BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM MAINTENANCE PERIOD 1 TO MAINTENANCE PERIOD 8 OF 2023

Article published in the Quarterly Review 2024:3, pp. 86-90

BOX 4: LIQUIDITY CONDITIONS AND MONETARY POLICY OPERATIONS FROM MAINTENANCE PERIOD 1 TO MAINTENANCE PERIOD 8 OF 2023[1,2]

Introduction

This box describes the liquidity conditions in the Maltese banking system, and the monetary policy operations conducted by the Central Bank of Malta (the Bank), as part of the Eurosystem's single monetary policy framework during the eight maintenance periods (MPs), starting from 8 February 2023 and ending on 30 January 2024.

Until the end of February 2023, the Eurosystem continued to reinvest, in full, the principal payments from maturing securities purchased under the asset purchase programme (APP). Thereafter, the APP portfolio declined at a measured and predictable pace, as the Eurosystem did not reinvest all the principal payments from maturing securities. The decline amounted to €15 billion per month on average until the end of June 2023, with reinvestments under the APP discontinued as of July 2023. The Bank only participated in the Public Sector Purchase Programme (PSPP) component of the APP.

During the MPs under consideration, the Eurosystem continued with the reinvestment phase of the PEPP that was introduced on 18 March 2020, in response to the COVID-19 pandemic.[3] 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.

In line with the Governing Council's strong commitment to its price stability mandate, the ECB's key interest rates were raised six times during the review period, to ensure that inflation returns to its 2% target over the medium term. Higher interest rates, over time, reduce inflation by dampening demand, and act as guard against the risk of a persistent upward shift in inflation expectations. The total increase in policy rates amounted to 200 basis points during the period. The first increase of 50 basis points was effective as from 8 February 2023, followed by another 50 basis points increase as from 22 March. This was followed by four consecutive rate hikes of 25 basis points each effective as from 10 May, 21 June, 2 August, and 20 September, respectively of the same year. Accordingly at the end of the review period, the rates on the overnight deposit facility, the MROs, and the marginal lending facility stood at 4,00%, 4.50% and 4.75%, respectively (see Chart 1).

---

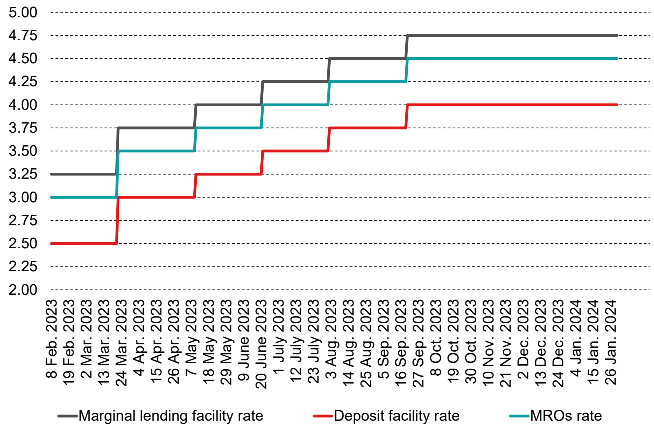
[1] Prepared by Ritlen Abela, Officer II, Monetary Operations and Government Securities Office and reviewed by Josette Grech, Head, Monetary Operations and Government Securities Department and André Psaila, Chief Officer, Financial Markets Division. The views expressed in the Box are the author's own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

[2] MP2023 01 (from 8 February to 21 March); MP2023 02 (from 22 March to 9 May); MP2023 03 (from 10 May to 20 June); MP2023 04 (from 21 June to 1 August); MP2023 05 (from 2 August to 19 September); MP2023 06 (from 20 September to 31 October); MP2023 07 (from 1 November to 19 December); MP2023 08 (from 20 December to 30 January 2024).

[3] On 14 December 2023 the Governing Council decided that for the first half of 2024, the Eurosystem will reinvest, in full, the principal payments from maturing securities purchased under PEPP. Over the second half of the year, it expects to reduce the PEPP portfolio by €7.5 billion per month on average and discontinuing reinvestment completely by the end of the year.

Furthermore, in July 2023, the Governing Council decided to set the remuneration of minimum reserves at 0% effective as of the beginning of the reserve MP starting on 20 September 2023.

Chart 1
KEY INTEREST RATE DEVELOPMENTS
(per cent)



Source: ECB.

Excess liquidity

Throughout the eight MPs under review, the Maltese banking system remained characterised by high levels of excess liquidity. Excess liquidity is defined as the amount of deposits placed by credit institutions at the overnight deposit facility of the Bank, net of the recourse to the marginal lending facility, together with the current account holdings, in excess of the minimum reserve requirements (excess reserves).

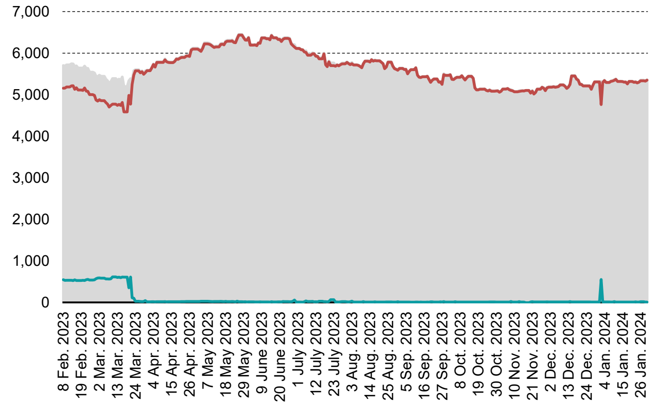
At the beginning of the first MP, excess liquidity stood at €5,701.4 million, consisting of €545.2 million in excess reserves and €5,156.2 million in overnight deposits. The daily average excess liquidity was €5,631.0 million, reaching a peak of €6,452.2 million on 26 May 2023. Furthermore, the change in the minimum reserve remuneration did not have any effect on the composition of excess liquidity.

During the period under review, daily average excess reserves stood at €80.3 million, with minimal fluctuations through the period, apart from a shift from excess reserves to the overnight deposit facility in March 2023. This shift occurred after the Eurosystem's new real-time gross settlement (RTGS) system and central liquidity management tool went live on 20 March 2023. This system enables participants to steer, manage and monitor liquidity in central bank money across all TARGET services.

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 funds overnight 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 overnight deposits amounted to €5,550.7 million, reaching a peak of €6,434.8 million also on 26 May 2023. By the end of March, two additional banks started utilising the overnight deposit facility, shifting funds from excess reserves to overnight deposits following the go-live of the

RTGS system and central liquidity management tool as explained above (see Chart 2).



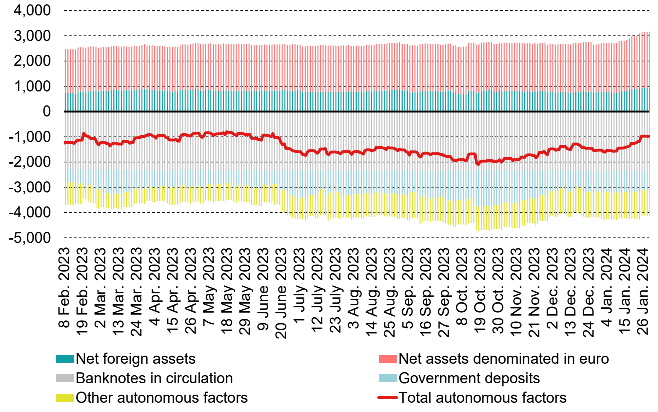
Source: Central Bank of Malta.

By the end of MP8, excess liquidity in Malta was equivalent to around 27% of GDP. This compares with 24% 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.

Autonomous factors were net liquidity absorbing and stood at an average of €1,391.4 million over the eight MPs under review.[6] Combined autonomous factors were relatively stable throughout the period, with the lowest point amounting to €2,096.6 million reached on 18 October 2023. This was driven by an increase in government deposits resulting from the issuance of MGS in October (see Chart 3).



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

On average, when compared to the previous year, autonomous factors increased, hence

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.

becoming less liquidity absorbing. The drivers behind the year-on-year increase in autonomous factors were an increase in the liquidity providing components, net assets denominated in euro (NADIE) and net foreign assets (NFA). NADIE and NFA increased due to higher bond purchases in both euro and foreign currency portfolios, respectively. In fact, NADIE increased from an average of €1,608.1 million in 2022 to €1,852.0 million in 2023, and NFA increased from an average of €613.6 million in 2022 to €811.2 million in 2023. This increase was then partially offset by an increase in the liquidity absorbing components, banknotes in circulation (which also includes the excess over the allocation based on the capital key), and government deposits, mainly due to a higher net issuance of securities when compared to the previous year.

Monetary policy instruments

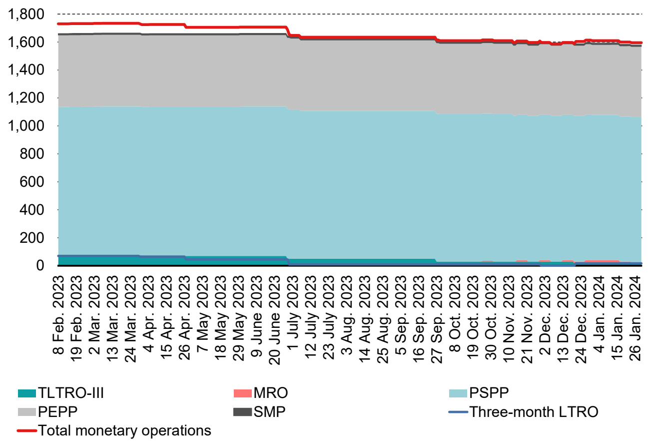
Open market operations

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 €140.0 million, divided equally between the third series of the targeted longer-term refinancing operations (TLTRO-IIIs), and three-month longer-term refinancing operations (LTROs). During the review period, there were €50.0 million in maturing TLTRO-IIIs and no early repayments from these operations. Additionally, participation by Maltese counterparties in both the MROs and the three-month LTROs was limited.

Overall, during the reviewed period, the volume of liquidity injected into the domestic banking system through open market operations decreased by €98.0 million (see Chart 4). Therefore, at the end of MP8, the outstanding open market operations stood at €42.0 million, with €20.0 million in TLTRO-IIIs, €17.0 million in three-month LTROs and €5.0 million in MROs.

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 APPs during the eight MPs reviewed. As of 30 January 2024, the outstanding assets under the Monetary Policy Outright

Purchase programmes amounted to €1,553.3 million, while the average for the whole period stood at € 1,576.7 million.

The Bank's holdings of debt instruments under the Securities Markets Programme (SMP) stood at an average of €9.8 million.[7] PSPP holdings under the APP stood at an average of €1,068.5 million in MP1. These holdings grew slightly till the end of June 2023, which marks the end of the reinvestments phase, and declined thereafter due to maturities occurring during the interim, standing at an average value of €1,039.0 million in MP8.

PEPP holdings decreased from an average of €514.2 million in MP1, to €504.9 million in MP8. This decrease reflects the quarterly portfolio revaluation along with net maturities of securities during the period under review.

Overall, the Bank's holdings of securities in terms of the Eurosystem's PSPP and PEPP decreased by €37.0 million since the start of MP1, implying a net absorption 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.