Analysis

Interest rate steering as liquidity declines

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The implementation of Eurosystem monetary policy is undergoing a transition as the volume of central bank reserves – or liquidity – declines. The Eurosystem's future implementation of monetary policy will rest on there being a demand for liquidity by banks, access to standard refinancing operations, and a smoothly functioning money market. The Eurosystem will ensure that the transition is carried out in a controlled manner. This article examines how the determination of short-term money market rates may change in the new environment.

Bullet point summary produced with the assistance of AI

- Through monetary policy implementation, short-term money market rates are steered towards the policy rates decided by the ECB's Governing Council.
- Banks need liquidity for settlement of payments and precautionary purposes and to meet regulatory requirements. The amount of liquidity in the Eurosystem is declining as securities acquired under the monetary policy purchase programmes mature.
- As liquidity declines, banks will seek to redistribute the existing liquidity among themselves in the money market. When the shortest money market rates rise, banks will make increasing use of the Eurosystem's refinancing operations, as these are the only means by which banks can increase the aggregate amount of liquidity in the banking system.



What does monetary policy implementation mean and what is interest rate steering?

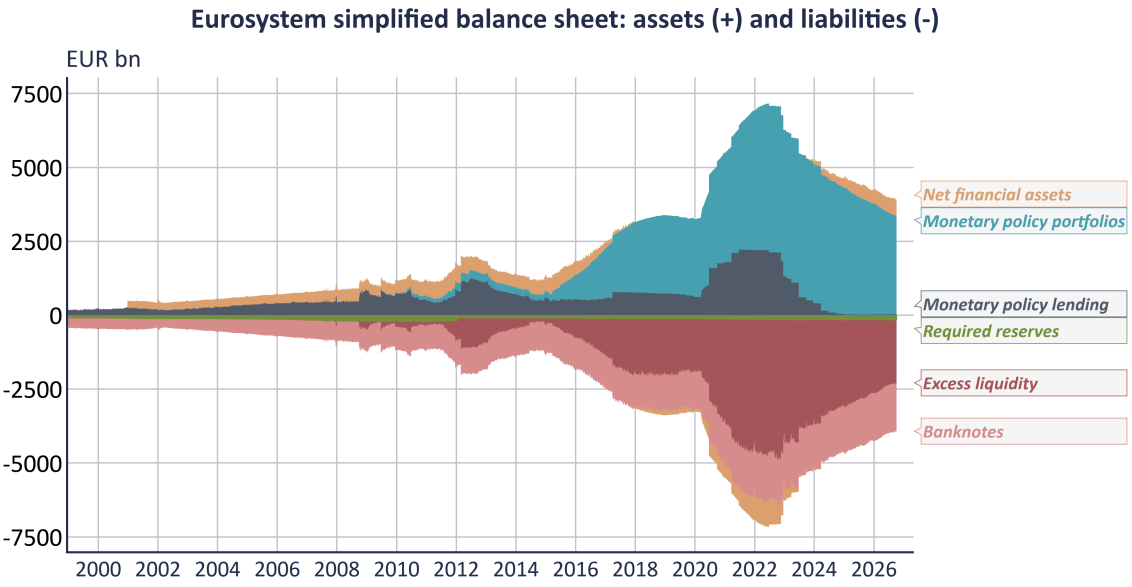
The Governing Council of the European Central Bank (ECB) decides on the level of interest rates for the euro area. In its decisions, the Governing Council sets the principal policy rate and the two other key interest rates. Monetary policy implementation steers short-term money market rates towards these three key ECB interest rates, or policy rates. This implementation process is, in a sense, the engine of monetary policy. It ensures that the principal policy rate is effectively transmitted to money market rates, so that monetary policy has the intended effect on the euro area economy and inflation remains at the ECB's 2% target over the medium term.

Over the past few years, the steering of short-term market rates has taken place in an environment where the Eurosystem's balance sheet has been exceptionally large and the banking system has had considerable excess liquidity, that is, deposits that commercial banks hold at their national central bank. Due to this excess liquidity in the system, banks have not needed to borrow from one another or regularly from the central bank. Therefore, overnight rates have remained close to the deposit facility rate (DFR; currently at 2.50%), the interest rate at which banks make deposits with the Eurosystem.

The Eurosystem balance sheet has continued to decline as planned (Chart 1). Securities acquired in asset purchase programmes have matured and redemptions will continue in the years ahead. At the same time, the amount of liquidity in the banking system, which the Eurosystem had created through its purchases of debt securities[1], will decline.

In March 2024, the Governing Council of the ECB decided on changes to the procedures for implementing monetary policy, setting out how short-term interest rates will be steered in the future.[2] As banks' liquidity declines, the practical significance of these changes will increase. However, some details of the new operational mode still remain undecided and will be determined at a later stage. Some of the key outstanding issues are the more detailed conditions for structural operations and the timing for introducing different instruments.[3]

Chart 1.



Sources: European Central Bank and Macrobond.
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The key aim with the new mode of implementation is that in the future, banks will participate more in the Eurosystem's refinancing operations and also trade more actively with one another in the money market. Only a small number of banks so far are participating in the Eurosystem's standard refinancing operations – the one-week main refinancing operations (MROs) and the three-month longer-term refinancing operations (LTROs) – although the number of participating banks is growing steadily. The transition to the new mode of implementing monetary policy will bring significant changes to the way in which banks obtain funding from the central bank and from the money market.

This article looks at how short-term money market rates are steered currently and what will change in the future. It also examines the transition to a new liquidity environment and the extent of the Eurosystem's preparedness for any challenging situations associated with it.

Current state of the euro area money market

The deposit facility rate (DFR), the interest rate which banks receive when they deposit excess liquidity with their national central bank, is currently the ECB's principal policy rate. In accordance with the ECB's March 2024 decisions, the aim is to keep short-term money market rates in the vicinity of the DFR. In addition to making deposits, banks can currently borrow funds from their Eurosystem central bank through standard refinancing operations at the main refinancing operations rate (MRO), which is 0.15 percentage points above the DFR and, if necessary, obtain overnight credit through the marginal lending facility (MLF) to meet unexpected liquidity needs at a rate 0.4 percentage points above the DFR.

As liquidity remains abundant in the banking system, banks make little use of Eurosystem borrowing. Nevertheless, trading continues in the money market, and the Eurosystem's DFR is the main factor determining the level of market interest rates. However, interest rates vary to some extent across different money market segments and are determined in part by different factors.

€STR is the main unsecured rate

The main unsecured reference rate in the euro area money market is the ECB's euro short-term rate (€STR).[4] This rate reflects the wholesale euro unsecured overnight borrowing costs of banks located in the euro area. In practice, the €STR measures the price at which financial institutions make overnight deposits with euro area banks. The role of the €STR is particularly important as it serves as a reference rate for the most common money market derivatives, such as the overnight indexed swaps (OIS).

In recent years, the €STR has been slightly below the DFR (Chart 2). This is due to the structure of the unsecured money market, which currently consists mainly of deposits made with banks by financial institutions, such as money market funds, investment funds, pension funds and insurance companies. Since these institutions cannot deposit funds directly with the Eurosystem's national central banks, they invest their short-term cash holdings in, for example, bank deposits. The receipt of these deposits increases banks' balance sheets, which in turn raises operational and regulatory costs. When liquidity is abundant, banks do not need to compete for these deposits by offering higher interest rates. Instead, they can pass the costs on to customers by paying a lower return on deposits than the DFR. However, the decline in liquidity has also been reflected slightly in the €STR rate. Over the last couple of years, the €STR has gradually edged closer to the DFR (Chart 2).

Secured repo rates play a key role

Collateralised transactions form the largest segment of the euro area money market (Chart 3). The significance of repo rates (interest rates on repurchase agreements) has increased especially since the global financial crisis.[5] This is due to regulation and market participants' own risk management, which both encourage secured lending over unsecured lending. In addition, the increased use of central counterparties and improved collateral management infrastructure has encouraged the use of repo markets. It can be assumed that the repo market will continue to play a key role in interbank liquidity management.

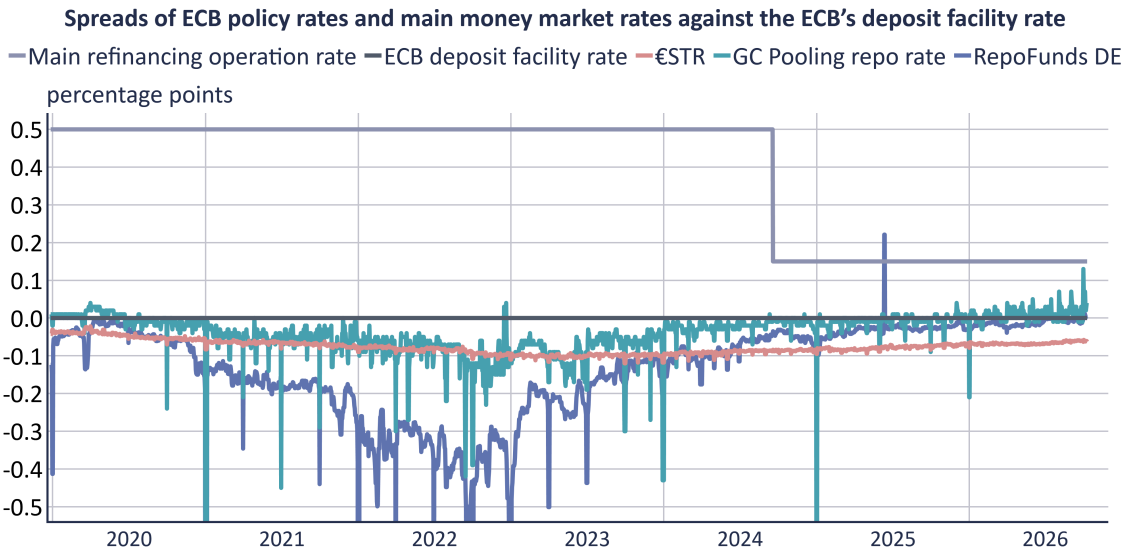
Unlike unsecured rates, repo rates have two 'moving parts': cash and collateral. Therefore, the determination of repo rates is affected not only by liquidity demand and supply but also by the collateral used and by the demand and supply of collateral in general. Consequently, relative to the DFR, repo rates have fluctuated more over time than the €STR (Chart 2).

Because repo transactions involve collateral, repo rates are also more closely linked to other financial market segments than unsecured rates. For example, in the euro area government bond market, hedge funds often finance their government bond purchases by borrowing against purchased bonds in the repo market. In recent years, the role of these funds in the cash market for euro area government bonds and in the repo market has increased significantly.[6]

Currently, short-term repo rates are close to, or even slightly above, the ECB's DFR (Chart 2). However, the interest rates on individual repo transactions vary considerably depending on the collateral and the counterparty. The general increase in repo rates reflects not only the decline in liquidity, but also the ample supply of collateral.[7] Repo rates may even trade above the DFR, and this appears to be linked especially to strong demand for repo financing from hedge funds. Hedge funds are willing to pay a premium to finance their operations in other market segments. When banks borrow money in the repo market, the interest rates they pay are still typically below the DFR.[8]

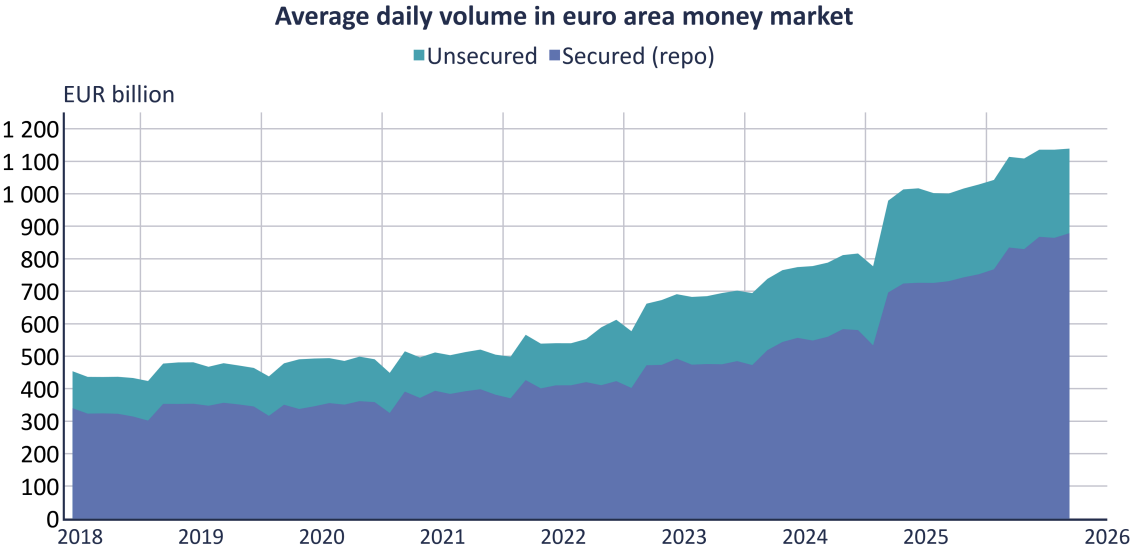
It may seem counterintuitive that unsecured rates (€STR) are lower than secured rates (repos), as if it were cheaper to borrow money without collateral than against collateral. However, the difference between the €STR and repo rates does not primarily measure differences in the credit risk between secured and unsecured lending. Interest rates are determined in different markets where lenders, borrowers and trading drivers differ. The €STR largely reflects the price of cash offered to banks by other financial institutions, whereas repo rates also reflect the availability of collateral and, for example, hedge funds' demand for funding.

Chart 2.



Sources: European Central Bank, Macrobond and Bloomberg. The y-axis is truncated at -0.5.
Eurex GC Pooling represents overnight repo rates against a broad basket of standardised collateral. RepoFunds DE represents average overnight repo rates against German government bonds (including both cash driven and securities driven transactions).
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Chart 3.



Sources: European Central Bank (Money Market Statistical Reporting, MMSR) and Macrobond.
The chart indicates the average daily lending volumes of reporting banks (all maturities).
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What will change in transitioning to the new mode of implementing monetary policy?

Banks need liquidity for settlement of payments and precautionary purposes and to meet regulatory requirements.[9] As a result of the Eurosystem's large-scale asset purchases, the banking

system has held more liquidity than banks need for these purposes. The Eurosystem will, in the near term, continue steering short-term interest rates in an environment where banks have an abundance of liquidity in excess of their minimum reserve requirements.

The minimum reserve requirement has in other respects become less important for steering interest rates, as banks now prefer to hold liquidity well in excess of their minimum reserve requirement (see box 'Role of the minimum reserve system in monetary policy implementation').

The liquidity coverage ratio (LCR) has become particularly important for liquidity demand. It requires banks to hold high-quality liquid assets (HQLA) to withstand sudden liquidity outflows. Although government bonds, for example, also qualify as HQLAs, banks prefer to meet part of their requirement with central bank reserves, i.e. liquidity, because these are not exposed to any market or liquidity risk. In order to steer market interest rates, the Eurosystem must provide banks with this liquidity.

The amount of liquidity that is needed is not known, as liquidity has not been scarce since changes to the regulatory framework. In the future, the Eurosystem will detect growth in the demand for liquidity on the basis of increases in central bank refinancing operations. The Eurosystem will conduct its standard refinancing operations (MROs and LTROs) on a fixed rate full allotment (FRFA) basis. This will allow banks to borrow unlimited amounts through these operations at the MRO rate, provided they have sufficient collateral.

As liquidity declines, banks will first seek to redistribute the existing liquidity among themselves in the money market. By reducing the uneven distribution of liquidity, efficient redistribution will curtail the desire to maintain liquidity buffers solely on these grounds. As excess liquidity declines and the shortest money market rates rise, banks will make increasing use of the Eurosystem's refinancing operations, as these are the only means to increase the aggregate amount of liquidity in the banking system. Over time, the demand for refinancing operations will grow at the same pace as the assets held under the earlier purchase programmes mature. At that point, the aggregate amount of liquidity will have found a new equilibrium.[10] Once demand proves sufficiently persistent in standard refinancing operations, part of it will be met through structural refinancing operations and a structural bond portfolio.[11]

Short-term repo rates in the euro area will rise during the transition to the new mode of liquidity management, but the extent of the increase will depend on many factors. The rise in rates will give banks an incentive to participate in the central bank's refinancing operations. For banks, the repo market will be the primary alternative to the Eurosystem's refinancing operations. As long as short-term market funding is available at a lower rate than the ECB's lending rate, banks will have no reason to make use of central bank refinancing operations. The logic also works in reverse,

however. The MRO rate will set a ceiling on banks' borrowing in the repo market, as it will not make sense to obtain market funding at a higher rate than that available from the central bank against the same collateral.[12]

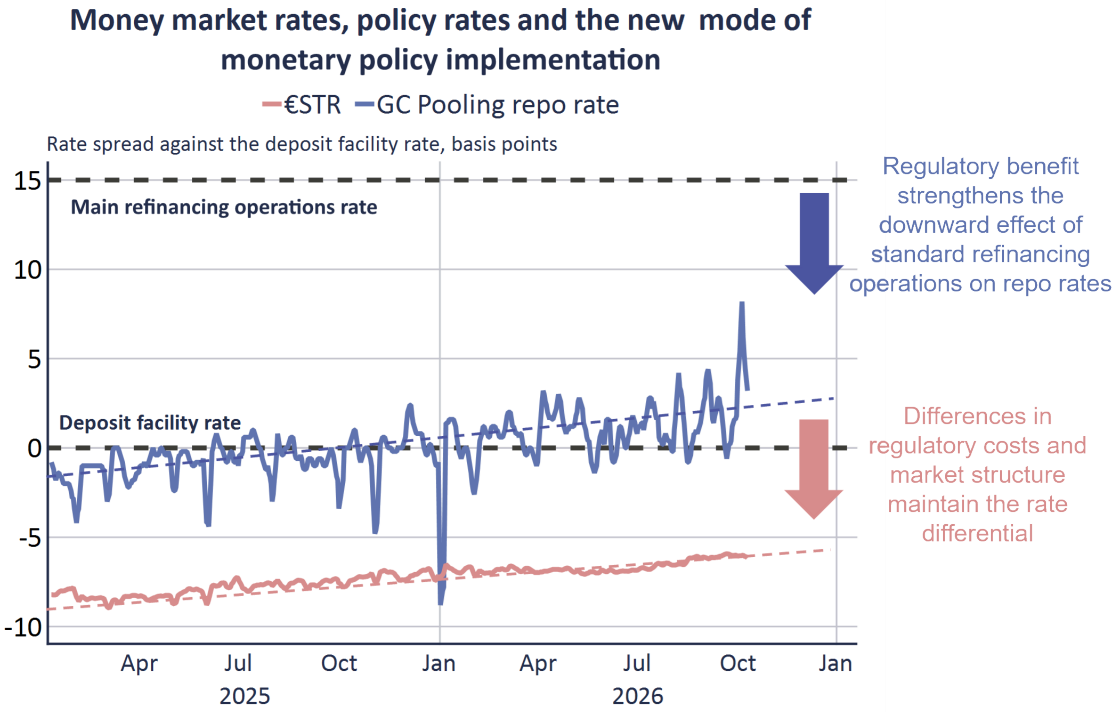
It is difficult to predict precisely where repo rates will eventually settle relative to the ECB's policy rates. This is because assets other than HQLAs are also eligible as collateral in the Eurosystem's refinancing operations. By pledging these other assets in refinancing operations, banks obtain liquidity and can simultaneously improve their LCR position. Because of this regulatory benefit, banks have an incentive to pay a higher rate on Eurosystem credit than on government bond-backed repos, which do not provide an equivalent regulatory benefit. The value of this benefit varies over time and will ultimately determine the rate at which banks obtain funding through government bond-backed repos. Banks, in turn, lend in the repo market at a rate slightly higher than the borrowing rate, as determined by supply and demand.

Short-term unsecured money market rates, such as the €STR, will also rise as liquidity declines. However, they are very likely to remain closer to the DFR than repo rates. This is due to regulation that encourages banks to engage in secured rather than unsecured wholesale borrowing.[13] In addition, unlike repo borrowing, unsecured borrowing increases banks' minimum reserve requirements. These additional cost factors and differences in market structure will maintain the interest rate spread between the two markets, keeping unsecured rates below repo rates unless collateral becomes scarce in the repo market for some reason. However, no such collateral shortage is in sight.

Since the beginning of 2025, the spread between the GC Pooling repo rate and the €STR has generally been 5–10 basis points (Chart 4). The two rates have therefore, at least so far, risen at almost the same pace relative to the DFR. The spread may, however, change over time.

The decline in liquidity will also probably be reflected in a somewhat greater rise in long-term money market rates than in short-term rates. This, too, is due to regulation, which favours long-term funding and makes it more beneficial than short-term borrowing. The effect may be seen in, for example, a rise in Euribor rates relative to expected risk-free rates.

Chart 4.



Eurex GC Pooling repo rate = overnight repo rate based on standard collateral baskets.
Sources: European Central Bank, Bloomberg and Macrobond. The interest rates are 5 -day moving averages.
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Role of the minimum reserve system in monetary policy implementation

The minimum reserve system has been one of the Eurosystem's monetary policy tools since the introduction of the euro. Under this system, euro area banks are required to hold deposits with their respective national central banks to meet their minimum reserve requirements. The requirement must be met on average over each maintenance period of 6–7 weeks. The requirement is 1% (2% before 2012) of a bank's reserve base, which consists of deposits and debt securities with maturities of up to 2 years.

The original purpose of minimum reserve requirements was to increase the demand for central bank reserves and, in particular, to stabilise short-term money market rates. This was particularly important in the corridor system used before the 2008 global financial

crisis, in which banks were provided with only slightly more liquidity than the aggregate amount of their minimum reserve requirements. Under this system, the averaging of minimum reserve requirements helped to smooth daily liquidity fluctuations and keep interest rates close to the midpoint of the symmetric interest rate corridor, i.e. the main refinancing operations (MRO) rate.

Minimum reserves do not currently play a key role in steering interest rates. This is due to the abundant liquidity in the banking system. Since money market rates are determined by the marginal cost of liquidity, under conditions of abundant liquidity they do not follow the interest rate paid on minimum reserves, but rather the rate paid on liquidity held in excess of the minimum reserve requirement. At the same time, abundant liquidity has eliminated the role of reserve averaging in smoothing interest rate fluctuations, as banks do not need to respond to every minor liquidity shock. Moreover, the current narrow spread between the DFR and the MRO rate limits interest rate volatility irrespective of the averaging mechanism under the minimum reserve system. For these reasons, the minimum reserve system is not, in the current circumstances, essential for steering the level of interest rates or smoothing interest rate fluctuations.

Determining the minimum reserve requirement on the basis of banks' short-term liabilities was previously linked to the maintenance of sufficient liquidity buffers. This function has now become less relevant or been transferred to other regulatory instruments, such as the LCR.

As central bank reserves held to meet the minimum reserve requirement do not count as HQLAs required under the LCR, the minimum reserve requirement increases banks' demand for liquidity. In order to meet this demand, the Eurosystem must, in turn, increase the supply of liquidity, either through monetary policy refinancing operations or by expanding its bond portfolio.

Minimum reserves were initially remunerated at the MRO rate to ensure that holding them was cost-neutral for banks. In November 2022, the remuneration rate was changed to the DFR, after money market rates had remained close to this rate for an extended period. Since September 2023, minimum reserves have no longer been remunerated.
In the current circumstances, the practical significance of minimum reserves therefore lies in the fact that, as they are unremunerated, they improve the Eurosystem's financial result and thereby enhance the efficiency of monetary policy implementation. As a side effect, banks have an incentive to reduce their minimum reserve requirement. This occasionally

causes minor fluctuations in money market rates around the turn of the month, as banks may, for example, be reluctant to accept new deposits.

Main challenges of the transition

Important to ensure smooth uptake of standard refinancing operations

The main challenge of the transition to the new operational mode is to get banks to indicate their liquidity demand in a timely manner in the Eurosystem's standard refinancing operations. Interest rate steering does not require the Eurosystem to know in advance the amount of liquidity needed in the banking system. However, banks must actively participate in the refinancing operations when their liquidity or market financing is no longer sufficient.

Banks make their decisions based on their own liquidity forecasts and their assessments of market conditions. They do not have access to detailed information on changes in the aggregate amount of liquidity in the system or other banks' participation in the standard refinancing operations.[14] Therefore, the amount of liquidity sought by banks through the refinancing operations may occasionally turn out to be either insufficient or excessive. This may, in turn, cause fluctuations in the money market, as seen in 2014, when liquidity declined in the Eurosystem as the advantageous three-year LTROs matured.[15]

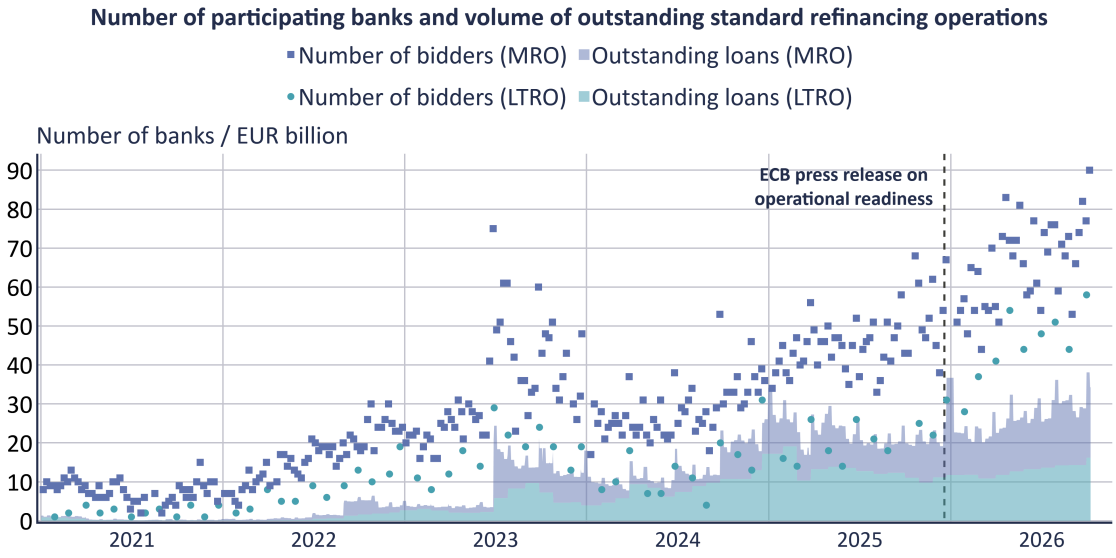
To facilitate banks' planning, the ECB publishes on its website the monthly redemption amounts for its asset purchase programmes at an annual frequency and with a 24-month horizon. As these redemptions account for the majority of the decline in liquidity, this schedule gives banks a good basis for assessing changes in the aggregate supply of liquidity.

The Eurosystem also uses the annual bank treasurer survey to estimate demand for liquidity and refinancing operations. The survey results are published to give banks further insight into the expected demand for liquidity. Based on the 2025 survey, the ECB estimates that around half of euro area banks, as measured by total assets, will have reached their preferred level of reserves by the end of 2026. Despite this, only a small proportion of banks had plans to participate in the Eurosystem's standard refinancing operations in the immediate years ahead. This appears to potentially conflict with the estimate concerning the expected demand for liquidity.

A smooth transition also requires banks to have the operational readiness to participate in standard refinancing operations. To ensure this, the ECB and the Bank of Finland have also urged

banks to test their readiness for these refinancing operations on an annual basis, starting in 2026. The number of banks participating in the operations has, in fact, increased this year, even though the aggregate volume of outstanding refinancing operations has remained low (Chart 5).[16] This suggests that banks are testing their readiness before their actual need for financing grows.

Chart 5.



MRO = main refinancing operation. LTRO = longer-term refinancing operation (3 month).
Sources: European Central Bank, Bloomberg and Macrobond.
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In addition to technical readiness, banks must be willing to participate in the refinancing operations when this is financially justified. Any reputational damage, or stigma, that may be associated with central bank refinancing operations could cause banks to postpone their participation in these. The ECB, as both a monetary and supervisory authority, has therefore emphasised that banks should consider these operations as an integral part of their day-to-day liquidity management.[17] National central banks relay the same message to their counterparty banks. It is of paramount importance that this view of the refinancing operations is held not only by the authorities, but also by international credit rating agencies, investors and banks themselves.

Money market will play a greater role

The second challenge in transitioning to a new framework is to ensure a smooth flow of liquidity in the money market. The new mode of liquidity management encourages banks to seek liquidity and participate in interbank lending more actively than before. So far, developments have been favourable: commercial banks have been actively trading with each other and across national

borders.[18] As liquidity continues to decline, its redistribution needs to be further enhanced.

The efficient distribution of liquidity in the money market depends particularly on the functioning of the repo market. Banks differ in the extent to which they can use different trading platforms, central counterparties and intermediaries, as well as in the collateral available to them. Another factor that may restrict trading is the balance sheet capacity of intermediary banks. These factors may weaken the efficient redistribution of liquidity via the repo market. As a result, the role of unsecured money markets in smoothing liquidity shocks may once again increase, particularly as banks start to compete more actively for deposits from non-bank financial institutions.[19]

If liquidity does not move sufficiently smoothly between banks, this may lead to an uneven transition to the new mode of liquidity management. Increasing volatility may be seen in market rates, especially in connection with reporting and balance sheet dates. In addition, liquidity pressures may arise regionally in individual banks or in certain market segments, without being reflected significantly in general market rates. This may also widen the spreads between the different money market rates.

Frictions in the redistribution of liquidity on market terms could also lead to banks transitioning to the Eurosystem's standard refinancing operations at different times. This is not a problem in itself, as the steering of interest rates is designed to meet the different liquidity needs of banks. However, if the transition continues to progress unevenly, banks may become split into those that obtain funding from the money market and those that participate in refinancing operations, and in the worst case this could disrupt the smooth transmission of monetary policy. This also increases the risk that a stigma might be attached to participating in standard refinancing operations.

All the challenges related to the transition ultimately lie in how these significant changes in banks' funding – both from the central bank and from the money market – can be implemented while ensuring that the steering of short-term interest rates remains under the Eurosystem's control. In September 2024, the ECB narrowed the spread between its MRO rate and the DFR to 15 basis points. The objective of the narrower interest rate corridor is to limit any excessive rise in interest rates and volatility in relation to the monetary policy stance sought by the ECB's Governing Council, while still leaving sufficient room for market-based trading. The narrow interest rate corridor therefore reflects a balancing act between the effective steering of interest rates and the market-based distribution of liquidity.

Eurosystem will ensure controlled transition to new mode of steering interest rates

The Eurosystem will continue to steer money market interest rates with the aim of keeping them in the vicinity of the DFR even as the volume of liquidity declines. The new operational mode will be demand-driven, which means that the supply of liquidity will adapt to banks' demand for reserves through the Eurosystem's standard refinancing operations. Banks must therefore prepare for changes in money market conditions and be ready to use the central bank's standard refinancing operations as part of their day-to-day liquidity management. In particular, the repo market is expected to play a key role in interbank trading in the money market.

The shift from the current abundance of liquidity to the new operational mode may occasionally cause money market rates to fluctuate more than in recent years. This is natural as all actors will adapt to the new situation in which the volume of liquidity in the banking system is determined by banks' demand rather than by the abundant supply of liquidity from the central bank. The Eurosystem will closely monitor liquidity demand, market interest rates and banks' activities and, if necessary, adjust monetary policy implementation to ensure that the transition progresses smoothly and that interest rate steering remains under the control of the Eurosystem.

Notes

1. The Eurosystem funded its asset purchases by creating new central bank money in the banking system. These newly created euros were recorded in the central bank balance sheet as commercial banks' central bank reserves, i.e. as liquidity in the banking system. ↑

2. The Governing Council decided, among other things, that short-term money market interest rates will continue to be steered using the deposit facility rate (DFR); liquidity will be provided to banks through a broad mix of instruments; and main refinancing operations (MROs) will continue to be conducted through fixed rate tenders and will play a central role in meeting banks' liquidity needs. For more detail, see the ECB's press release and Tuomas Välimäki's blog post 'ECB revises framework for implementing monetary policy' (in Finnish). Kristian Tötterman and Niko Herrala discuss the rationale for the changes to the framework in their Bank of Finland Bulletin article 'How will the European Central Bank control interest rates in the future?'. ↑

3. The future role and potential features of structural operations are discussed in more detail in the article 'Structural operations will meet part of the banking system's liquidity needs in the future' by Matti Ilmanen, Rasmus Rannikko and Sivi Palmén. ↑

4. See Joonas Koukkunen's blog post about the €STR replacing the euro overnight index average (EONIA), published 15 October 2018 (in Finnish). ↑

5. For more information on money market volumes, see e.g. Euro Money Market Study 2024, and for a longer-term perspective, see e.g. Euro Money Market Survey 2015. ↑

6. See e.g. the ECB's blog post of 23 September 2024 or the summary of the ECB's Bond Market Contact Group meeting in November 2025. ↑

7. When a particular security is scarce, a cash investor may accept a lower interest rate than usual in exchange for temporary access to that security. With government bonds and other collateral now more readily available, the benefit of collateral is declining and repo rates are rising. ↑

8. See the ECB's blog post of 2 April 2026 on the Eurosystem's analysis of the state of commercial banks and money markets. ↑

9. Liquidity demand in fast developing payment systems is examined in the article 'Developments in digital finance will reshape monetary policy implementation and central bank services' by Kaisa Liikkanen, Joonas Koukkunen and Katri Järvinen. ↑

10. At the Bank of England, whose operational framework closely resembles that of the Eurosystem, the transition towards reliance on lending operations has proceeded smoothly. The amount of central bank reserves has for the time being stabilised at around GBP 650 billion, a level already reached in September 2025. For the past year already, banks have fully offset the decline in reserves by increasing the amount of liquidity obtained through the Bank of England's lending operations. ↑

11. The future role and potential features of structural operations are discussed in more detail in the article 'Structural operations will meet part of the banking system's liquidity needs in the future' by Matti Ilmanen, Rasmus Rannikko and Sivi Palmén. ↑

12. The MRO rate constrains, in particular, the market funding costs of Eurosystem counterparty banks, but it does not constitute an absolute ceiling on repo rates. Repo rate pricing is also affected by the collateral used, the counterparty, maturity, regulatory costs and any obstacles concerning the use of central bank refinancing operations (see the discussion on the determination of repo rates earlier in this article). ↑

13. Short-term unsecured wholesale borrowing weakens banks' liquidity coverage ratio (LCR) and leverage ratio (LR). In short-term repo borrowing, the impact on these ratios depends on the collateral used in the transaction, the haircut applied to the collateral and whether the transaction is netted against other repos. Depending on these details, the ratios either deteriorate or remain unchanged. In general, however, unsecured borrowing weakens these ratios more than secured borrowing. ↑

14. In accordance with the fixed rate full allotment (FRFA) policy, the ECB does not decide the amount of central bank credit provided through its standard refinancing operations (MROs and LTROs), but instead accepts all bank bids based on demand. ↑

15. In the United Kingdom, the key secured money market rates have settled in the range of approximately 5–10 basis points above the Bank of England's core interest rate, while the amount of central bank reserves has stabilised for the time being at around GBP 650 billion (Bank of England). This shows that the transition has not caused significant fluctuations in the volume of liquidity or in money market interest rates. However, the Bank of England's short-term liquidity operation has an important distinguishing feature: the cost of the operation to participating banks is, in practice, limited to the opportunity cost of the collateral pledged. As a result, the threshold for seeking liquidity through the operation is very low, which has probably helped smooth the transition to the new framework. ↑

16. On average, 59 banks participated in each Eurosystem standard refinancing operation carried out in January–July 2026, in contrast to 39 banks over the same period in 2025. However, in the same period, the average volume of outstanding credit increased by only about EUR 700 million, to EUR 25.6 billion. ↑

17. See blog post by Claudia Buch and Isabel Schnabel, 18 March 2025. The Bank of Finland has also encouraged banks to include standard refinancing operations as part of their day-to-day liquidity management. ↑

18. See the ECB's blog post of 2 April 2026, which examines the situation of commercial banks and the money market based on an analysis conducted by the Eurosystem. ↑

19. In principle, unsecured lending between banks may also become more common again. However, this will be limited by regulation which makes unsecured lending to banks particularly expensive. Unsecured lending increases banks' balance sheets and weakens the leverage ratio, which increases the need for capital. For this reason, banks include the resulting capital costs in the pricing of unsecured lending, which weakens the competitiveness of unsecured funding relative to collateralised alternatives. ↑

Keywords

interest rate steering, monetary policy implementation, monetary policy implementation, money markets, reserves