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PRESS RELEASE

What can we and can't we infer from the recourse to the deposit facility?

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The two massive liquidity-providing operations carried out by the Eurosystem on 22 December 2011 and 1 March 2012 certainly did not go unnoticed. These operations have been given wide coverage by various media and market participants. In particular, the subsequent huge increase in the recourse to the deposit facility – an account with the central bank where banks can transfer their surplus liquidity at the end of the day at a penalty interest rate – was often used in news coverage to illustrate the seriousness of the banking crisis and growing mutual mistrust among banks.

This article strives to qualify two interpretations put forward for this increasing recourse to the deposit facility. The first involves interpreting the daily fluctuations in the recourse to the deposit facility as daily changes in banking sector stress. Because banks have to meet a reserve requirement only on an average basis over a reserve maintenance period, there is a seasonal pattern in the recourse to the deposit facility. This seasonal pattern is not to be found in the liquidity surplus on the money market: the latter consists of the recourse to the deposit facility and the banks' current account holdings with the Eurosystem above the required reserves. In any case, the liquidity surplus seems to be a better candidate for gauging tensions in the banking system – or the extent to which the central bank is acting as an intermediary between the banks.

A second misinterpretation concerns the claim that the large recourse to the deposit facility means that banks are not lending to the real economy and simply hoarding the borrowed liquidity with the Eurosystem. Since the relationship between the Eurosystem and its counterparties is a closed circuit, the large recourse to the deposit facility tells us almost nothing about how the banks are using the central bank liquidity and therefore nothing about banks lending to the non-financial sector. This is illustrated with a few examples in the article.

Moreover, this finding suggests that the substantial liquidity surplus does not necessarily imply risks for price stability since developments in bank lending and the broad money supply – that is, money held by the general public – are more of a determining factor for this. It is precisely for this reason that the Eurosystem's monetary policy strategy attributes an important role to the development of broad money and credit supply and not to the quantity of base money.