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LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM MAINTENANCE PERIOD 1 TO MAINTENANCE PERIOD 8 OF 2020

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BOX 2: LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM MAINTENANCE PERIOD 1 TO MAINTENANCE PERIOD 8 OF 2020[1,2]

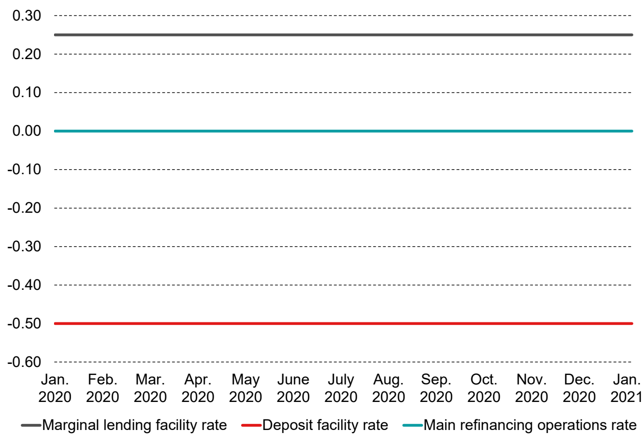
Introduction

This box describes the liquidity conditions in the Maltese banking system and the monetary policy operations conducted by the Bank, as part of the Eurosystem's single monetary policy framework during the eight maintenance periods (MP), starting from 29 January 2020 and ending on 26 January 2021.

During the period under consideration, the Eurosystem continued with the net purchase phase of the APP, resulting in the Eurosystem purchasing public sector debt securities, covered bonds, asset-backed securities as well as corporate sector debt securities. In this regard, the Bank only participates in the public sector purchase programme (PSPP) component of the APP.

Furthermore, the period under review covers the ECB's response to the economic and financial market fallout of the COVID-19 pandemic. This entailed the introduction of a number of additional (bridge) long-term refinancing operations, conducted as fixed-rate tender procedures with full allotment, with the interest rate at the average deposit facility rate over the life of the respective operation. The Governing Council also introduced the PELTROs, conducted as fixed-rate tender procedures with full allotment with the interest rate set at 25 basis points below the average rate applied in the Eurosystem MRO over the life of the respective operation. Additionally, the Governing Council decided to modify some of the key parameters of TLTRO-III. The modifications included an increase in the borrowing allowance, the removal of the bid limit per operation, the reduction of the lending performance threshold to 0%, the early repayment

Chart 1
KEY INTEREST RATE DEVELOPMENTS
(per cent)



Source: Central Bank of Malta.

[1] MP2020 01 (29 January-17 March); MP2020 02 (18 March-5 May); MP2020 03 (6 May-9 June); MP2020 04 (10 June-21 July); MP2020 05 (22 July-15 September); MP2020 06 (16 September-3 November); MP2020 07 (4 November-15 December); MP2020 08 (16 December-26 January 2021).

[2] Prepared by Antonella Sciberras, Assistant Executive, Monetary Operations and Collateral Management Office, and Nathan Chatland, Officer II, Monetary Operations and Collateral Management Office of the Bank and reviewed by Josette Grech, Manager, Monetary Operations and Collateral Management Office. The views expressed in the Box are the authors' own and do not necessarily reflect the views of the Bank.

option after one year from settlement of the operation starting in September 2021, and the recalibration of the interest rate on such operations.

As regards asset purchases, the Governing Council temporarily increased the purchasing envelope for the APP. Furthermore, on 18 March 2021, the Governing Council introduced the PEPP. The PEPP comprises the same purchasing components of the APP, though with greater flexibility across asset classes and jurisdictions. Similar to the APP, the Bank only purchases public sector debt securities under the PEPP.

During the period under review, the key ECB interest rates – that is, the rates on the MROs, the marginal lending facility and the overnight deposit facility – stood unchanged at 0.00%, 0.25% and -0.50%, respectively (see Chart 1).

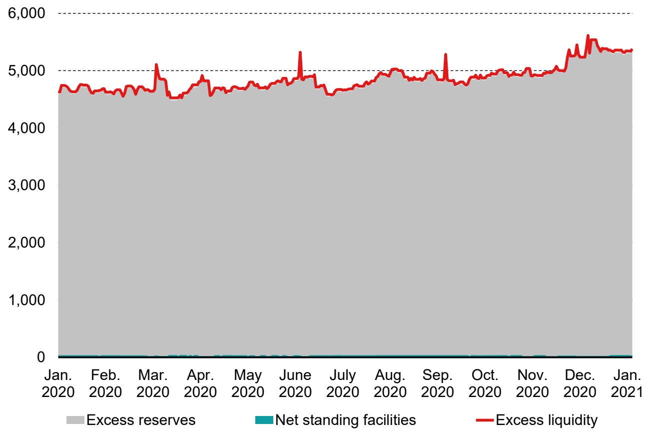
Excess liquidity

Throughout the period reviewed, the Maltese banking system was characterised by high levels of excess liquidity. Excess liquidity is defined as the amount of deposits placed by banks at the overnight deposit facility of the Bank, net of the recourse to the marginal lending facility, plus current account holdings, in excess of the minimum reserve requirements (excess reserves).

At the beginning of the period, excess liquidity stood at €4,636.5 million and grew in a relatively linear manner, reaching €5,380.2 million at the end of MP8. The daily average excess liquidity was €4,859.1 million, reaching a peak of €5,614.4 million on 29 December 2020. The increase in excess liquidity illustrated in Chart 2 was driven mainly by growth in excess reserves, while the use of standing facilities was minimal.

At the beginning of the period, excess reserves stood at €4,599.5 million and grew at a slow but steady pace between MP1 and MP7, with significant current deposits placed at the end of each quarter. During MP8, excess reserves increased significantly, with a daily average of €5,327.3 million, mainly due to large current account deposits placed by one credit institution. Average excess reserves stood at €4,825.3 million over the entire period reviewed.

Chart 2
EXCESS LIQUIDITY
(EUR millions)



Source: Central Bank of Malta.

During the period under review, credit institutions continued benefiting from the two-tier system for reserve remuneration introduced by the Governing Council as from MP7 2019 that started on 30 October 2019. This system exempts part of the credit institutions' excess liquidity holdings from negative remuneration at the rate applicable on the deposit facility. With the two-tier system in place, during the period under review, credit institutions in Malta saved an estimated €6.4 million in interest expense compared to a situation where the negative interest rates would have applied to all their excess reserves.

Developments in excess liquidity also reflect the use of standing facilities. Standing facilities are monetary policy instruments that facilitate the provision and absorption of overnight liquidity. The Eurosystem provides two types of standing facilities: the marginal lending facility and the overnight deposit facility. The marginal lending facility allows counterparties to borrow in order to meet short-term liquidity needs. On the other hand, the deposit facility allows counterparties to deposit overnight funds with the Eurosystem.

During the period reviewed, there was no utilisation of the marginal lending facility by local credit institutions.

The balance on the overnight deposit facility was rather constant over the period with a daily average of €33.9 million. The low utilisation of the overnight deposit facility is attributable to the fact that the two-tier system does not apply to the facility.

Autonomous liquidity factors

Autonomous liquidity factors are items in the central bank balance sheet that are neither monetary policy operations nor current account holdings of credit institutions. As the transactions driving autonomous factors involve central bank money, they have a liquidity-providing or liquidity-absorbing effect.[3,4] Essentially, increases in central bank assets entail the provision of liquidity, while increases in central bank liabilities involve the absorption of liquidity, and vice-versa.

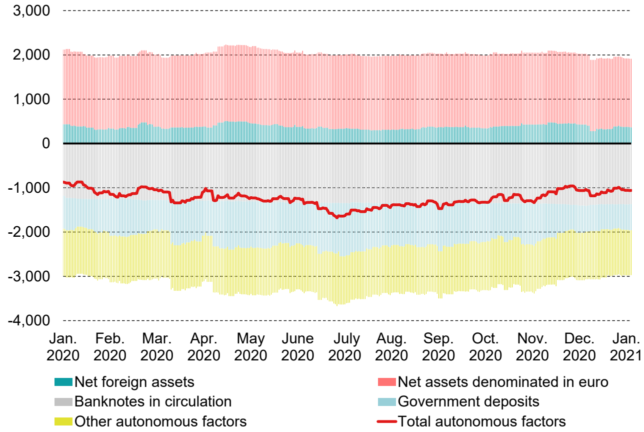
Autonomous factors were net liquidity absorbing and stood at an average of €1,277.3 million throughout the period under review.[5] Despite experiencing significant fluctuations, autonomous factors declined until MP5, reaching the lowest point of €1,673.4 million on 22 July 2020. Thereafter, the autonomous factors started to increase, rising to an average of €1,056.3 million during MP8 (see Chart 3).

The decline in autonomous factors between MP1 and MP5 was mainly the result of an increase in government deposits held with the Bank due to strong net issuances of Malta Government securities. In fact, government deposits increased from an average of €757.3 million in MP1 to €1,033.6 million in MP5. Furthermore, banknotes in circulation, which also includes the excess over the allocation based on the capital key, also increased from an average value of €1,518.1 million in MP1 to €1,713.7 million in MP5, further contributing to

[3] Liquidity-providing factors include net foreign assets and net assets denominated in euro.
[4] Liquidity-absorbing factors consist of government deposits, banknotes in circulation and other autonomous factors.
[5] Given that total autonomous factors were net liquidity-absorbing, in the Chart these are depicted with a negative sign.

the decline in autonomous factors.[6] Following MP5, banknotes in circulation continued to increase, reaching an average of €1,821.8 million during MP8. However, government deposits held with the Bank decreased as from MP6 onwards leading to an increase in the autonomous factors and an injection of liquidity into the banking system. In fact, government deposits stood at an average of €581.6 million as at MP8, considerably less than their peak level earlier in the year.

Chart 3
AUTONOMOUS FACTORS EVOLUTION BETWEEN MP1 AND MP8 2020[(1)]
(EUR millions)



Source: Central Bank of Malta.
[(1)] Liquidity providing factors are shown in positive figures whilst liquidity absorbing factors are shown in negative figures.

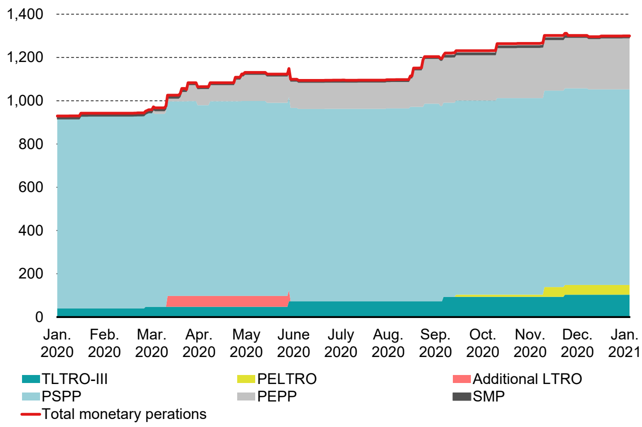
Monetary policy instruments

Open market operations

The Eurosystem uses open market operations to provide liquidity in euro to monetary policy eligible counterparties. During the period reviewed, the volume of liquidity injected into the domestic banking system through open market operations increased by €108.5 million.

At the beginning of the period, outstanding open market operations stood at €40.0 million, all stemming from the TLTRO-IIIs carried out in 2019. During the period under review, there was minimal participation in the MROs and the 3-month LTROs by Maltese counterparties. However, Maltese counterparties participated in the additional LTROs, PELTROs and TLTRO-III. At the end of the period, therefore, the outstanding open market operations stood at €148.5 million, consisting of €103.5 million and €45.0 million in terms of the TLTRO-IIIs and PELTROs, respectively (see Chart 4).

Chart 4
EVOLUTION OF MONETARY POLICY OPERATIONS[(1)]
(EUR millions)



Source: Central Bank of Malta.
[(1)] There were miniminal participation in the MRO and 3-month LTRO.

[6] Banknotes in circulation include a portion based on the capital key allocation and a portion based on the excess or shortfall depending on actual issuance. Chart 3 depicts only the former while the latter is included with Intra-Eurosystem liabilities or claims.

Asset purchases

Through its participation in the various asset purchase programmes, the Bank also influenced liquidity conditions during the period reviewed.

During MP1, the Bank's holdings of debt instruments under the Securities Markets Programme (SMP) stood at an average of €14.1 million.[7] These holdings subsequently declined, reflecting the maturing of securities, falling to an average value of €9.3 million in MP8.

PSPP holdings under the APP stood at an average of €884.3 million in MP1. These holdings grew steadily over the period, standing at an average value of €905.6 million in MP8. This change in volume reflects the net increase effect of the purchase of securities as well as the offsetting effect of the redemption of maturing securities that occurred in the interim.

Given that the PEPP was only launched in March 2020, holdings stood at an average of just €32.2 million in MP2. These holdings grew significantly during the period, standing at an average value of €236.0 million in MP8. This increase was driven solely by the purchases of securities over the period, as no securities matured.

On balance, the Bank's holdings of securities in terms of the Eurosystem's PSPP and PEPP increased by €266.4 million since the start of MP1, implying a net injection of liquidity during the period reviewed.

[7] The SMP was announced by the Governing Council of the ECB on 10 May 2010, with the intention of ensuring depth and liquidity in malfunctioning segments of the debt securities markets and to restore an appropriate functioning of the monetary policy transmission mechanism. The SMP was terminated as from 6 September 2012 with the purchased securities held to maturity.