



# EUROSYSTEM MONETARY POLICY IMPLEMENTATION, FOREIGN EXCHANGE OPERATIONS, AND MANAGEMENT OF INVESTMENT ASSETS



## 2 EUROSYSTEM MONETARY POLICY IMPLEMENTATION, FOREIGN EXCHANGE OPERATIONS, AND MANAGEMENT OF INVESTMENT ASSETS

### 2.1 MONETARY POLICY OPERATIONS

The European Central Bank (ECB) implements monetary policy through the national central banks of the Eurosystem by means of various monetary policy instruments. The most widely used of these instruments are the main refinancing operations (MROs), longer-term refinancing operations (LTROs), fine-tuning operations (FTOs), and standing facilities, which include the deposit facility (DF) and marginal lending facility (MLF).

In response to the deepening financial crisis in the euro area, the ECB continued to conduct operations as fixed rate tender procedures with full allotment. The decision to continue this procedure, at least until the end of the last maintenance period of 2012, was taken by the ECB's Governing Council at its meeting in June. In 2012 the ECB did not decide to take any additional non-standard monetary policy measures. A 12-month longer-term refinancing operation matured in the last quarter of the year, without further prolongation by the ECB.

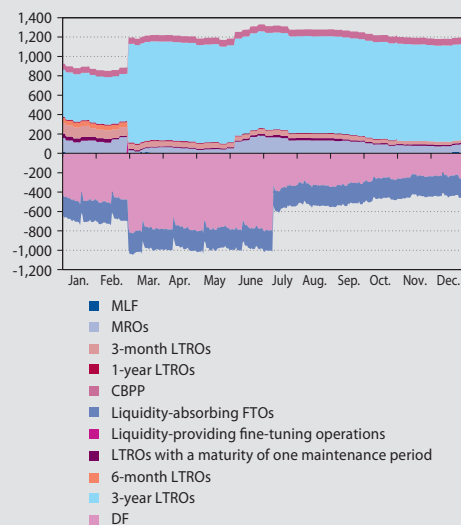
Activity in the interbank market remained mainly weak throughout the year. Banks obtained most of their funding directly from the ECB, with their demand heavily outweighing their actual needs. In this situation, longer-term funds were drawn from the ECB in greater quantity, with overall demand in two three-year LTROs amounting to more than €1 trillion. LTRO funds accounted for on average 91% of the total amount of liquidity provided to the euro area banking sector. Over the year as a whole the sector reported a large liquidity surplus, boosted also by the ECB's decision (of December 2011) to reduce the minimum reserve ratio from 2% to 1%, with effect as of the first maintenance period of 2012. The banking sector's liquidity surplus peaked in the period from May to July, as euro area banks stepped up their participation in main refinancing operations. Demand in these operations reached

a year high of €180 billion. The liquidity surplus corrected slightly only towards the year-end, when euro area periphery countries reduced their recourse to ECB refinancing operations. Following a decision taken in December 2011, the ECB discontinued fine-tuning operations carried out on the last day of each maintenance period. Its aim was to support money market activity in the euro area.

With the ECB maintaining US dollar liquidity swap arrangements with the Federal Reserve System, euro area banks used them to borrow USD 4 billion on average. In December 2012 the ECB announced an extension of these arrangements until February 2014, since they had previously been authorised only until February 2013.

In September 2012 the ECB terminated the Securities Markets Programme (SMP), which had been launched in 2010 as a way of enabling euro area national central banks to purchase government

Chart 9 Eurosystem operations in 2012 (EUR billions)



Source: ECB.

Notes: LTRO – longer-term refinancing operations, CBPP – Covered Bond Purchase Programme, FTO – fine-tuning operations.



bonds of selected countries. By the time the SMP ended, the total acquisition cost of ECB bond purchases through the programme was €208 billion. During the year the ECB conducted operations to absorb the liquidity injected through the SMP and thereby neutralised the programme's potential impact on the monetary stance. In connection with SMP's termination the ECB decided to launch a new programme known as Outright Monetary Transactions (OMTs). In essence, the OMT programme is a means of purchasing unlimited amounts of one-year to three-year government bonds issued by countries participating in an appropriate EFSF/ESM programme, with the ECB fully sterilising the OMTs (just as it absorbed liquidity injected by the SMP). A necessary condition for initiating OMTs is that a euro area country applies for a loan from the EFSF. Since no country had requested such loan by the end of 2012, OMTs were not activated in that year. Nevertheless, the announcement of OMTs in itself helped significantly to reduce risk premia in the bond market markets of periphery countries.

October 2012 saw the scheduled end of the covered bond purchase programme 2 (CBPP2), which had been running since November 2011 with the aim of reviving the covered bond market. The initially targeted total nominal amount of purchases was €40 billion, while the total nominal amount actually purchased by the Eurosystem, on primary and secondary markets, was €16 billion. Národná banka Slovenska did not participate in CBPP2. The ECB's first covered bond purchase programme was carried out in 2009, and the total nominal amount of purchases under that programme was €60 billion.

The only change in the ECB's monetary-policy settings in 2012 occurred in July, when the Governing Council responded to escalating difficulties in the euro area market by making monetary policy more accommodative; it cut the main refinancing rate by 25 basis points, from 1% to 0.75%. The width of the standing facilities corridor remained at  $\pm 75$  basis points. In reaction to a sizeable liquidity surplus in the euro area banking sector, the EONIA overnight rate fell to a historical low of 0.06% in December 2012 and ended the year at 0.131% (it remained below the main refinancing rate throughout 2012). The 12-month EURIBOR fell in September

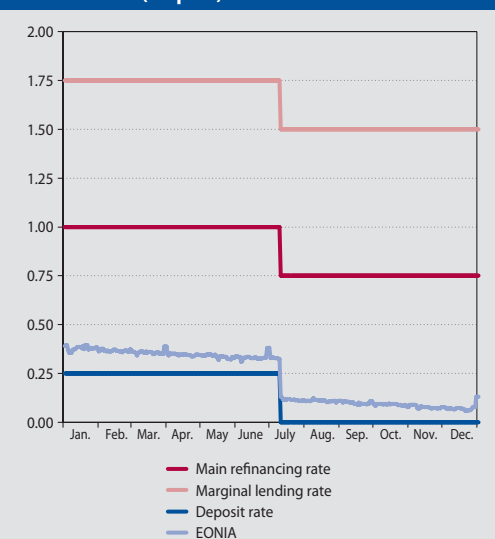
to below the main refinancing rate and stayed below it until the end of 2012. Following the cut in the ECB's key rates, euro area banks changed the way they deposited funds with the ECB. Before July's decision to reduce the deposit facility rate to zero, the vast majority of banks' deposits with the ECB were made via this overnight facility. Afterwards, however, overnight deposits as a share of banks' total deposits with the ECB fell to an average of 41%, the rest being held in current accounts.

#### MINIMUM RESERVES

Under Eurosystem rules, all credit institutions operating in the euro area are required to hold a minimum amount of reserves with their respective national central bank (NCB).

In 2012 a total of 27 credit institutions operating in Slovakia were subject to minimum reserve requirements; they comprised 14 banks established in Slovakia (including three home savings banks) and 13 branches of foreign credit institutions (including credit cooperatives). During the course of 2012 three of the credit institutions subject to the minimum reserve system ceased their operations in Slovakia. Based on a decision of the ECB's Governing Council, the minimum reserve ratio was reduced to 1% of the reserve base (selected types of deposit and debt securities issued).

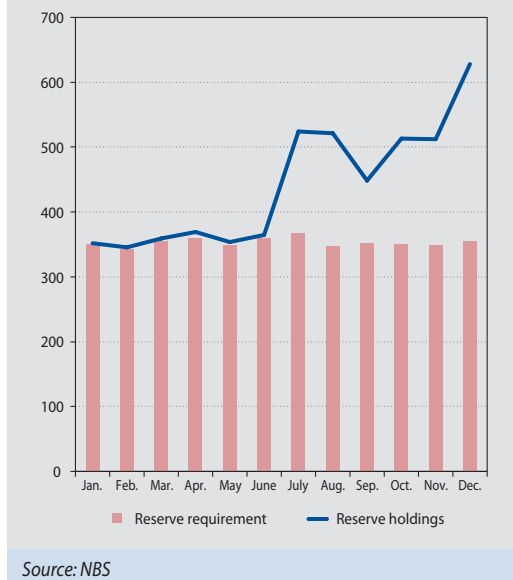
Chart 10 Key ECB interest rates and the EONIA rate (% p.a.)



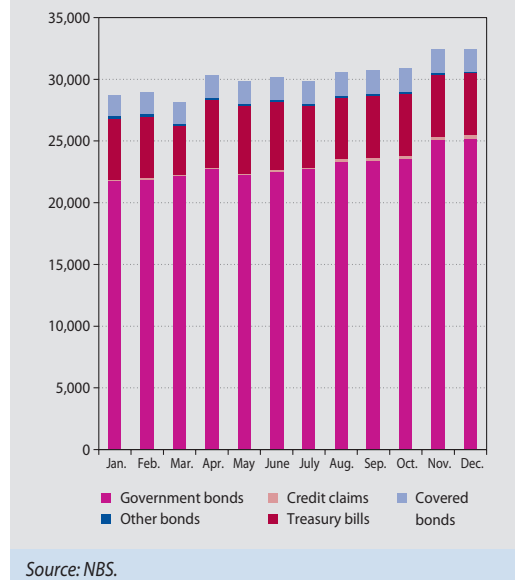
Source: ECB a Bloomberg.



**Chart 11 Minimum reserves developments in 2012 (EUR millions)**



**Chart 12 Composition of Slovak eligible assets in 2012 (EUR millions)**



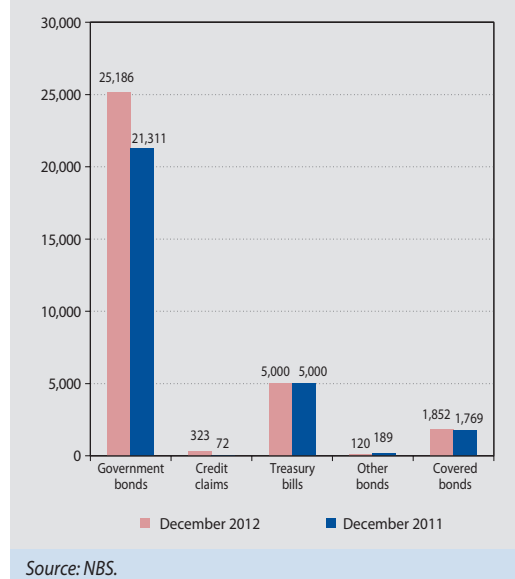
The average amount of required reserves was €353.58 million in 2012, around 49.66% lower than in 2011. This marked change was largely attributable to the reduction in the reserve ratio.

#### ELIGIBLE ASSETS

Collateral eligibility criteria for Eurosystem operations were partially relaxed in 2012 – i.e. the list of eligible assets (EAs) was expanded – thus continuing the trend from the previous year. The easing of the criteria concerned mainly asset-backed securities, but significantly it also saw the criteria extended to include assets denominated in certain non-euro currencies, specifically the US dollar, British pound and Japanese yen (providing all other eligibility criteria are met). In addition, eligibility criteria were set for additional credit claims. Altogether these changes had a significant effect on the overall implementation of the Eurosystem’s monetary policy, resulting in increased counterparty participation in the Eurosystem’s long-term refinancing operations.

The value of eligible assets issued and held in Slovakia continued to rise in 2012, maintaining the trend observed in 2011. Their total nominal value as at the end of 2012 was higher than at the end of the previous year by approximately 14.61% (or €32,482 million). Bonds and

**Chart 13 Comparison of Slovak eligible assets’ composition in December 2011 and December 2012 (EUR millions)**



Treasury bills issued by the Slovak government constituted almost 93% of the eligible assets, and covered bonds around 6%. The eligible assets that recorded the largest year-on-year increase were credit claims that could potentially be mobilised, with their share of the total increasing to almost 1%. By contrast, the value of other bonds declined by 40% year-on-year,

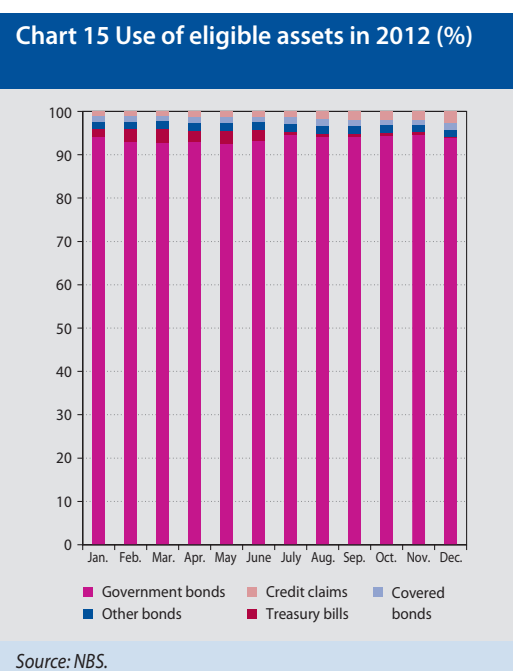


leaving them with the smallest share of eligible assets.

With the activation of the Eurosystem's long-term refinancing operations in December 2011 and March 2012, the participation of Slovak counterparties in Eurosystem monetary-policy operations increased. The elevated activity was reflected in the value of the collateral that Slovak banks pledged with Národná banka Slovenska, which was 18% higher at the end of 2012 than at the end of the previous year. At the same time there was a moderate rise in the use of assets issued in other euro area countries, as their share of the total collateral held increased year-on-year by almost four percentage points, to 13.46%; nevertheless, these assets were far outweighed by domestic eligible assets. Debt securities issued by central governments accounted for almost 95% of the assets used by Slovak banks as collateral in Eurosystem credit operations. Collateral in the form of credit claims recorded a relatively marked increase, particularly in the last months of the year. Slovak counterparties used a collateral pool to manage their collateral.

## 2.2 FOREIGN EXCHANGE OPERATIONS

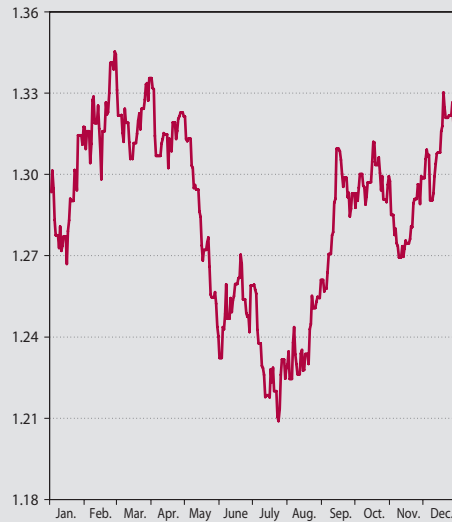
The euro was significantly more volatile in 2012 amid persisting public finance difficulties in sev-



eral European countries and the United States. The euro appreciated strongly in the first third of 2012: between January and February it strengthened from 1.294 USD/EUR to 1.345 USD/EUR, its highest level of the year. This movement was due mainly to the approval of a second bailout package for Greece as well as to the first country's debt write-off. In the second third of 2012, by contrast, the euro depreciated to 1.209 USD/

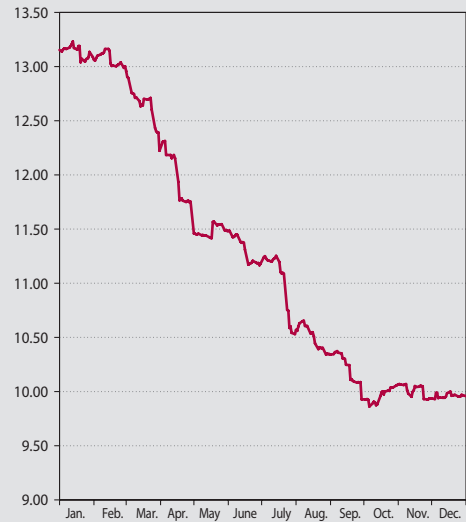


**Chart 16 USD/EUR exchange rate in 2012**



Source: Bloomberg.

**Chart 17 Investment assets managed by NBS in 2012 (EUR billions)**



Source: NBS.

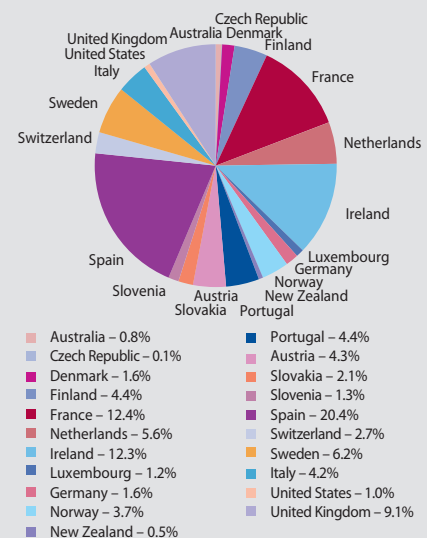
EUR, its weakest level of the year, in response to the mounting difficulties of certain euro area periphery countries. The exchange rate then strengthened over the last part of the year, supported by growing optimism about developments in Greece and by the ECB president's announcement of preparedness to activate a new asset-purchase programme. By close of trading in 2012 the currency pair's exchange rate stood at 1.319 USD/EUR, with the euro trading 2% stronger than at the end of 2011.

turn on the euro-denominated portfolio in 2012, after taking into account interest expenses and hedging, stood at 6.52%. The investment portfolio of assets denominated in US dollars, worth €210.7 million, reported a relative return against the respective benchmark of 1.32% in 2012.

### 2.3 MANAGEMENT OF INVESTMENT ASSETS

In managing its investment assets, Národná banka Slovenska aims to ensure that the portfolio contributes positively to the central bank's overall financial result. The total value of its investment assets as at 31 December 2012 was €10 billion (at corresponding exchanges rates and market prices). NBS manages its asset portfolio in accordance with the principles laid down in the NBS Investment Strategy approved in 2008. Thus in the case of euro-denominated assets, which make up 98% of the overall portfolio, interest rate risk is managed in a standard way through interest rate swaps and futures contracts. The re-

**Chart 18 Portfolio of investment assets denominated in euro (as at 31 December 2012) – broken down by country of issuer**



Source: NBS.