



EUROPEAN CENTRAL BANK

EUROSYSTEM

Jean-Claude TRICHET
President

Mr Mario Borghezio
European Parliament
Bât. Altiero Spinelli 08H346
60, rue Wiertz / Wiertzstraat 60
B-1047 Brussels

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Dear Mr. Borghezio,

Your letter from 2 October regarding the financial crisis in Europe

Thank you very much for your letter which raises some questions which I am answering below.

Question 1: Are the latest massive injections of liquidity by the Eurosystem being charged to market participants?

The recent large injections of the Eurosystem to banks in the form of main refinancing operations (MROs), longer term refinancing operations (LTROs) or fine tuning operations (FTOs) appear in the Eurosystem balance sheet as a claim of the Eurosystem on counterparties in the euro area, i.e. European based banks. The Eurosystem receives an interest on these operations which results from the outcome of a tender auction. Furthermore the operations are protected by adequate collateral posted by the counterparties borrowing liquidity from the Eurosystem.

A bank that is successful in a tender auction is charged the weighted average interest rate of its successful bids in case of a tender that follows a variable rate tender procedure, or a fixed interest rate in case a fixed rate tender procedure is used.

I understand that this also addresses your second question, in which you asked what we had received for these injections if they were not an interest-bearing claim on market participants.

Question 3: In the context of clear deflation (the ECB is pumping in more liquidity), why have the rates been increased with serious consequences for the payment of loans?

In this context, first of all, I would like to stress that what you refer to as “the ECB pumping in more liquidity” is by no means associated with deflation. The additional interventions of the Eurosystem merely address the additional demand for central bank money, which is a result of the current malfunctioning in the interbank market, where the banks with sufficient liquidity do not lend it to the banks that are seeking it.

With regards to the second part of this question, I assume you are referring to the increase in the minimum bid rate at the beginning of July 2008 from 4% to 4.25%. Let me recall to you that the ECB’s objective, as stated in the EU Treaty, is to preserve price stability in the euro area. The decision to increase short term interest rates at the beginning of July was fully consistent with this objective. That measure, as well as all monetary policy measures, are not affected by the money market operations we are carrying out to counter the financial market turmoil.

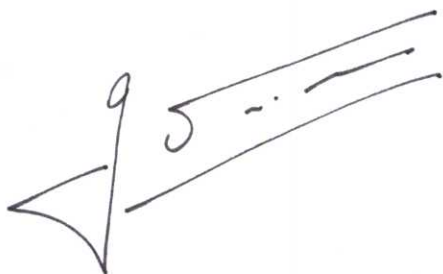
Question 4: How do you intend to place the operation of the private monetary banking system in the hands of the right political bodies?

I understand that your question refers to the issue of which authority is assessed to be most competent to supervise the banking industry. In this context, the challenge is to have an effective supervision and oversight given the different supervisory frameworks in different euro member states. In particular for banks that operate in several euro area member states, the recent orientation of the Council upon proposals of the Commission and the signature of the memorandum of understanding (MoU) on cooperation between the financial supervisory authorities, central banks and finance ministries of the European Union on cross-border financial stability as of 1 June 2008 (ECFIN/CEFCPE(2008)REP/53106 REV REV) provide guidance on cooperation between the different financial authorities.

Question 5: How do you intend to eliminate the spread of debt caused by the cash injections?

Our liquidity injections have not caused in any respect an increase in the cost of loans to households and corporations. Indeed it is exactly the contrary since, as mentioned already above; these injections addressed the specific additional demand of euro area counterparties for central bank money, thereby helping to contain the implications of the financial market turmoil for the real economy, in particular by reducing the risk of a contraction in the provision of loans to households and corporations.

With best regards,

A handwritten signature in black ink, consisting of a stylized 'J' followed by a series of horizontal strokes and a final upward stroke.