BLOG

Banks are encouraged to participate in Eurosystem standard refinancing operations as central bank reserves decline

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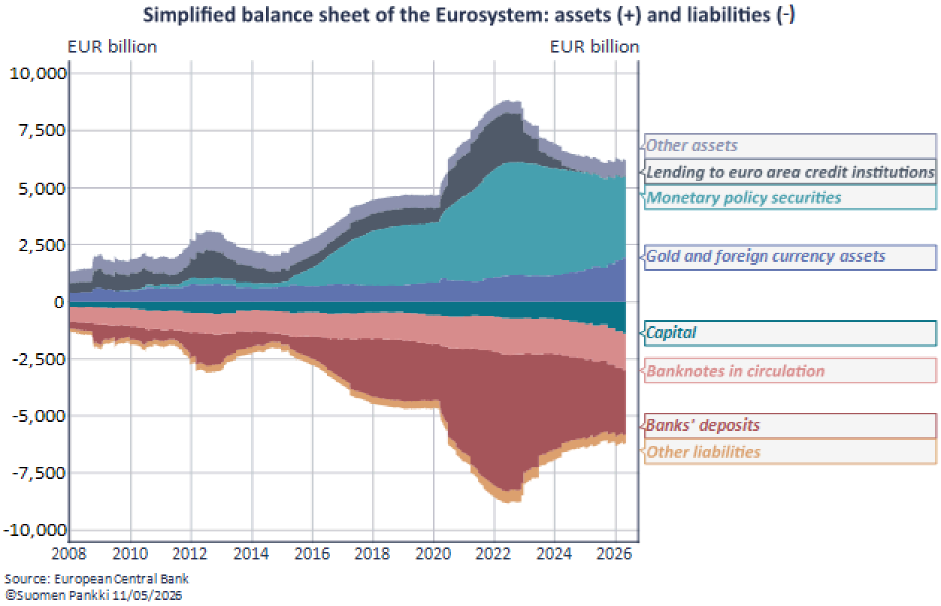
By the end of 2026, the continued decline in central bank reserves in the euro area banking system will mean that around half of euro area banks will have reached their preferred level of reserves, according to Eurosystem projections. As central bank reserves decline, the use of Eurosystem standard refinancing operations is in turn expected to increase from its current level.

The Eurosystem has been shrinking its balance sheet since the latter half of 2022. This balance sheet normalisation is expected to continue in the years ahead. Central banks' monetary policy securities holdings, which are on the assets side of the balance sheet, are being allowed to run off as bonds acquired under purchase programmes mature. As a result, there is also a corresponding decrease in the counterpart on the liabilities side of the balance sheet – central bank reserves, i.e. the deposits that commercial banks hold at the central bank (Chart 1). The amount of central bank reserves affects the determination of money market rates and the transmission of monetary policy.

Chart 1.



Money markets are functioning well

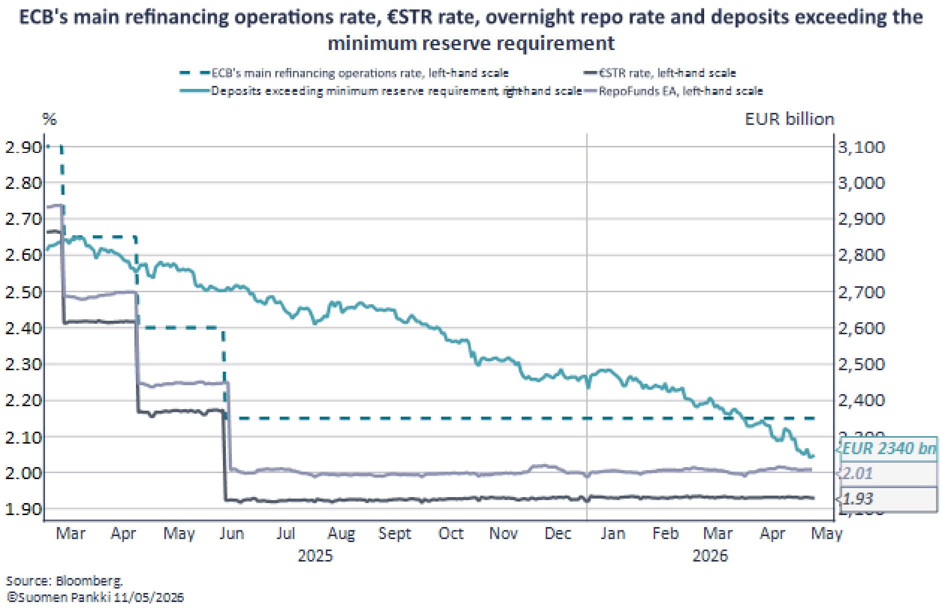
The central bank reserves of euro area banks have declined from a peak of around EUR 4.9 trillion in 2022 to the current level of about EUR 2.6 trillion. Looking ahead, reserves are expected to decline by about EUR 470 billion per year, according to the Eurosystem's projections.

Overall, central bank reserves remain abundant, although they are unevenly spread across banks. In the current environment, market funding for euro area banks is working well, as is the access of these banks to money markets, and banks do not currently need to maintain their liquidity through Eurosystem refinancing operations carried out by national central banks.

As central bank reserves decline, banks will increasingly rely on money markets when managing their liquidity. According to the Eurosystem's analysis, banks are becoming more active particularly in the secured money market, i.e. in the repo market. In money markets, banks seek short-term liquidity or lend funds against collateral to other banks.

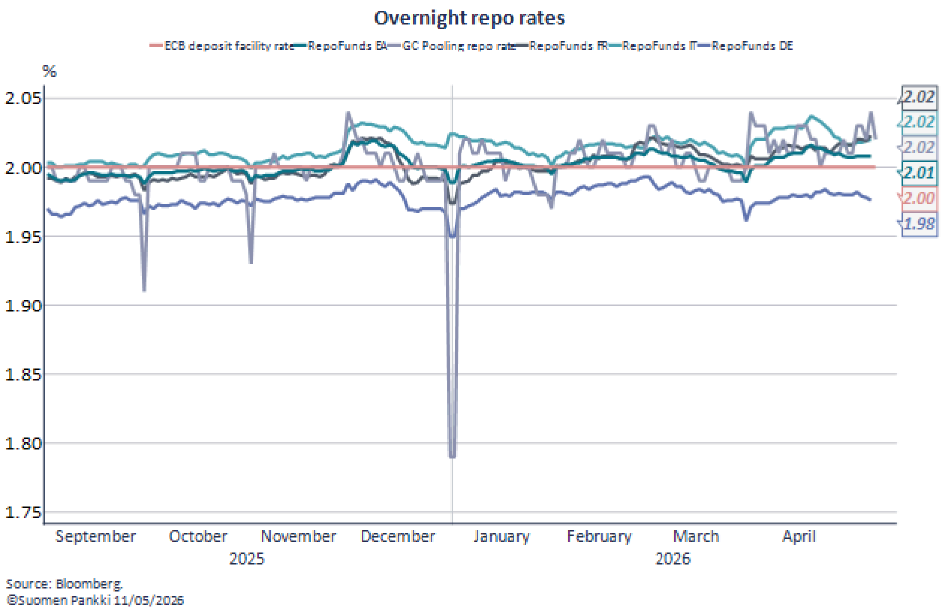
The unsecured money market rate, i.e. the euro short-term rate (€STR), has been lower than secured repo rates since 2023 (Chart 2). The unsecured and secured money markets differ from each other in regard to their structure and participants, and this also affects the level of their rates. In unsecured money markets, cash is provided particularly by entities that (unlike banks) are not eligible to place deposits with the central bank, or that do not have access to central counterparty clearing, which is required in the secured money market.

Chart 2.



Country-specific pricing of repo rates (Chart 3) shows that, despite the decline in central bank reserves, repo rates have remained relatively stable during 2025 and 2026. Repo rates are close to the level of the ECB's deposit facility rate (currently 2.00%). Looking ahead, however, it can be assumed that, among money market rates, repo rates in particular will move closer to the interest rate on the ECB's main refinancing operations (shown in Chart 2, currently 2.15%) as central bank reserves continue to decline.

Chart 3.



Eurosystem standard refinancing operations can become part of banks' day-to-day liquidity

management

The funding mix of euro area banks comprises not only long-term but also short-term funding. Banks' liquidity and funding objectives are also guided by regulation, in particular the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) requirements.

In addition to market funding, one way for banks to maintain their liquidity and their level of central bank reserves is to make use of Eurosystem refinancing facilities. At present, banks' participation in Eurosystem standard refinancing operations is, on average, historically very low, both in the euro area and in Finland. However, this is expected to change, although the timing of such a change cannot yet be estimated with any precision.

Last autumn, the Eurosystem conducted a large-scale survey of euro area banks' liquidity and funding functions, and the Bank of Finland also played an active role in the design and implementation of the survey. One of the objectives of the survey was to identify the minimum level of central bank reserves that banks themselves wish to maintain, i.e. their preferred level of reserves. While the survey results are treated confidentially within the Eurosystem, the general conclusions from the survey were published in an ECB blog post. The intention was also to encourage banks to prepare for the decline in central bank reserves. The Eurosystem's projections show that the decline in central bank reserves in the euro area banking system will mean that by the end of 2026 around half of banks in the euro area will have reached their preferred level of reserves. At present, around three quarters of banks are operating above their preferred reserve levels.

Before the global financial crisis – that is, in the early 2000s – banks regularly took part in the Eurosystem's standard refinancing operations. Since then, the Eurosystem's monetary policy regime of ample liquidity provision has reduced banks' need to rely on these operations.

At the Bank of Finland, we expect that banks will make increasing use of Eurosystem standard refinancing operations as central bank reserves continue to decline and market funding becomes more expensive relative to refinancing operations provided at fixed rates. We therefore encourage banks to use these operations as routine tools.

For this reason, banks should also annually test their operational readiness to access Eurosystem standard refinancing operations. The Bank of Finland has invited domestic monetary policy counterparties to prepare for the general decline in central bank reserves and to carry out such tests during 2026. Some banks have already become more active in this respect in the early part of this year, and others are encouraged to follow suit. The use of Eurosystem standard refinancing operations must not carry negative connotations for supervisors, investors or credit rating agencies, but should instead be seen as part of banks' day-to-day liquidity management.

Tags

monetary policy, money markets