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LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM MAINTENANCE PERIOD 1 TO MAINTENANCE PERIOD 8 OF 2021

Article published in the Quarterly Review 2022:3, pp. 79-83

BOX 5: LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM MAINTENANCE PERIOD 1 TO MAINTENANCE PERIOD 8 OF 2021[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 (MPs), starting from 27 January 2021 and ending on 8 February 2022.

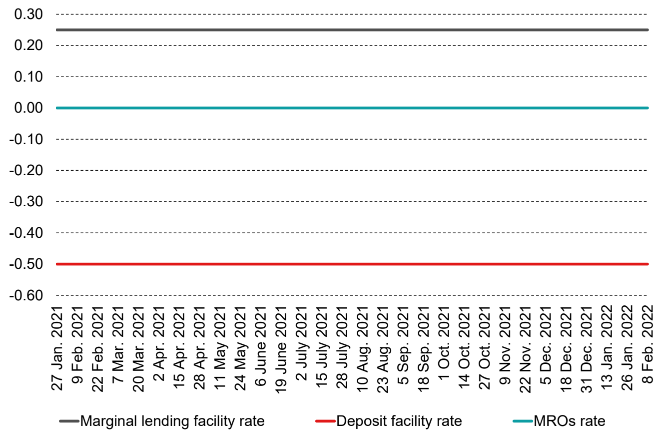
During this period, the Eurosystem continued with the net purchase phase of the APP, resulting in it purchasing public sector debt securities, covered bonds, asset-backed securities as well as corporate sector debt securities. In this regard, the Bank's participation is limited to the Public Sector Purchase Programme (PSPP) component of the APP.

Furthermore, the Eurosystem continued with the net purchase phase of the PEPP that was introduced on 18 March 2020 in response to the COVID-19 pandemic. The PEPP comprises the same purchasing components of the APP, though with greater flexibility across asset classes and jurisdictions. Like the APP, the Bank only purchases public sector debt securities under the PEPP. On 16 December 2021, the Governing Council of the ECB announced that it will discontinue the net asset purchases under the PEPP at the end of March 2022. However, the maturing principal payments from securities purchased under the PEPP will be reinvested until at least the end of 2024.

Furthermore, during the eight MPs reviewed in this box, the ECB continued implementing the quarterly pandemic emergency longer-term refinancing operations (PELTROs) and the third series of the TLTRO-III.

During this period, the key ECB interest rates – that is, the rates on the MROs, the marginal lending facility and the

Chart 1
KEY INTEREST RATE DEVELOPMENTS
(per cent)



Source: ECB.

[1] MP2021 01 (27 January-16 March); MP2021 02 (17 March-27 April); MP2021 03 (28 April-15 June); MP2021 04 (16 June-27 July); MP2021 05 (28 July-14 September); MP2021 06 (15 September-2 November); MP2021 07 (3 November-21 December); MP2021 08 (22 December-8 February 2022).

[2] Prepared by Ritlen Abela, Officer II, Monetary Operations and Collateral Management Office. The author would like to thank Josette Grech, Head, Monetary Operations and Government Securities Department and André Psaila, Chief Investment Officer, Financial Markets Division for their valuable suggestions. The views expressed in the box are the authors' own and do not necessarily reflect the views of the Bank.

overnight deposit facility – stood unchanged at 0.00%, 0.25% and -0.50%, respectively (see Chart 1).

Excess liquidity

Throughout the period, the Maltese banking system remained 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 the current account holdings in excess of the minimum reserve requirements (excess reserves).

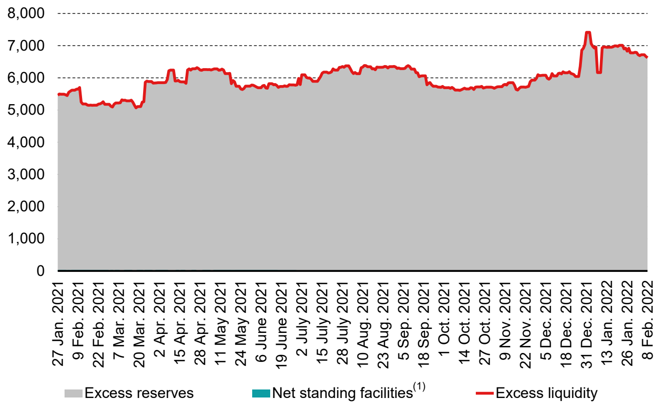
At the beginning of the period, excess liquidity stood at €5,459.3 million and gradually increased reaching €6,622.7 million at the end of MP8. The daily average excess liquidity was €5,980.2 million, reaching a peak of €7,413.0 million on 31 December 2021. The increase in excess liquidity illustrated in Chart 2 was mainly driven by growth in excess reserves while the use of the deposit facility was minimal.

At the beginning of the period, excess reserves stood at €5,434.3 million and grew steadily throughout the period reaching €6,622.7 million on 8 February 2022. Large current account deposits were placed by four credit institutions at the end of the first quarter, mid-year and at year-end. Average excess reserves stood at €5,964.5 million over the entire period reviewed.

During the period under review, credit institutions continued benefiting from the two-tier system for reserve remuneration as introduced by the Governing Council from MP7 2019 starting on 30 October 2019. This system exempts part of the credit institutions' excess reserve holdings from remuneration at the negative rate applicable on the deposit facility. With the two-tier system in place, during the period under review, credit institutions in Malta benefitted from an estimated saving of €7.3 million in interest expense compared to a situation where a negative interest rate 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

Chart 2
EXCESS LIQUIDITY
(EUR millions)



Source: Central Bank of Malta.
(1) Net standing facilities ranged between €0 and €35 million between 27 January 2021 and 8 February 2022.

deposit facility. The marginal lending facility allows counterparties to borrow to meet short-term liquidity needs while 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 generally declining until 27 October 2021, when the facility stopped being used by local credit institutions. The daily average over this period amounted to €21.7 million.[3] The low utilisation of the overnight deposit facility is attributable to the fact that the two-tier system does not apply to it.

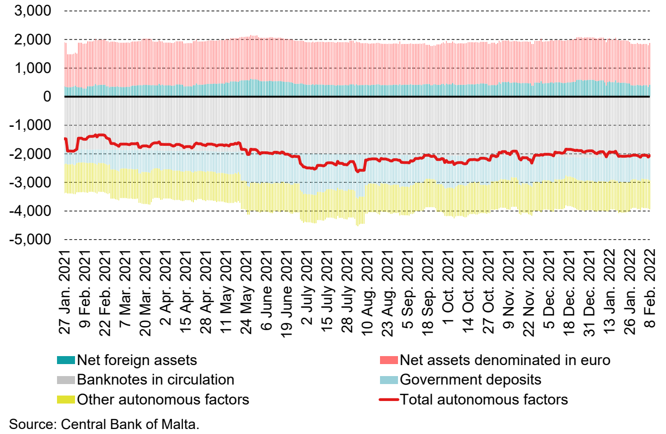
Autonomous liquidity factors

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.[4,5] 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 €1,982.1 million throughout the eight MPs under review.[6] It can be noted that combined autonomous factors were relatively stable for the first five months of the year and then started to decline. The lowest point amounting to €2,630.8 million was reached on 4 August 2021 due to an increase in government deposits following the issuance of Malta Government securities (see Chart 3).

The main contributors to the decline in autonomous factors when compared to the previous year were an increase in both banknotes in circulation (which also includes the excess over the allocation based on the capital key) and government deposits. These drivers of change were also observed in most euro area countries during the period under review.

Chart 3
AUTONOMOUS FACTORS EVOLUTION BETWEEN MP1 AND MP8 2021(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.

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3 The daily average for overnight deposits throughout the eight MPs amounted to €15.7 million.
4 Liquidity-providing factors include net foreign assets and net assets denominated in euro.
5 Liquidity-absorbing factors consist of government deposits, banknotes in circulation and other autonomous factors.
6 Given that total autonomous factors were net liquidity-absorbing, in the Chart these are depicted with a negative sign.

In fact, banknotes in circulation continued to increase in 2021 reaching an average of €1,997.3 million when compared to €1,682.2 million in 2020. The increase was mostly the result of the uncertainty surrounding the COVID-19 pandemic. Government deposits also increased albeit by a small amount from an average of €873.0 million in 2020 to €900.7 million in 2021. The increase in government deposits held with the Bank was mainly due to proceeds from net issuances of Malta Government securities.

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 €550.4 million.

At the beginning of the period, outstanding open market operations stood at €148.5 million, €103.5 million stemming from TLTRO-IIIs and €45.0 million from PELTROs. During the period under review, there was minimal participation in the MROs and in the 3-month longer-term refinancing operations (LTROs) by Maltese counterparties. However, Maltese counterparties participated in the PELTROs and TLTRO-III. At the end of MP8, the outstanding open market operations stood at €698.9 million, consisting of €623.5 million and €75.4 million in terms of the TLTRO-IIIs and PELTROs, respectively (see Chart 4).

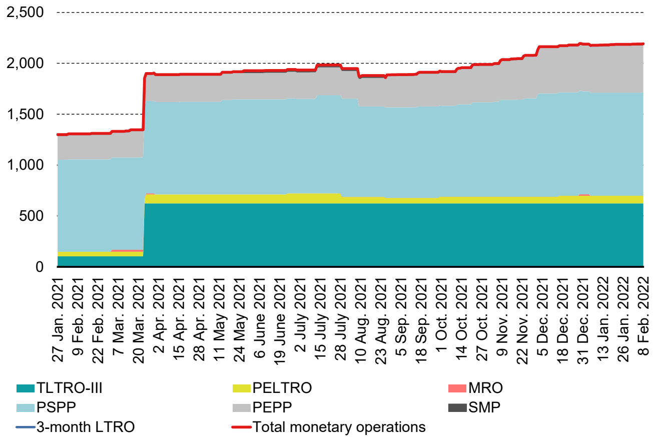
Asset purchases

During the eight MPs reviewed, the Bank also influenced liquidity conditions through its participation in the various APPs. The Bank mostly held assets that were purchased through the PEPP and the PSPP.

The Bank's holdings of debt instruments under the Securities Markets Programme (SMP) stood at an average of €9.4 million.[7]

PSPP holdings under the APP stood at an average of €906.6 million in MP1. These holdings grew steadily over the period, standing at an average value of €1,013.1 million in MP8. This increase

Chart 4
EVOLUTION OF MONETARY POLICY OPERATIONS
(EUR millions)



Source: Central Bank of Malta.

[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.

reflects the purchases of securities which were partially offset by a maturing security that occurred in the interim.

PEPP holdings increased substantially from an average of €244.7 million in MP1 to €461.1 million in MP8. These holdings grew significantly due to large purchases of securities which were marginally offset by the redemption of a single security during the period under review.

On balance, the Bank's holdings of securities in terms of the Eurosystem's PSPP and PEPP increased by €341.6 million since the start of MP1, implying a net injection of liquidity during the period reviewed.