



OPINION OF THE EUROPEAN CENTRAL BANK

of 11 August 2010

on reserve requirements for credit institutions

(CON/2010/68)

Introduction and legal basis

On 20 July 2010 the European Central Bank (ECB) received a request from the Magyar Nemzeti Bank (MNB) for an opinion on a draft decree on reserve requirements (hereinafter the 'draft decree').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and Article 2(2) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions¹, as the draft decree relates to instruments of monetary policy of a Member State whose currency is not the euro. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft decree

- 1.1 According to the explanatory memorandum attached to the consultation request, in November 2008 the MNB reduced the minimum reserve ratio in a single step from 5 %, the reserve ratio which had been in effect from 2002, to 2 %, which is the reserve ratio currently applying to the Eurosystem. This was done in response to the confidence crisis affecting the Hungarian interbank market. The reduction of the reserve ratio was prompted mainly by liquidity shortages experienced by a number of large Hungarian banks due to their foreign exchange exposures. It also contributed significantly to the increase in these credit institutions' surplus HUF liquidity, thereby mitigating the risks to the stability of the banking sector. However, the lower reserve requirement posed a challenge for a number of smaller banks in the Hungarian market in coping with large fluctuations in their liquidity needs. This problem has been exacerbated by the fact that the interbank market is still weak compared to the period before the crisis in 2008, due to, *inter alia*, risk aversion.
- 1.2 Pursuant to Decree 15/2008 (XI.24.) of the Governor of the MNB on the reserve requirement ratio, the current reserve ratio applicable to Hungarian credit institutions subject to reserve requirements is 2 %. The purpose of the draft decree is to enable credit institutions subject to reserve

¹ OJ L 189, 3.7.1998, p. 42.

requirements to choose from one of the following reserve ratios: 2 %, 3 %, 4 % or 5 %. The draft decree will enter into force upon approval by the MNB's Monetary Council.

2. General observations

- 2.1 Experience from the recent crisis has shown the importance of the buffering function played by reserves held at the central bank. This may imply that it is beneficial for some banks to have a reserve ratio that is not too low. In this context, the ECB understands the MNB's approach of transferring the responsibility for determining the reserve ratio to the banking system. At the same time, incentives encouraging credit institutions to have active liquidity management are needed to ensure a dynamic and efficient interbank market. In this regard, a continual and long-term monitoring of the possible impacts of the measures introduced by the draft decree on the functioning of the Hungarian interbank market is recommended. Similarly, alternative ways of reducing the size and frequency of liquidity shocks should be considered. It could also be beneficial to address the sources of the liquidity shocks that led the MNB to introduce the draft decree.
- 2.2 More specifically, the difficulties some Hungarian banks had in coping with large shocks in their liquidity demand, e.g. due to large transactions from their clients, appear to be a key reason behind the significant accumulation of overnight deposits. In the short term and during the convergence process towards joining the euro area, the MNB may need greater flexibility to address liquidity shocks and market inefficiencies which hinder the implementation of national monetary policy. Member States whose currency is not the euro retain their powers in the field of monetary policy. However, in the implementation of the single monetary policy, consistency with the Eurosystem's operational framework at an early stage will be required. Credit institutions in such Member States will need to be familiar with requirements that will apply to them when the euro is introduced, such as the single reserve ratio of 2 %.

3. Specific observations

Upon adoption of the euro in Hungary, the ECB's minimum reserves framework will apply, in particular. (a) Article 19 of the Statute of the European System of Central Banks and of the European Central Bank; (b) Council Regulation (EC) No 2531/98 of 23 November 1998 concerning the application of minimum reserves by the European Central Bank²; (c) Regulation ECB/2003/9 of 12 September 2003 on the application of minimum reserves³; and (d) in relation to the definition and calculation of the reserve base, Regulation ECB/2008/32 of 19 December 2008 concerning the balance sheet of the monetary financial institutions sector (recast)⁴. Article 11 of and Annex III to Regulation ECB/2008/32 requires statistical information reported by credit institutions under Regulation ECB/2008/32 to be used for the purpose of

² OJ L 318, 27.11.1998, p. 1.

³ OJ L 250, 2.10.2003, p. 10.

⁴ OJ L 15, 20.1.2009, p. 14.

minimum reserves. Special rules set out in this Regulation prevail over Regulation ECB/2003/9 and concern small credit institutions, group reporting and reserve requirements in the case of mergers.

This opinion will be published on the ECB's website two months after the date of its adoption.

Done at Frankfurt am Main, 11 August 2010.

[signed]

The Vice-President of the ECB

Vítor CONSTÂNCIO