



EUROPEAN CENTRAL BANK

EUROSYSTEM

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Floor versus corridor systems in monetary policy regimes –

Overview of the euro area experience
and forward-looking issues

13th ECB Central Banking Seminar

Policy panel on monetary policy implementation
frameworks in constantly evolving financial markets

Federal Reserve favours a floor system with an ample supply of central bank reserves

January 2019 FOMC meeting minutes:

“Committee intends to continue to implement monetary policy in a regime in which an **ample supply of reserves** ensures that control over the level of the federal funds rate and other short-term interest rates is exercised primarily through the setting of the Fed’s administered rates and in which **active management of the supply of reserves is not required.**”

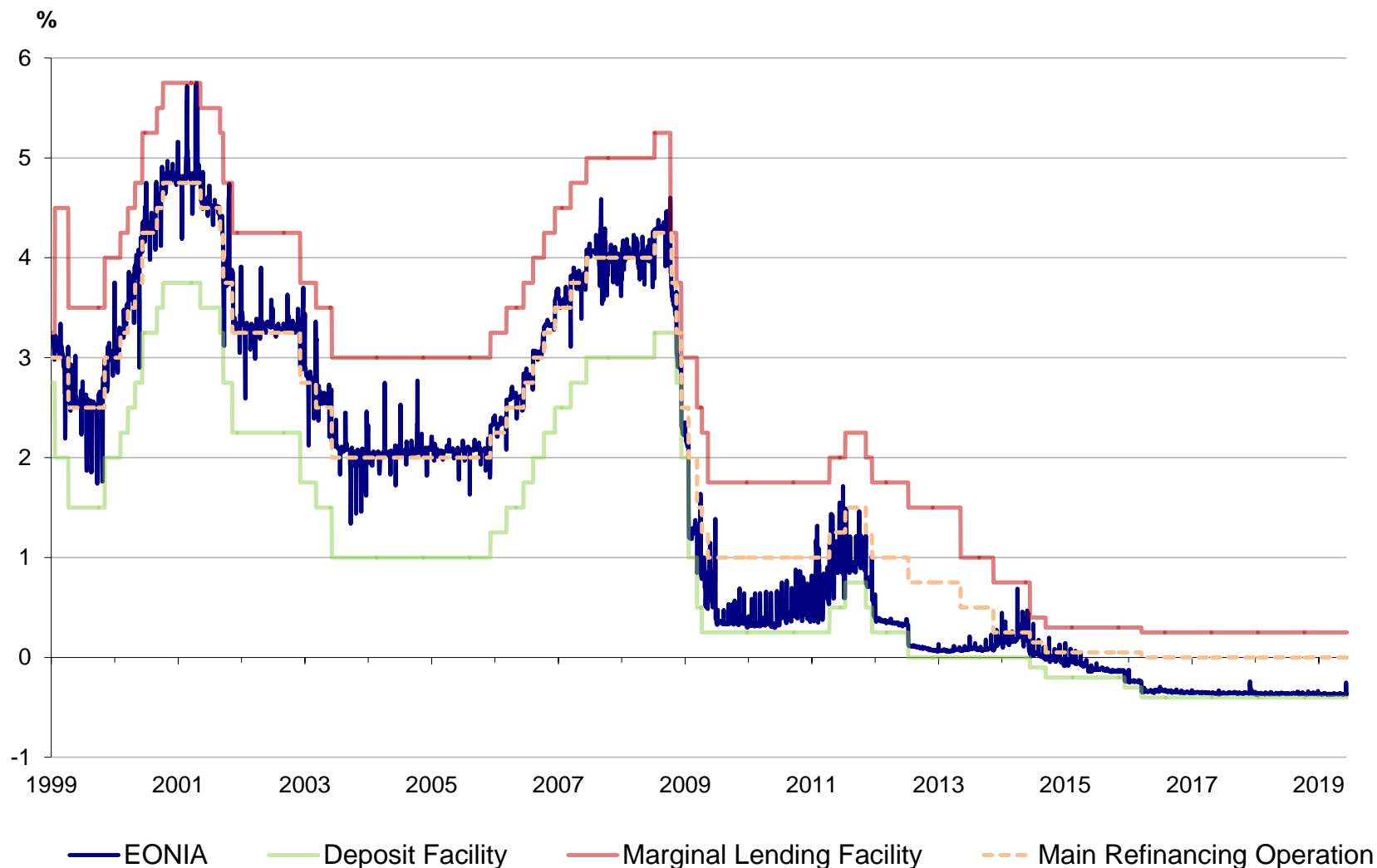
“... key advantages of the Fed’s current operating regime, incl. good control of the policy rate in a variety of conditions and good transmission to other money market rates and broader financial markets ... level and variability of reserve demand and supply were likely to be much larger than in the period before the crisis, and stabilizing the policy rate in this environment would require large and frequent open market operations.”

March 2019 FOMC meeting minutes:

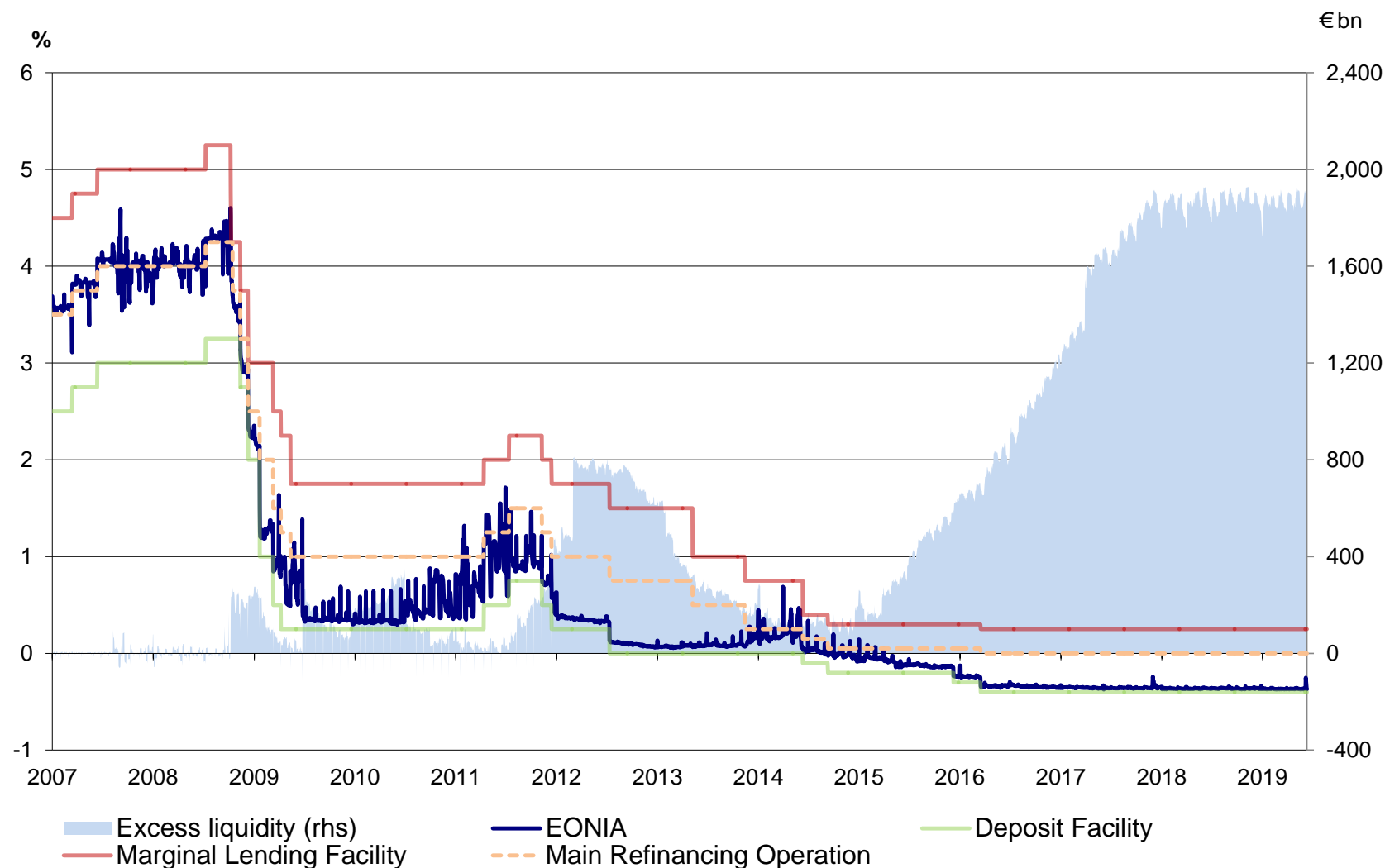
“... **longer-run level of reserves** and size of the balance sheet would ultimately be **determined by long-term demand for Federal Reserve liabilities** ... eventual resumption of **purchases of securities** ... would be a **normal part of operations to maintain the ample-reserves monetary policy implementation regime** and would not represent a change in the stance of monetary policy.”

“Some participants suggested that ... the Committee should discuss the potential benefits and costs of tools that might reduce reserve demand or support interest rate control.”

Pre-crisis corridor system of the Eurosystem has evolved to a de facto floor system since late-2015

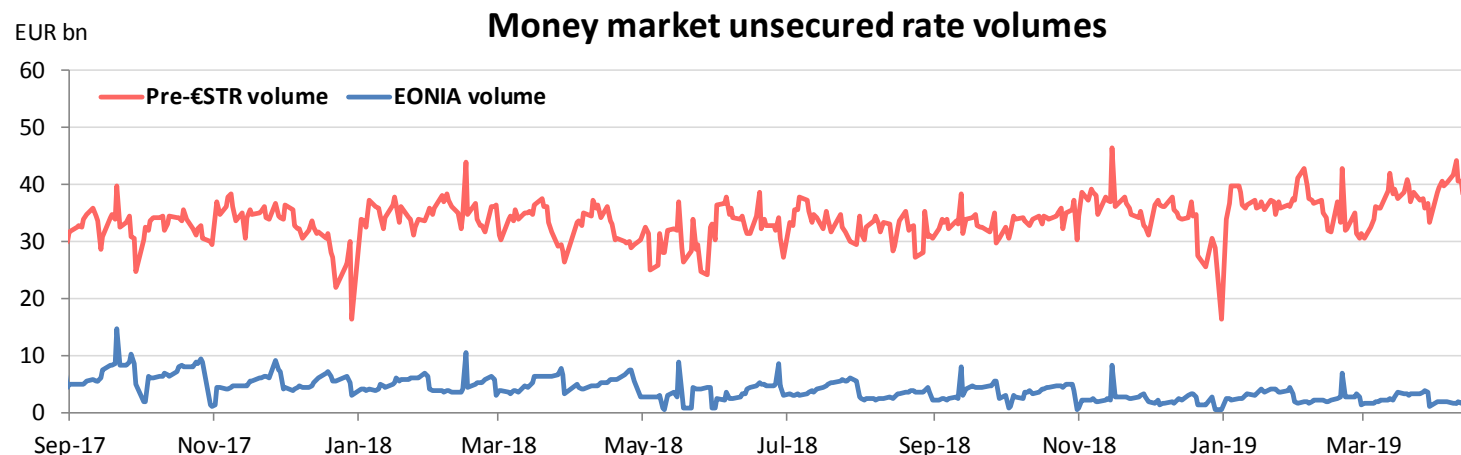
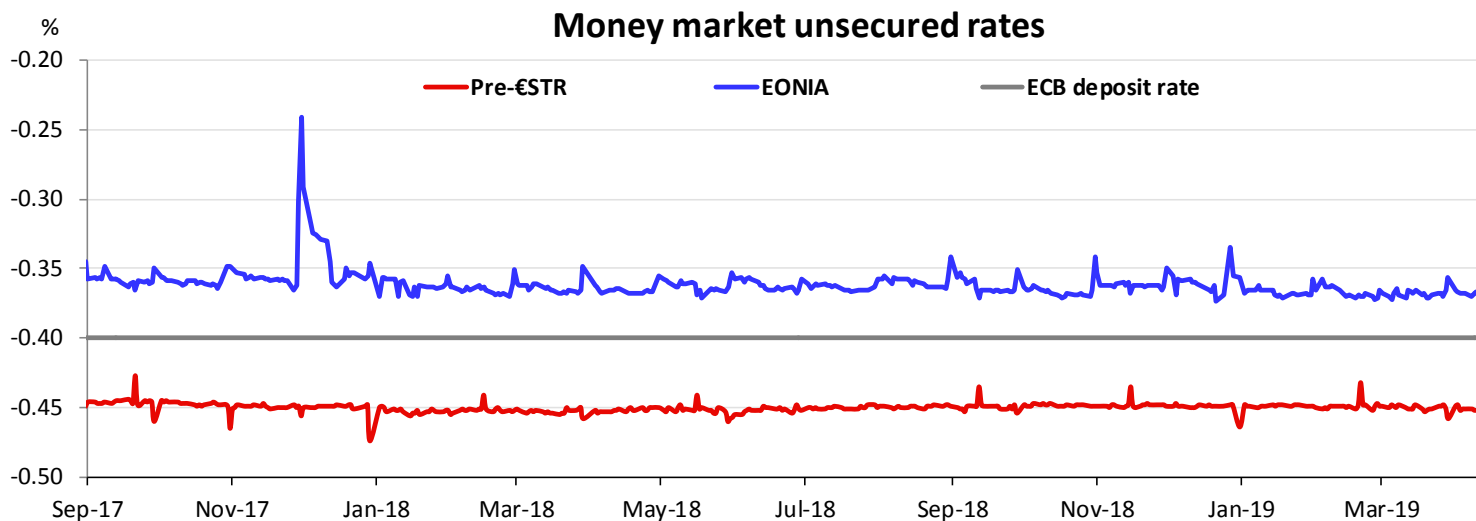


Excess liquidity created by non-standard measures key factor behind de facto floor system

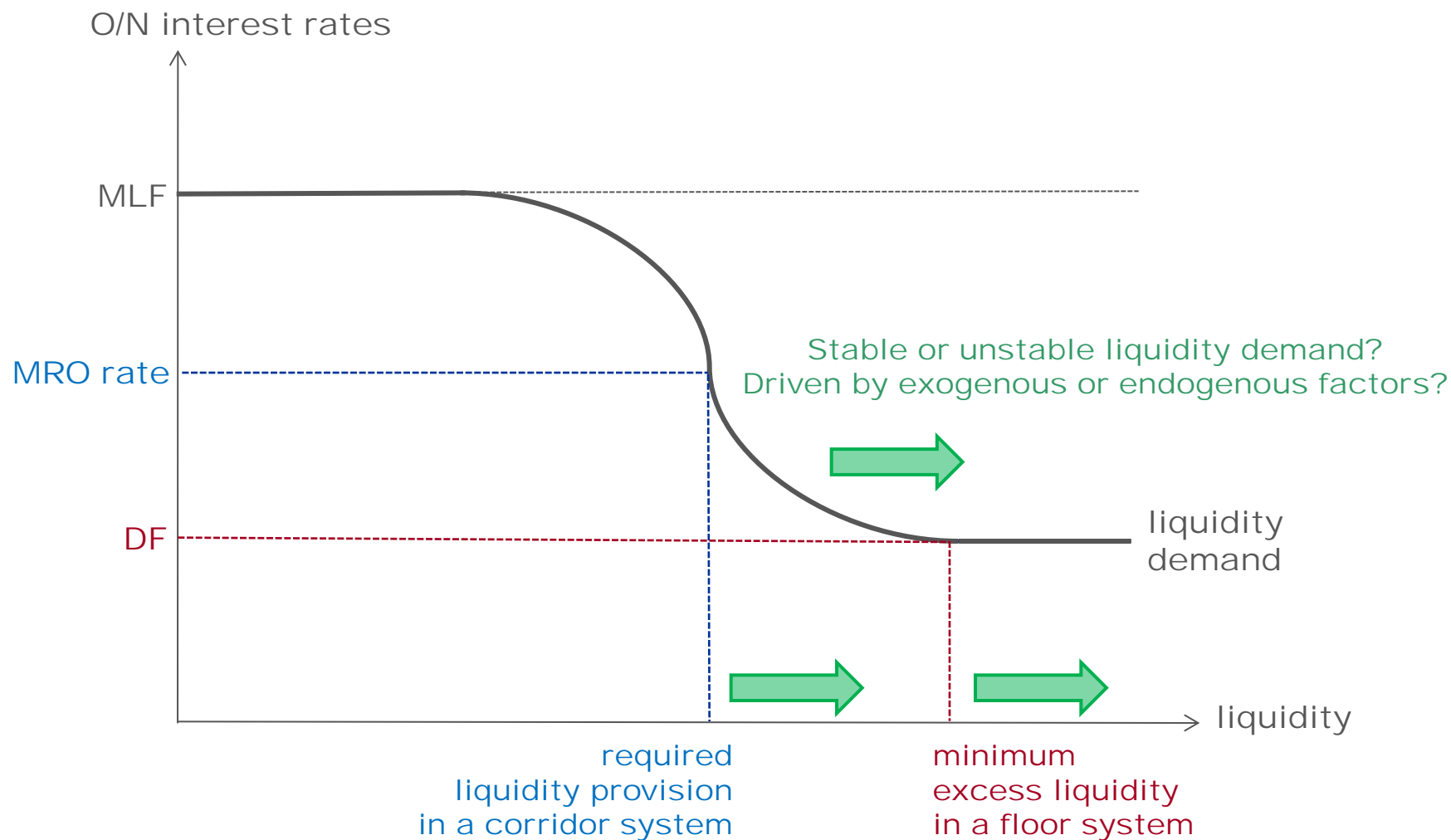


Arbitrage involving banks and non-banks drives money market activity & rates in a floor system

Is it a floor or a magnet?



Amount of liquidity required in corridor and floor systems depends on evolving liquidity demand



Policy preferences and objectives will determine choice of monetary policy regime for the future

Pros of a floor system:

- better steering of the short-term interest rates due to potentially lower volatility of money market rates and less operational complexity
- robust to a further expansion of the balance sheet to serve monetary policy or other policy objectives

Cons of a floor system:

- larger financial market footprint of the Eurosystem
- lower (unsecured) interbank market activity
- could endogenously create additional liquidity demand due to incentives implied by the arbitrage mechanism and (short-term) interest rates below the floor

➤ **Alternative to a pure floor system** in a world of uncertain demand for reserves:
symmetric corridor system with fixed-rate full allotment MROs and a tiered/quota-based remuneration scheme for banks' reserve holdings