

Money Market Report for the week ending 9 September 2022

ECB Decisions

On 8 September 2022, the Governing Council of the European Central Bank (ECB) decided to raise the three key ECB interest rates by 75 basis points. This major step frontloads the transition from the prevailing highly accommodative level of policy rates towards levels that will ensure the timely return of inflation to the ECB's 2% medium-term target. Based on its current assessment, over the next several meetings the Governing Council expects to raise interest rates further to dampen demand and guard against the risk of a persistent upward shift in inflation expectations. The Governing Council will regularly re-evaluate its policy path in light of incoming information and the evolving inflation outlook. The Governing Council's future policy rate decisions will continue to be data-dependent and follow a meeting-by-meeting approach.

The Governing Council took that decision, and expects to raise interest rates further, because inflation remains far too high and is likely to stay above target for an extended period. According to Eurostat's flash estimate, inflation reached 9.1% in August. Soaring energy and food prices, demand pressures in some sectors owing to the reopening of the economy, and supply bottlenecks are still driving up inflation. Price pressures have continued to strengthen and broaden across the economy and inflation may rise further in the near term. As the current drivers of inflation fade over time and the normalisation of monetary policy works its way through to the economy and price-setting, inflation will come down. Looking ahead, ECB staff have significantly revised up their inflation projections and inflation is now expected to average 8.1% in 2022, 5.5% in 2023 and 2.3% in 2024.

After a rebound in the first half of 2022, recent data point to a substantial slowdown in euro area economic growth, with the economy expected to stagnate later in the year and in the first quarter of 2023. Very high energy prices are reducing the purchasing power of people's incomes and, although supply bottlenecks are easing, they are still constraining economic activity. In addition, the adverse geopolitical situation, especially Russia's unjustified aggression towards Ukraine, is weighing on the confidence of businesses and consumers. This outlook is reflected in the latest staff projections for economic growth, which have been revised down markedly for the remainder of the current year and throughout 2023. Staff now expect the economy to grow by 3.1% in 2022, 0.9% in 2023 and 1.9% in 2024.

The lasting vulnerabilities caused by the pandemic still pose a risk to the smooth transmission of monetary policy. The Governing Council will therefore continue applying flexibility in reinvesting redemptions coming due in the pandemic emergency purchase programme portfolio, with a view to countering risks to the transmission mechanism related to the pandemic.

Key ECB interest rates

The Governing Council decided to raise the three key ECB interest rates by 75 basis points. Accordingly, the interest rate on the main refinancing operations (MRO) and the interest rates on the marginal lending facility and the deposit facility will be increased to 1.25%, 1.50% and 0.75% respectively, with effect from 14 September 2022.

Following the raising of the deposit facility rate to above zero, the two-tier system for the remuneration of excess reserves is no longer necessary. The Governing Council therefore decided today to suspend the two-tier system by setting the multiplier to zero.

Asset purchase programme (APP) and pandemic emergency purchase programme (PEPP)

The Governing Council intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it started raising the key ECB interest rates and, in any case, for as long as necessary to maintain ample liquidity conditions and an appropriate monetary policy stance.

As concerns the PEPP, the Governing Council intends to reinvest the principal payments from maturing securities purchased under the programme until at least the end of 2024. In any case, the future roll-off of the PEPP portfolio will be managed to avoid interference with the appropriate monetary policy stance.

Redemptions coming due in the PEPP portfolio are being reinvested flexibly, with a view to countering risks to the monetary policy transmission mechanism related to the pandemic.

Refinancing operations

The Governing Council will continue to monitor bank funding conditions and ensure that the maturing of operations under the third series of targeted longer-term refinancing operations (TLTRO III) does not hamper the smooth transmission of its monetary policy. The Governing Council will also regularly assess how targeted lending operations are contributing to its monetary policy stance.

The Governing Council stands ready to adjust all of its instruments within its mandate to ensure that inflation stabilises at its 2% target over the medium term. The Transmission Protection Instrument is available to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across all euro area countries, thus allowing the Governing Council to more effectively deliver on its price stability mandate.

ECB Monetary Operations

On 5 September 2022, the ECB announced the 7-day MRO. The operation was conducted on 6 September 2022 and attracted bids from euro area eligible counterparties of €3.68 billion, €0.19 million less than the previous week. The amount was allotted in full at a fixed rate equivalent to the prevailing MRO rate of 0.50%, in accordance with current ECB policy.

On 7 September 2022, the ECB conducted the 7-day US dollar funding operation through collateralised lending in conjunction with the US Federal Reserve. This operation attracted bids of \$203.00 million, which was allotted in full at a fixed rate of 2.58%.

Domestic Treasury Bill Market

In the domestic primary market for Treasury bills, the Treasury invited tenders for 91-day and 183-day bills for settlement value 7 September 2022, maturing on 7 December 2022 and 9 March 2023, respectively. Bids of €60.00 million were submitted for the 91-day bills, with the Treasury accepting €28.00 million, while bids of €24.00 million were submitted for the 183-day bills, with the Treasury accepting €21.00 million. Since €43.00 million worth of bills matured during the week, the outstanding balance of Treasury bills increased by €6.00 million, standing at €963.00 million.

The yield from the 91-day bill auction was 0.521%, increasing by 2.9 basis points from bids with a similar tenor issued on 1 September 2022, representing a bid price of

€99.8685 per €100 nominal. The yield from the 183-day bill auction was 1.157%, increasing by 15.3 basis points from bids with a similar tenor also issued on 1 September 2022, representing a bid price of €99.4153 per €100 nominal.

During this week, there was no trading on the Malta Stock Exchange.

This week the Treasury will invite tenders for 91-day and 182-day bills maturing on 15 December 2022 and 16 March 2023, respectively.