



Some aspects of the performance of monetary policy after Slovakia's accession to the euro area

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Slovakia becomes part of the euro area on the first day of January. Thus the period of autonomous performance of monetary policy will end for the National Bank of Slovakia, and it the bank will become the "national" executor of decisions adopted at the level of the European Central Bank. The actual monetary policy decisions are adopted by voting in the ECB Governing Council, which means in practice that also Slovakia will be able to influence this decision making process through a vote of the Governor of the National Bank of Slovakia.

In this article, however, we would like to deal, in particular, with issues associated with the practical implementation of monetary policy decisions. We therefore consider it useful to summarize briefly the monetary policy instruments and procedures used by the European Central Bank. Since its creation, the ECB has used three types of instruments to achieve its monetary policy targets. They are the following:

- open market operations,
- standing facilities,
- minimum reserves.

The key role in signalling monetary policy targets is attributed to open market operations.

According to their purpose, they are classified into:

- Main Refinancing Operations – *MRO*
- Longer-Term Refinancing Operations – *LTRO*,
- Fine tuning Operations – *FTO*,
- Structural operations – *SO*.

Open market operations are performed by means of five types of transactions:

- reverse transactions,
- collection of fixed-term deposits,
- foreign exchange swaps,
- issuance of debt certificates,
- outright transactions.

Two forms of execution are used in open market operations:

- a (standard or quick) tender,
- bilateral transactions.

OPEN MARKET OPERATIONS

The use of open market operations by the ECB has passed several phases, the current period being characterised by their most intensive use. Under standard circumstances, as the name suggests,

the core of monetary policy operations is made up of main refinancing operations. Today these operations have weekly maturity and they are carried out as reverse transactions. They are announced on Monday, carried out on Tuesday and settled on the following day, i.e. on Wednesday. The Slovak banking sector knows this schedule well, as the time course of a standard (two-week) tender carried out by the NBS is the same.

The current turbulent period had significant impact on longer-term refinancing operations. This originally just supplementary refinancing instrument currently reaches more than 60% of the total volume of refinancing resources drawn by commercial banks. In addition to a standard 3-month maturity, the portfolio of longer-term refinancing operations has been extended by a 6-month maturity, and tenders are also carried out, the maturity of which corresponds to the length of period set as the evaluation period for the minimum reserves. For a better distinction, longer-term operations that have extended the structure of the three concurrent three-month tenders used so far are called Supplementary Longer Term Refinancing Operations – *SLTRO*. The tender, the maturity of which has been harmonised with the current MR maintenance period is called Special Term Refinancing Operation (*STRO*). Thus the current status of tenders with longer maturity currently covers:

- one *STRO* operation,
- three 3-month *LTROs*,
- two 3-month and three 6-month *SLTROs*.

Like the *main refinancing operations*, *longer-term refinancing operations* are also carried out through reverse transactions. Under standard circumstances, tenders for three-month or six-month resources are announced on Tuesday, carried out on Wednesday, and settled on Thursday. The



tender, the maturity of which is identical with the minimum reserve maintenance period, has the same time course as a standard main refinancing operation, i.e. it is announced on Monday, carried out on Tuesday and settled on Wednesday.

The third component of open market operations, the fine tuning operations, also goes through changes. Under standard circumstances, their use is closely related to the operative target of the ECB, which is to keep the EONIA rate close to the key rate for main refinancing operations. In case of considerable deviations, especially at the end of the period for the evaluation of minimum reserves, the ECB carried out a fine tuning operation of refinancing nature or sterilisation nature with a one-day maturity in order to bring the EONIA rate back to the desired level. Unlike the previous operations, on the open market the specific nature (refinancing or sterilisation) of a fine tuning operation depends on the current situation in market liquidity. Fine tuning refinancing operations are carried out by reverse transactions; sterilisation operations are carried out by collection of fixed term deposits. In the previous period, except the last day of the minimum reserves period, the ECB performed fine tuning operations also out of this date, thereby reacting to a deviation of the EONIA from the target value. Under standard circumstances, the period of fine tuning operations does not exceed the maturity of one business day.

At present, all open market operations are carried out in the form of tenders, with fine tuning operations being carried out in the form of so-called quick tenders. It is characteristic of quick tenders that both the execution day and the settlement day are identical. Under standard circumstances, the announcement falls on the same day as their actual execution. Due to the relatively short period of time reserved to conduct this type of operations, under standard circumstances it is carried out with a selected circle of banks, i.e. counterparties for quick tenders and bilateral transactions. In principle, quick tenders are currently available to all banks that are able to provide for all indispensable steps related to their complex settlement within a defined period of time.

Structural operations are the only type of open market operations, which are not used today like in the past. Their possible use is supposed to lead to be oriented towards a change in the overall structural position of the banking sector.

In addition to tenders, some operations, specifically the fine tuning or structural operations, may be performed also in the form of bilateral transactions. However, the ECB does not use this method at present.

Despite a relatively complex condition in the euro area financial market, no changes have occurred yet in the originally implemented structure of open market operations. However, it is true that the ECB uses some operations more intensively and in a more goal-directed way than before August 2008. However, there have been changes in

the manner of the method of assignment applied in tenders. In October 2008, the ECB returned to volume tenders, i.e. to tenders at a fixed interest rate. Moreover, in its effort to ensure sufficient means for the sector and to restore confidence and activity in the interbank market, the ECB accepts the entire demand in all main and longer-term refinancing operations. This approach is new, we expect however that only temporary and that after stabilising the situation or assessing the benefit of this approach in comparison with the previous method, in which the ECB actively determined the volume of liquidity delivered to the banking sector, the ECB will return there. Part of the changed approach is also the application of an identical fixed rate to main and longer-term refinancing operations.

Before implementing this change, the ECB carried out longer-term refinancing operations at market rates and had no ambition to determine or influence the rates of 3-month or 6-month deposits in the interbank market. In this case, too, the ECB has left itself a back door open and does not preclude the execution of tenders at various fixed rates depending on the period of maturity.

In addition to open market operations, the ECB carries out operations, the purpose of which is to support liquidity for markets with a currency other than the euro. Thus operations adding liquidity in US dollars, or e.g., in Swiss francs are currently carried out on a weekly basis. These operations are performed either by a reverse-type transaction and collateralised by the same eligible assets as those in the case of main and longer-term refinancing operations, or they are carried out as foreign exchange swaps, or as a combination of the two. The periods of maturity of operations carried out at present are 7, 28 or 84 days. Although these operations are not primarily monetary policy operations, they affect also euro area market liquidity in the case of adding liquidity in a foreign currency through foreign exchange swaps. The ECB must take this fact into account when planning and conducting its own open market operations.

STANDING FACILITIES

Standing facilities as the second pillar of monetary policy operations are, in their essence, also well known among the domestic banking sector. Their original purpose is to provide banks with the possibility of individual counterbalancing of liquidity in the form of marginal lending facility or deposit facility. Those are the so-called automatic operations, which means in this context that banks have an automatic claim to conduct them and the initiation of the operations comes from the bank itself. The limiting factor in conducting them is for refinancing transactions the amount of eligible assets available to the specific commercial bank. The sterilisation variant of these operations is not limited.

The ECB has responded to the current situation in the financial market by an adjustment of the spread between the refinancing and sterilisation



rate of these operations to one percentage point. In doing so, the ECB tries to facilitate the achieving of the operative target stated above, since in practice narrowing of the band should decrease possible deviations of the EONIA rate from the main refinancing rate applied in main refinancing operations.

MINIMUM RESERVES

The minimum reserves are the last instrument. The most important difference in comparison with the system applied by the NBS up to now is the maintenance period of reserve holdings. While under domestic conditions the maintenance period is identical with a calendar month, the euro area applies a different approach. The MR maintenance period in the euro area begins on the settlement date of a major refinancing operation that follows after a session of the ECB Governing Council, at which the setting of monetary policy parameters – the interest rates for the following period – is decided. In practice, this should help to prevent banks from speculative behaviour in tenders, because in the past expectations associated with a new fixation of the interest rates were reflected in the demand. Together with this change introduced within the adjustment of monetary instruments in March 2004, the ECB also shortened the length of standard tenders from two weeks to one.

THE PRACTICAL PERFORMANCE OF MONETARY POLICY OPERATIONS AFTER ACCESSION TO THE EURO AREA

As stated in the introduction, the NBS has autonomy in the performance of monetary policy till the end of the year. In line with a decision of the Bank Board of the NBS, the bank will apply unchanged instruments, with the last two (sterilisation) tenders being conducted as at dates according to the following table:

Performance	Start	Maturity	Days to maturity
22 December 2008	23 December 2008	7 January 2009	15
30 December 2008	31 December 2008	14 January 2009	14

In addition, in its effort to make the transition to 2009 easier for the banking sector, an extraordinary 7-day sterilisation tender starting on 31 December 2008 and with maturity on 7 January 2009, and an extraordinary issue of 33-day NBS bills starting on 19 December 2008 and maturing on 21 January 2009 will be conducted.

Standing facilities also remain available, and transactions carried out as at 31 December 2008 will mature on 2 January 2009. In accordance with a decision of the Bank Board of the NBS, this schedule can be modified operatively to ensure a smooth transition to the euro area environment.

In terms of the performance of monetary policy operations, the NBS will become the local provider

of the process of those operations as from January 2009. This means that all decisions adopted at the ECB level will be applied in practice in the territory of Slovakia through the NBS. Banks and branches of foreign banks that are situated in Slovakia, are subject to MR requirements and fulfil the conditions set for the so-called eligible counterparties (the signing of contracts, fulfilment of operational criteria) will be allowed to participate in standing facilities and in open market operations.

In accordance with the decentralised approach applied within the Eurosystem, all tender-based open market operations are ensured exclusively by national central banks. For possible operations carried out in the form of bilateral transactions, the ECB keeps the option to participate in them directly. That means that the ECB can apply the centralised approach and carry out operations by direct contact of selected counterparties on its own, or – which is much more practicable – select only certain national central banks and empower them to carry out the operation. A combination of both approaches is also possible, i.e. both direct participation of the ECB and a narrow circle of national central banks, and thereby ultimately also a narrow circle of counterparties. However, the ECB has not applied this approach yet in monetary policy operations (the ECB may act in the same way in foreign exchange interventions, which, however, the ECB does not consider to be monetary policy operations in the strict sense).

The performance of open market operations from 2009

The dates of the main refinancing tenders are known in advance and disclosed through a so-called indicative calendar, which is published on the official ECB website www.ecb.europa.eu (and it will also be on the NBS website www.nbs.sk). The ECB confirms that they take place by a formal announcement before the actual alloca-

tion process at 15:30 in the Bloomberg and Reuters systems and on the ECB website. National central banks may disclose information related to operations carried out only after the disclosure by the ECB.

Like until now, the NBS will publish announcements as well as the results of tenders on the respective Reuters website. In addition, for the time being the NBS plans to keep the form of announcements used so far – the sending of fax messages to banks. The period for sending applications to the NBS starts to run at the time of disclosure of the operations. Under standard circumstances, banks can send them until 9:30 of the following day, the NBS having kept in force the



present methods of servicing applications (fax, Reuters, phone). Then, between 9:30 and 11:00, a two-step processing of the applications takes place, first at the NBS level and then at the Eurosystem level. The ECB publishes the results after 11:15. The national central banks can publish the results subsequently. The published results contain data for the entire euro area and do not contain any national information. The same schedule and procedure is also applied to longer-term refinancing operations and their variants.

Fine tuning operations do not have a fixed time schedule and they can be, according to current experience, announced at any time throughout the day. It is a custom applied to fine tuning operations in the form of quick tenders that the whole implementation must be completed within

90 minutes after the announcement of the particular tender conditions. The parties to a quick tender have a maximum of 35 minutes to send applications to the competent national central bank, in our case to the NBS. Not later than 55 minutes after the deadline for sending applications, the banking sector should be informed of the results of quick tender. Like in the case of main or long-term refinancing operations, immediately after the disclosure of the results by the ECB, the NBS will also make this data available on its usual website. The actual performance of fine tuning tenders does not have a fixed schedule within a day. Fine tuning refinancing tenders have recently used to be announced before noon, while tenders absorbing liquidity are usually announced in the afternoon.

Standing facilities from 2009

Standing facilities are carried out without exception and completely at the level of the relevant national banks. The NBS will apply the optional module of "*Standing Facilities*" within the TARGET2 payment system for this purpose. The balance on a predefined account opened for such purpose will be considered the implementation of an overnight sterilisation operation. The respective commercial bank will be allowed to deposit arbi-

trarily on this account or to draw funds deposited there before, but only the final balance will be considered a deposit within an automatic sterilisation operation. The last deposit will be possible at 18:15 of the current day or at 18:30 on the last day of meeting the minimum reserve requirements. On the following day when TARGET2 is in operation, the "*Standing Facilities*" module will transfer the amount of term deposit increased by interests to the account of the contracting party.

It will be possible to carry out a marginal lending facility using two methods. The first will be automatic conversion of an outstanding intraday credit; the debit balance of the bank on its RTGS account in the TARGET2 system will be deemed to be an application for a refinancing operation. The second method will be a refinancing operation on demand. In this case, the bank will contact the NBS directly and enter into a refinancing transaction in the required amount. The transaction must be concluded not later than at 18:15 of the current day or at 18:30 on the last day when the MR requirements are met, just like in the case of sterilisation operations. The maturity of a refinancing operation by any of the methods specified above is on the following day when the TARGET2 is in operation. On that day, the "*Standing Facilities*" module will transfer the amount of the refinancing operation increased by interests to the NBS account.

CONCLUSION

In conclusion, some general notes related to all types of operations. The main refinancing operations and fine tuning operations have a minimum bid amount of one million EUR. This amount is reduced to 10 000 EUR for longer-term operations. In monetary policy operations that require collateralized transactions, the NBS will apply collateral management using the pooling method and will prefer the collateralisation technique making use of a pledge. The NBS will carry out the operations in compliance with the ECB time schedule, i.e. regardless of any possible national holidays falling on a specific day.