



TOPICS:

IRRBB & Liquidity risk

SOURCE

European Central Bank

ECB: Liquidity Dependencies in the Euro Area

- This ECB working paper explores how significant liquidity injections over the past 15 years have influenced euro area banks' behaviour, potentially fostering a dependency on central bank liquidity. Building on methodologies from Acharya et al. (2024) for the U.S., the study examines whether **banks' growing reserves altered their incentives, particularly concerning the composition of deposits and susceptibility to liquidity shocks.**
- The analysis employs both **aggregate time-series data and bank-level data**, applying an instrumental variable approach to address endogeneity. The main finding is that during periods of balance sheet expansion—especially under the Asset Purchase Programme (APP) between 2015–2017—banks increased demand deposits and reduced time deposits, a trend not fully reversed during subsequent balance sheet reductions. However, this dependency effect was not observed during the pandemic's liquidity expansion under the PEPP, likely due to altered depositor behaviour and balance sheet constraints.
- Crucially, **the impact varies depending on the source of liquidity.** Liquidity from outright asset purchases (non-borrowed reserves) had a more pronounced effect on deposit structures compared to temporary refinancing operations (borrowed reserves). Moreover, the shift toward more liquid liabilities was concentrated among smaller, more fragile banks and those less reliant on ECB refinancing operations. These banks exhibited behaviours consistent with a risk-taking channel during periods of low and stable interest rates.
- In contrast to the U.S., **the euro area displayed weaker signs of liquidity dependency**, likely due to differing regulatory frameworks - especially the broader application of liquidity coverage ratio (LCR) requirements - and structural differences in banking systems. The study underscores that while central bank liquidity provision can alter banks' balance sheet composition, the effects are nuanced and context-dependent.

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