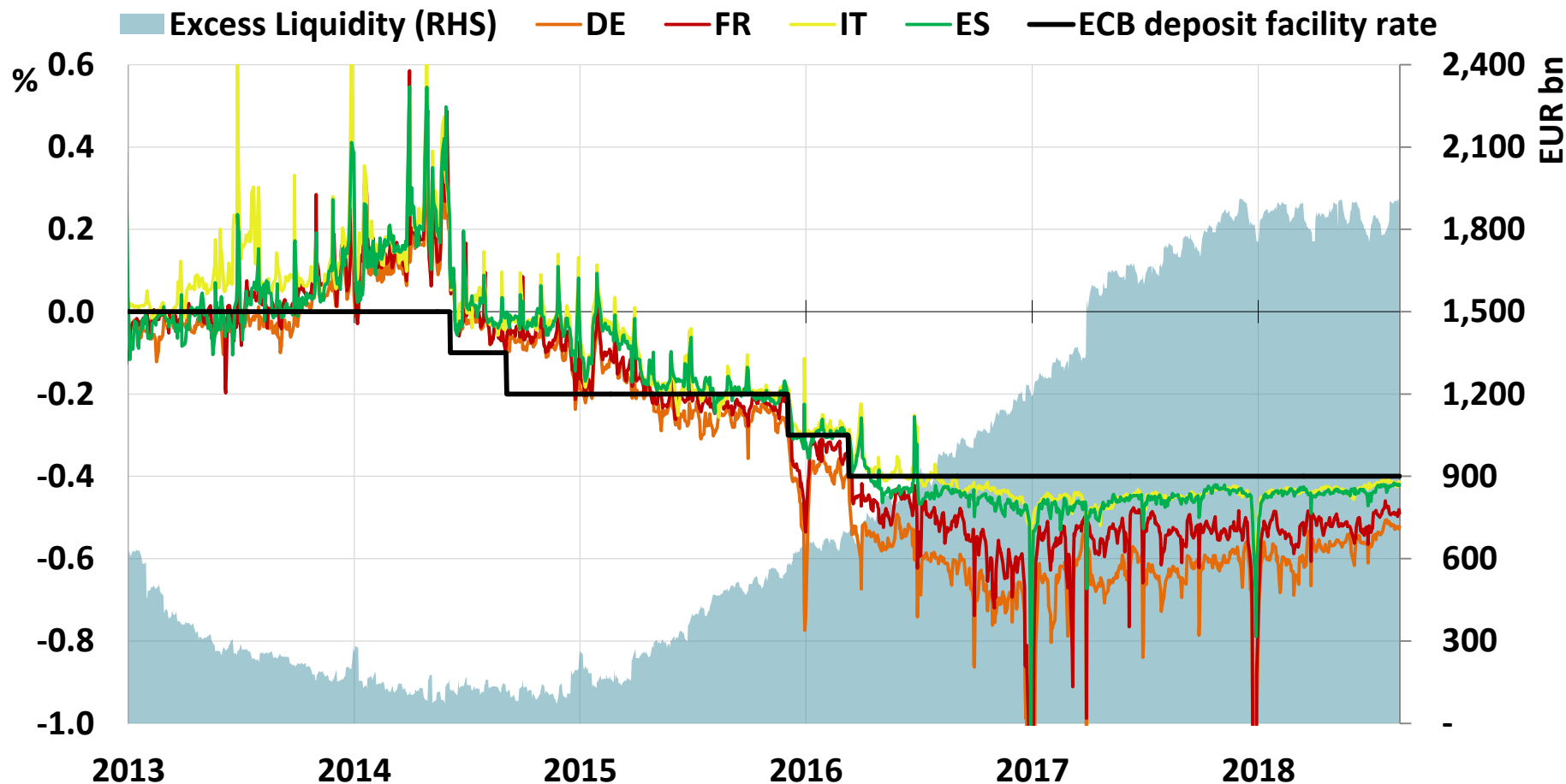
- Excess liquidity holding countries
- Non excess liquidity holding countries
- Non euro area



Notes: the lines represent clockwise from-to flows, with the thickness representing average volume and the colour the destination country group. The size of nodes represents the net inflow into a banking system, with blue nodes indicating excess liquidity holding banking systems. Sample period: July 2016 to April 2018.

Source: ECB, ECB calculations.

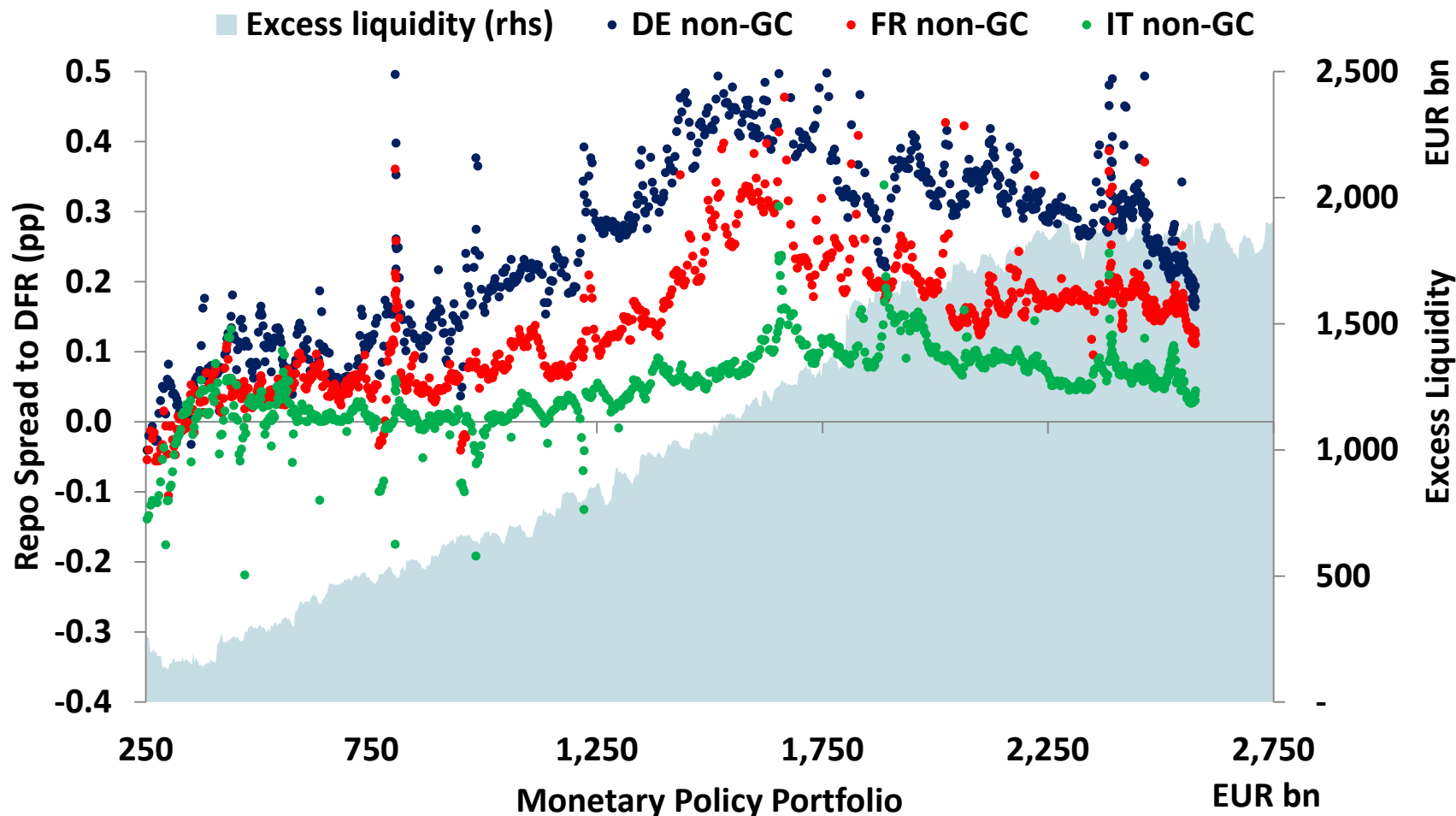
Repo rate dispersion is likely to decline, leaving only differences in perceived creditworthiness



Note: repo rates against German, French, Italian and Spanish collateral.

Source: Brokertec, ECB, MTS.

Repo rate dispersion contained owing to sec lending and adjusted bank behaviour



Note: spread on repo against French, German and Italian non general collateral below the ECB's deposit facility rate (DFR) versus the size of the asset purchase programme.

Source: Brokertec, ECB, MTS and ECB calculations.

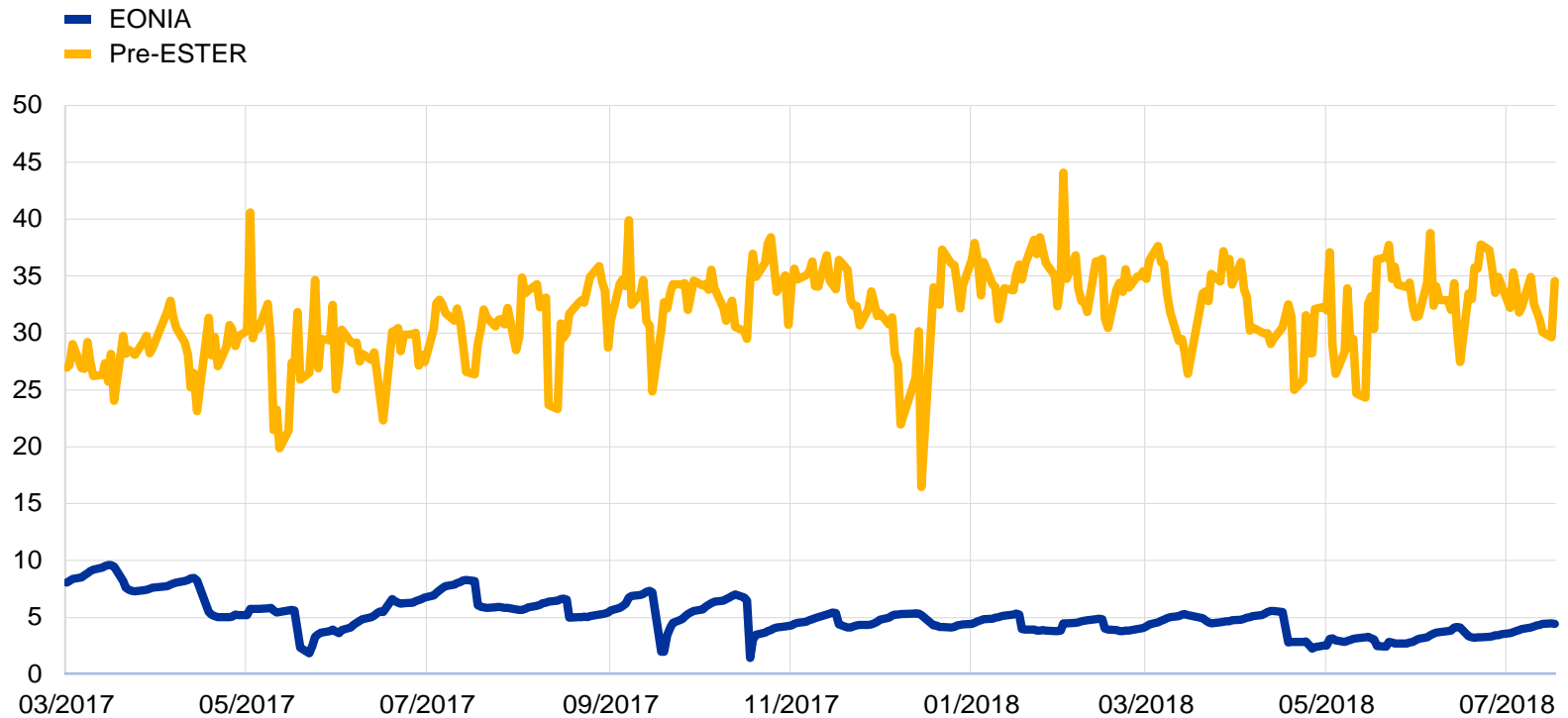
Conclusion

- LCR over-compliance and the large stock of HQL securities predict limited frictions from the reduction in reserves
- Euro area banks will want to replace a contained but sizeable share of the reserves with bonds, implying a redistribution of HQLA and competition with non-banks.
- The demand for HQLA will interact with other parts of the monetary policy framework: possible spillover to refinancing operations, dependence on the size of the corridor, etc.
- Cash driven market activity is expected to rise, but unlikely that the unsecured interbank segment reaches pre-crisis levels.
- The concentration of reserves in certain countries may involve frictions, but effects are likely to remain contained post-crisis.

Background

EONIA und ESTER - Volumens

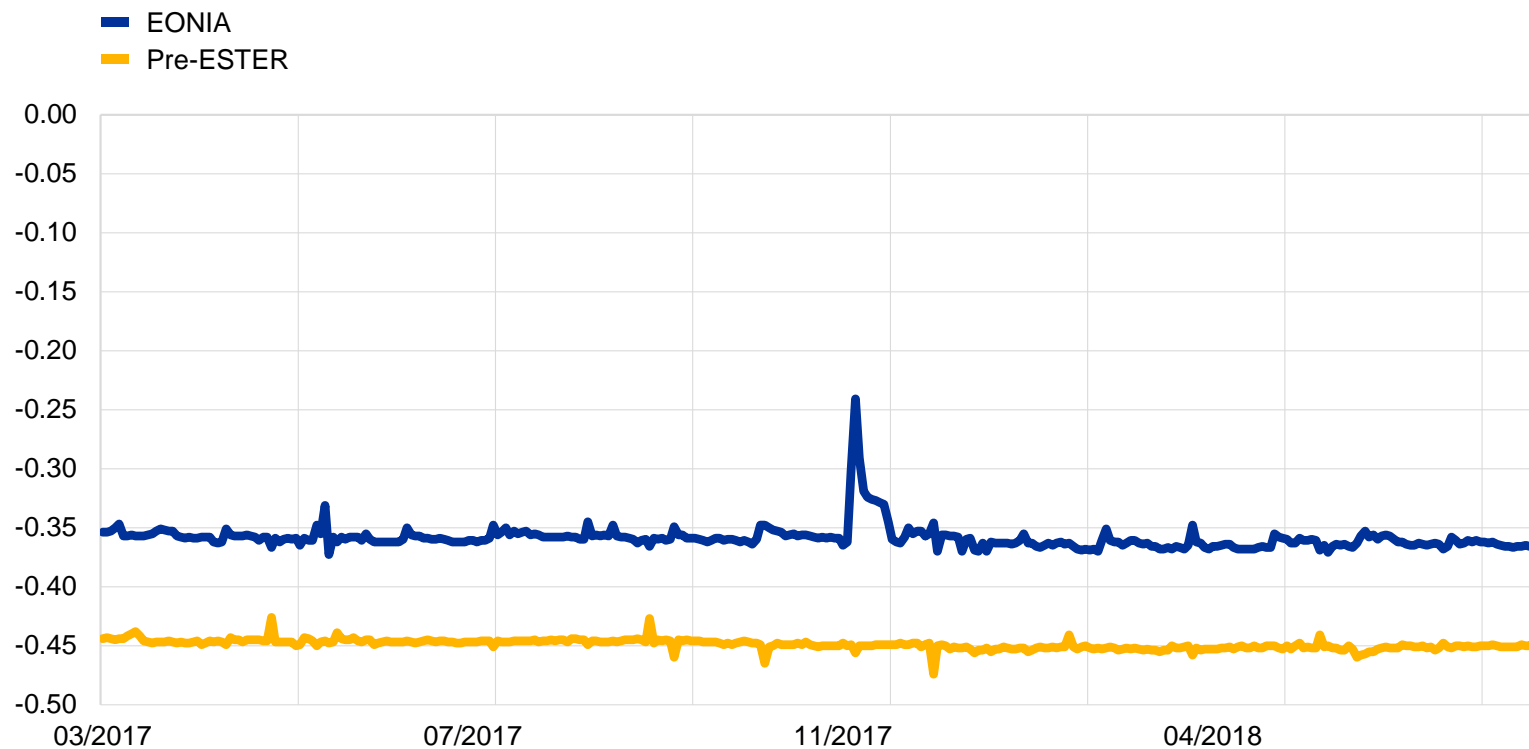
(15 March 2017 – 31 July 2018; EUR billion)



Quellen: ECB and EMMI.

EONIA und ESTER – Spread and volatility

(15 March 2017 – 31 July 2018; per cent)



Quellen: ECB and EMMI.