BOX 3: LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM MAINTENANCE PERIOD 1 TO MAINTENANCE PERIOD 8 OF 2022[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 9 February 2022 and ending on 7 February 2023.

During the period under consideration, the Eurosystem continued with the net purchase phase of the APP until end June 2022, resulting in the Eurosystem purchasing public sector debt securities, covered bonds, asset-backed securities as well as corporate sector debt securities. From 1 July 2022 until the end of February 2023, the Eurosystem continued to reinvest, in full, the principal payments from maturing securities under the APP. The Bank only participates in 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, until end March 2022. 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. As from 1 April 2022, the ECB started the reinvestment phase of the PEPP portfolio and expects to reinvest the maturing principal payments from securities purchased under the PEPP until at least the end of 2024.[3]

During the period under review, the Governing Council recalibrated the conditions of the third series of TLTRO-IIIs, as part of the monetary policy measures adopted to restore price stability over the medium term. From 23 November 2022 until the maturity or early repayment date of each respective outstanding TLTRO-III operation, the interest rate is indexed to the average applicable key ECB interest rates over this period. Furthermore, three additional voluntary early repayment dates were introduced to provide TLTRO-III participants with additional opportunities to partly, or fully, repay their respective TLTRO-III borrowings before their maturity.

Also, the four pandemic emergency longer-term refinancing operations (PELTROs) allotted on a quarterly basis in 2021, matured during the reporting period.

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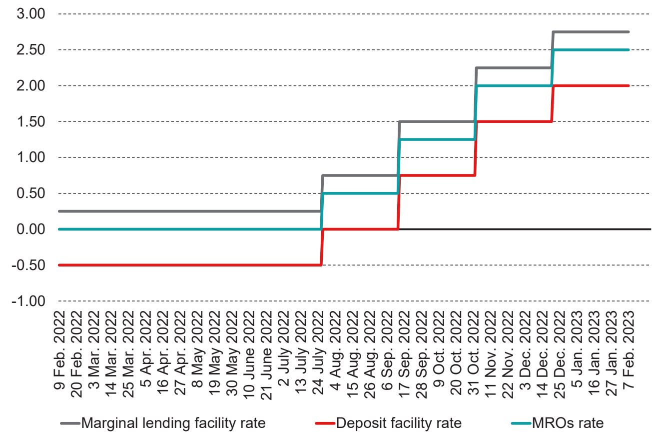
[1] Prepared by Ritlen Abela, Officer II, Monetary Operations and Government Securities Office and reviewed by Josette Grech, Head, Monetary Operations and Government Securities Department and André Psaila, Chief Investment Officer, Financial Markets Division. The views expressed in the Box are the authors' own and do not necessarily reflect the views of the Bank.

[2] MP2022 01 (9 February-15 March); MP2022 02 (16 March-19 April); MP2022 03 (20 April-14 June); MP2022 04 (15 June-26 July); MP2022 05 (27 July-13 September); MP2022 06 (14 September-1 November); MP2022 07 (2 November-20 December); MP2022 08 (21 December-7 February 2023).

[3] In July 2022, the Governing Council approved the Transmission Protection Instrument to support the effective transmission of monetary policy which is an addition to the ECB's toolkit and can be activated to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across the euro area.

In line with the Governing Council's strong commitment to its price stability mandate, the ECB's key interest rates were raised four times during the review period to ensure that inflation returns to its 2% target over the medium term. The increasing interest rates will, over time, reduce inflation by dampening demand, and will also guard against the risk of a persistent upward shift in inflation expectations. At the beginning of the period, the rates on the MROs, the marginal lending facility, and the overnight deposit facility, stood at 0.00%, 0.25% and -0.50%, respectively. Effective from MP5, the key interest rates were raised by 50 basis points. Two further 75 basis point increases became effective in MP6 and MP7, with another 50 basis points implemented as from MP8. As at MP8, the rates on the MROs, the marginal lending facility and the overnight deposit facility stood at 2.50%, 2.75% and 2.00%, respectively (see Chart 1).

Chart 1
KEY INTEREST RATE DEVELOPMENTS
(per cent)



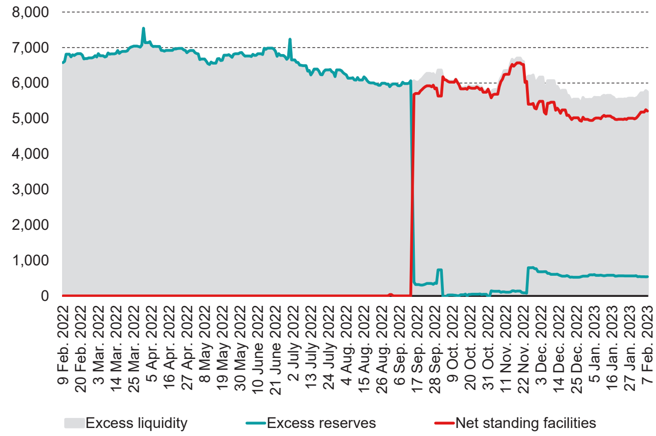
Source: ECB.

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 current account holdings, in excess of the minimum reserve requirements (excess reserves).

At the beginning of the period, excess liquidity stood at €6,574.0 million, which was fully attributable to excess reserves (see Chart 2). This gradually decreased reaching €5,751.3 million on 7 February 2023, consisting of

Chart 2
EXCESS LIQUIDITY BETWEEN MP1 AND MP8 2022
(EUR millions)



Source: Central Bank of Malta.

€541.9 million in excess reserves and €5,209.4 million in overnight deposits. The daily average excess liquidity was €6,335.6 million, reaching a peak of €7,544.4 million on 31 March 2022.

During the period under review, average excess reserves stood at €4,107.3 million. On 9 February 2022, excess reserves stood at €6,574.0 million, and decreased to €3,314.9 million on 14 September 2022, when the deposit facility rate (DFR) was raised above zero. It decreased further in the following days, standing at €304.4 million on 20 September. In fact, following the move of the DFR into positive territory, counterparties shifted their current account holdings to the overnight deposit facility. By then, the two-tier system, which had been activated in October 2019 to exempt part of the credit institutions' excess reserve holdings from remuneration at the negative rate applicable on the deposit facility, was suspended. The suspension of the two-tier system did not materially affect excess liquidity in the Maltese banking system or its composition. However, until the two-tier system was in place, credit institutions in Malta benefitted from an estimated saving of €3.4 million in interest expense, compared to a situation where a negative interest rate would have applied to all their excess reserves. Furthermore, with effect from 21 December 2022, the Governing Council decided to set the remuneration of minimum reserves at the Eurosystem's DFR.

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 to meet short-term liquidity needs. On the other hand, the deposit facility allows counterparties to deposit overnight funds with the Eurosystem.

During the reporting period, there was no utilisation of the marginal lending facility by local credit institutions. Additionally, along the eight MPs reviewed, the daily average for overnight deposits amounted to €2,228.3 million. There was no daily participation until 14 September 2022, when counterparties shifted most of their excess liquidity holdings to the overnight deposit facility, reaching a peak of €6,567.3 million on 18 November 2022.

By the end of MP8, excess liquidity in Malta was equivalent to a third of GDP. This compares with 30.6% in the euro area. When expressed as a share of GDP, Malta's excess liquidity was the seventh highest in the euro area.

Autonomous liquidity factors

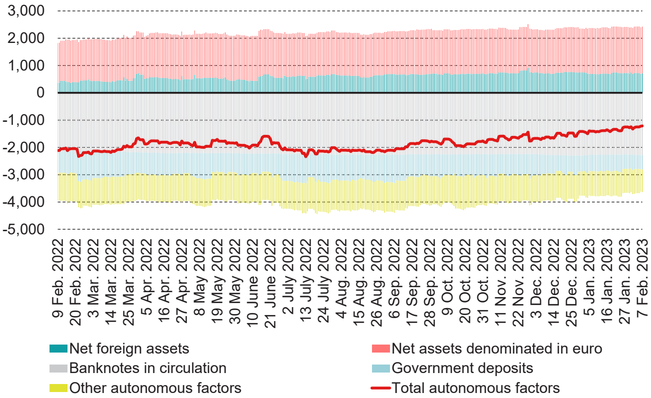
Autonomous liquidity factors are items in the central bank balance sheet that are neither monetary policy operations nor current account holdings of credit institutions. As the transactions driving autonomous factors involve central bank money, they have a liquidity-providing or liquidity-absorbing effect.[4,5] 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.

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.

Autonomous factors were net liquidity absorbing and stood at an average of €1,843.6 million throughout the eight MPs under review.[6] It can be noted that combined autonomous factors were relatively stable throughout the period. The lowest point, amounting to €2,341.8 million, was reached on 13 July 2022, due to a decrease in net foreign assets (see Chart 3).

Chart 3
AUTONOMOUS FACTORS EVOLUTION BETWEEN MP1 AND MP8 2022[(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.

The drivers behind the increase in autonomous factors when compared to the previous year were a decrease in government deposits and 'other autonomous factors' together with an increase in net foreign assets and net assets denominated in euro. This increase was partially offset by an increase in banknotes in circulation (which also includes the excess over the allocation based on the capital key). Government deposits held with the Central Bank of Malta decreased from an average of €900.7 million in 2021, to €808.9 million in 2022. The main driver behind such a decrease was a lower net issuance when compared to the previous year. Government withdrawals also increased, making it another contributor to the decline, albeit to a lesser extent. The decrease in government deposits indicates that the government deposits are moving towards the pre-pandemic levels.

Monetary policy instruments

Open market operations

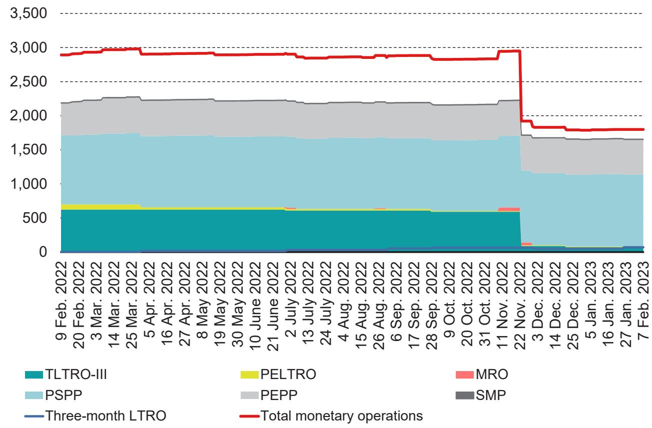
The Eurosystem uses open market operations to provide liquidity in euro to monetary policy eligible counterparties.

At the beginning of the period, outstanding open market operations stood at €698.9 million, €623.5 million stemming from TLTRO-IIIs and €75.4 million from PELTROs. During the period under review, there was limited participation in the MROs by Maltese counterparties. However, Maltese counterparties participated in the three-month longer-term refinancing operations (LTROs). By the end of MP8, these had almost replaced the maturing PELTROs. During the period there were also €40.0 million in maturing TLTRO-IIIs, as well as early repayments from these operations amounting to €513.5 million. Overall, during the reviewed period, the volume of liquidity injected into the domestic banking system through open market

6 Given that total autonomous factors were net liquidity-absorbing, in the Chart these are depicted with a negative sign.

operations decreased by €558.9 million (see Chart 4). Therefore, at the end of MP8, the outstanding open market operations stood at €140.0 million, divided equally between TLTRO-IIIs and three-month LTROs.

Chart 4
EVOLUTION OF MONETARY POLICY OPERATIONS
(EUR millions)



Source: Central Bank of Malta.

Asset purchases

The Bank also influenced liquidity conditions through its participation in the various asset purchase programmes, during the eight MPs reviewed. As of 7 February 2023, the outstanding assets under the Monetary Policy Outright Purchase programmes amounted to €1,588.9 million, while the average for the whole period stood at €1,568.9 million.

The Bank's holdings of debt instruments under the Securities Markets Programme (SMP) stood at an average of €9.6 million.[7]

PSPP holdings under the APP stood at an average of €1,024.2 million in MP1. These holdings grew steadily over the period, standing at an average value of €1,060.8 million in MP8. This increase reflects the purchases of securities which were partially offset by maturing securities that occurred in the interim.

PEPP holdings increased from an average of €497.0 million in MP1, to €514.2 million in MP8. This increase reflects the purchases of securities, which were marginally offset by the redemption of securities during the period under review.

On balance, the Bank's holdings of securities in terms of the Eurosystem's PSPP and PEPP increased by €95.6 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.