SPEECH

Euro liquidity lines and the international monetary system

Remarks by Philip R. Lane, Member of the Executive Board of the ECB, at the CF40-Euro50 luncheon “Monetary System Beyond the Dollar”

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The provision of liquidity is a basic task for a central bank.[1]

The ECB injects liquidity through its refinancing operations (currently the main refinancing operations and the longer-term refinancing operations, with very long-term refinancing operations and targeted longer-term refinancing operations deployed in the past) and asset portfolios (previously built up under the asset purchase programme and the pandemic emergency purchase programme).[2]

Since the ECB only has domestic counterparties in its refinancing operations, it is essential to complement the domestic liquidity framework with international liquidity lines. These lines, which consist of both repo and swap lines, mitigate adverse spillovers in the event of increased demand for euro liquidity abroad and/or impairment in cross-border euro liquidity flows. In the absence of international liquidity provision, such shocks might exert upward pressure on euro money market rates or disrupt the functioning of securities markets and the banking system, and thereby impair monetary policy transmission.

In recent years, the world economy has undergone profound structural shifts related to geopolitics and changes in the international financial system. These shifts have altered the dynamics of global trade and financial integration and suggest that the macroeconomic and financial environment will remain uncertain and potentially more volatile. More frequent financial disruptions and possible knock-on effects on euro area financial markets have the potential to hamper the smooth transmission of monetary policy.

Given their backstop pricing, international liquidity lines are designed to be drawn down only in response to shocks and in crisis situations. However, their mere existence – even without being drawn upon – can help to prevent adverse market dynamics from arising in the first place. Empirical evidence suggests that the ECB’s liquidity lines have been effective in reducing financial pressures on euro funding markets.[3]

This year, the ECB decided to enhance the Eurosystem repo facility for central banks (EUREP) to make it more flexible and effective in supporting the smooth transmission of euro area monetary policy.[4] Under EUREP, the Eurosystem provides backstop euro liquidity to non-euro area central banks against high-quality euro-denominated collateral, with appropriate risk mitigants. The updated framework introduces standing access, in principle, for all central banks, unless excluded on the

grounds of, in particular, money laundering, terrorist financing or international sanctions. The framework will enable central banks in jurisdictions outside the euro area to swiftly address risks of euro liquidity shortages. These changes aim to make the facility more flexible, broader in terms of its geographical reach, and more relevant for global holders of euro securities.

Central banks onboarded to EUREP will receive euro liquidity in the form of loans against high-quality euro-denominated collateral, priced at the main refinancing operations (MRO) rate plus a spread set by the Governing Council to preserve the backstop character of the facility. The maturity of a single transaction will range from one day to one week and may be extended. The maximum line size per individual central bank is €50 billion. Onboarded central banks can use EUREP funds flexibly, without ex ante restrictions. After completing the onboarding process, central banks will be able to draw from the facility as of the fourth quarter of 2026. Appropriate risk mitigants are in place to adequately protect the Eurosystem. More than thirty central banks have expressed interest in EUREP in the past six months and the onboarding of first foreign central banks to the enhanced facility was completed at the beginning of October.

EUREP can be expected to exert a strong positive impact on the euro-denominated bond market, boosting the savings and investments union initiative. In particular, EUREP encourages the holding of euro-denominated debt securities by foreign central banks, which are price-insensitive investors. It also encourages the holdings of longer-duration bonds, since it enhances the liquidity of these bonds: the liquidity enhancement is considerable as EUREP offers same day liquidity of up to €50 billion off-market in a single transaction. Since reserve managers would be able to hold bonds from all euro area countries rather than just the most liquid bonds, EUREP also enhances the playing field between more liquid and less liquid euro area sovereign bonds, contributing to better integration of the euro area bond market. Importantly, this argument extends to Eurosystem-recognised supranational bonds (e.g. European Commission bonds) which suffer from lower liquidity than large sovereigns.

Swap lines complement EUREP from a monetary policy perspective, strengthening the overall international liquidity lines framework. EUREP lends against euro-denominated collateral, which enables breadth of access. However, the collateral constraint limits its role: a country may have extensive euro liabilities and excessive self-insurance (by matching euro liabilities with euro assets) would be an undesirable equilibrium, whereas the availability of swap lines can facilitate more efficient liquidity risk management.

Swap lines can be deployed against local-currency collateral, such that combined swap and EUREP access offers stronger overall support than EUREP alone. In particular, swaps are not contingent on having euro-denominated collateral. Thus, swaps have stronger signalling effects than EUREP alone in terms of access to liquidity, which helps to reduce the likelihood of escalating crises abroad and limits adverse spillovers to the euro area. In particular, provided fundamentals are sufficiently strong, the existence of swap lines can reduce the risk of adverse confidence shocks abroad becoming self-fulfilling.

There are some differences in the transmission channels of swap and repo lines, which enhances their complementarity. In particular, swap lines work more directly through the bank credit channel, as recipient foreign central banks lend euro cash to their domestic banks, which then lend to the financial system. This is consistent with the theoretical literature showing that central-bank lending programmes

reduce ex-post financing risk and encourage ex-ante investment through global banks operating across integrated financial markets.

In this way, swap lines can provide deep, targeted euro liquidity support to the domestic banking system of selected partners, even if the lines are expected to be used only in times of crisis, while EUREP is mainly focused on supporting the functioning of euro-denominated debt securities markets at the global level. This is consistent with the empirical evidence that access to swap lines is associated with stronger cross-border bank credit flows, while repo-type access is closely tied to developments in securities holdings.[5]

Since swap lines entail greater risks than EUREP, it is appropriate to provide them only to foreign central banks that are clearly capable of repaying their euro debt in due course, requiring the backing of a highly-rated sovereign. Careful calibration and assessment are also needed to mitigate potential overreliance and moral hazard.[6]

From a European perspective, it is also sensible to restrict swap lines to jurisdictions where the impact on the euro area from defaults on euro-denominated debt or fire-sales of assets – including via indirect or network effects operating through the global financial system – have the potential to impair monetary policy transmission. Global trade, financial and supply chain linkages mean that seemingly isolated idiosyncratic shocks in one country or region – especially if the economy is large, a major financial centre or closely tied to the euro area – may transmit rapidly and unpredictably, escalate through network effects and pose a threat to monetary policy transmission.

The monetary policy case for liquidity lines is reinforced by their dynamic interaction with other policy areas. In particular, liquidity lines can boost the international role of the euro, which further supports the ability of the ECB to achieve its monetary policy objectives.[7] Liquidity lines bolster confidence in the currency and reduce the associated risks, supporting its wider usage in trade invoicing and settlements. Liquidity lines also support expanded issuance of euro-denominated debt. Such an expansion can entail two dimensions: (i) an increase in the volume of (new) euro-denominated credit as a swap line would encourage foreign counterparts to borrow in euro, either through loans or market-based debt instruments; and (ii) currency switching, whereby some FX loans previously extended by European lenders (including through their global subsidiaries) in foreign currency might – if a currency backstop exists – be made in euro. Both of these channels strengthen the effectiveness of ECB monetary policy transmission.[8]

Greater use of the euro internationally, in turn, supports the ability of the ECB to achieve price stability by increasing the international impact of euro area monetary policy and thereby influencing foreign demand as well as domestic demand. For example, a tightening of euro area monetary policy makes it more expensive for foreign entities to source euro denominated funding, which weighs on demand in economies that use the euro, particularly for debt issuance, as well as for trade invoicing and funding of working capital. This spillover of euro area monetary policy spills back via weaker foreign demand, reinforcing the monetary policy tightening. Furthermore, a stronger international role for the euro reduces the sensitivity of euro area import prices to external shocks by fostering invoicing in euro.

1.

The views expressed in these remarks are mine and should not be interpreted as representing the collective view of the ECB Governing Council.

2.

In addition, assets are purchased by the ECB and the national central banks for non-monetary policy portfolios under the agreement on net financial assets.

3.

See Albrizio, S., Kataryniuk, I., Molina, L. and Schäfer, J. (2021), "ECB Euro Liquidity Lines", *International Journal of Central Banking*, Vol. 22, No. 4.; and Beck, R., Ferrari, M. and Titzck, S. (2021), "The effectiveness of ECB currency liquidity lines", *The international role of the euro*, ECB, pp. 50-52. See also Cipollone, P., Lane, P.R. and Schnabel, S. (2024) "Learning from crises: our new framework for euro liquidity lines", The ECB Blog, ECB. For more general evidence see Bahaj, S. and Reis, R. (2022), "Central Bank Swap Lines: Evidence on the Effects of the Lender of Last Resort", *Review of Economic Studies*, Vol. 89, No. 4.

4.

ECB (2026), "ECB enhances repo facility for central banks", *press release*, 14 February.

5.

For more extensive evidence on the effects of Federal Reserve System liquidity lines, see Choi, M., Goldberg, L., Lerman, R. and Ravazzolo, F. (2021), "The Fed's Central Bank Swap Lines and FIMA Repo Facility", *Federal Reserve Bank of New York Staff Reports*, No 983; and Goldberg, L. and Ravazzolo, F. (2021), "The Fed's International Dollar Liquidity Facilities: New Evidence on Effects", *Federal Reserve Bank of New York Staff Reports*. Issue 4, July, pp. 1654–1693.

6.

There are also scenarios in which the credit status of a country can deteriorate quickly, which can create a discontinuity risk whereby a country that previously qualified for a credit line might no longer meet the criteria.

7.

Gräb, J. and Mehl, A. (2019), "The benefits and costs of the international role of the euro", The international role of the euro, ECB.

8.

Of course, any expansion in euro-denominated debt liabilities requires careful monitoring, especially if an accumulation of short-term euro denominated liabilities exacerbates maturity mis-matches, increasing vulnerability to dysfunctions in funding markets.

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