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Europäische Zentralbank
Präsidentin Christine Lagarde
60640 Frankfurt am Main

Review of the operational framework for implementing monetary policy

Berlin, 12.02.2025

Dear President Lagarde,

In March 2024, the ECB announced a review phase of the operational framework that will last until 2026. A reform of the minimum reserves will certainly also be discussed during this phase. In recent years, the minimum reserves have been particularly important for increasing the efficiency of monetary policy measures and at least partially compensating for the bank subsidies from the low-interest rate phase. We would therefore urge you to retain the minimum reserves as an instrument.

Finanzwende is an independent and non-partisan organization that advocates fair, stable and sustainable financial markets. We are committed to make financial markets serve society. In doing so, we act as a counterweight to the financial lobby.

From July 2022 onwards, after years of low interest rates, the ECB raised the interest rate for its deposit facility significantly to 4 percent. During this period, banks earned billions of euros in risk-free interest income from their deposits with the ECB. German and Austrian banks in particular profited from this: they received high interest rates from the ECB while paying hardly any interest on their customers' deposits.

Even more important in relation to the minimum reserves: during the period of low interest rates, the ECB supported European banks with generous subsidies. This involved either providing liquidity below market interest rates or paying interest on bank deposits above the market rate. This enabled European banks to exploit interest rate differences to generate risk-free profits.

As part of the TLTRO-III program, banks could borrow liquidity below market interest rates from the ECB between June 2020 and June 2022. Furthermore, the two-tier system exempted bank deposits from the negative deposit rate at the ECB between December 2019 and July 2022. In addition, the banks'

minimum reserves earned interest above the market rate at the main refinancing rate between July 2014 and November 2022. These subsidies amounted to an estimated 36 billion euros.¹

In this context, we welcomed the ECB's decisions to pay interest on the minimum reserves at the deposit rate instead of the main refinancing rate (October 2022) and to reduce the subsequent interest rate to zero percent (July 2023). If the ECB de facto subsidizes banks in times of expansive monetary policy, then it inevitably follows that it should take measures in times of restrictive monetary policy that benefit taxpayers at the expense of banks. After all, the subsidies reduce the central banks' profit transfer to public budgets and thus reduce the state's leeway for fiscal action. As an independent institution, the ECB lacks the legitimacy to pursue a policy that repeatedly transfers public funds to banks throughout the cycle (in every expansionary phase) without compensating for these measures.

Not paying interest on the minimum reserves reduced the ECB's interest costs by an estimated six billion euros in 2024. In order to compensate for the full extent of the subsidies, the minimum reserves would even have to be significantly increased and not abolished, as is currently being discussed.

If in the future, the Eurosystem wants to keep the option open of adopting measures that generate losses during expansionary phases, then it should also adopt measures to limit losses during restrictive phases. Non-interest-bearing minimum reserves are the best mechanism for this, which is precisely why they must be retained.

We would be delighted if you would like to discuss this with us.

Yours sincerely

Michael Peters

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¹ <https://www.finanzwende.de/themen/banken-und-schattenbanken/bankengeschenke-der-ezb/>