

TARGET2 balances – mirroring developments in financial markets

Origin

TARGET2, the Eurosystem’s high-value payment system, may run on a single shared platform (SSP), but legally speaking, it is made up of multiple component systems operated by the national central banks (NCBs) and the ECB. Thus, both the Bundesbank and the Banque de France will be involved in a cross-border payment transaction¹ made in settlement of a German export to France, for instance. That transaction begins when the French importer’s commercial bank in France debits the purchase amount from the importer’s account and submits a credit transfer in TARGET2 to the German exporter’s commercial bank in Germany. The Banque de France then debits the amount from the TARGET2 account it operates for the French commercial bank and posts a liability owed to the Bundesbank. For its part, the Bundesbank posts a claim on the Banque de France and credits the amount to the German commercial bank’s TARGET2 account. The transaction is concluded when the commercial bank

credits the amount in question to the account it operates for the German exporter.²

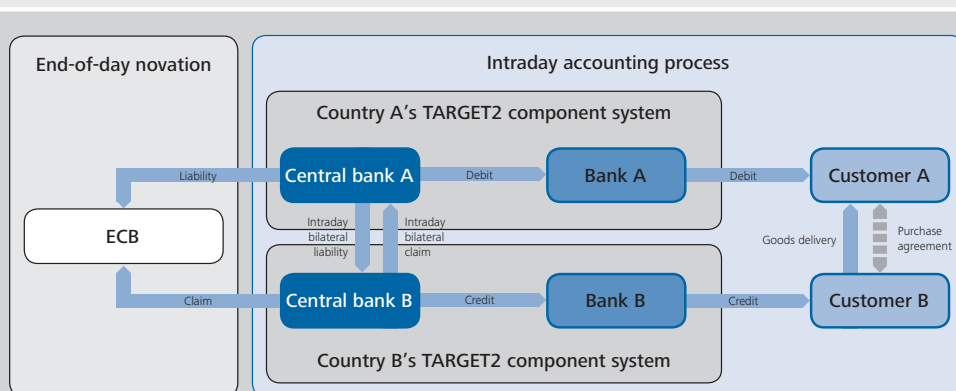
At the end of the business day, all the intraday bilateral liabilities and claims are automatically cleared as part of a multilateral netting procedure and transferred to the ECB via novation, leaving a single NCB liability to, or claim on, the ECB.³ Viewed in isolation, the transaction used as an example above leaves the Banque de France with a liability to the ECB and the Bundesbank with a claim on the ECB at the end of the business day. These claims on, or liabilities to, the ECB are generally referred to as TARGET2 balances.

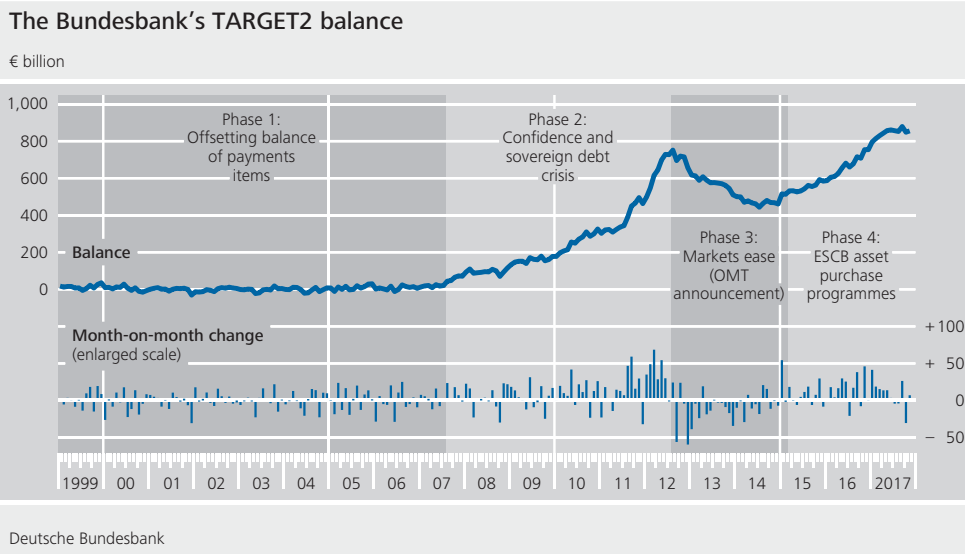
¹ Transactions are said to be cross-border transactions when the originators and beneficiaries are connected to TARGET2 via separate NCBs.

² In transactions confined to a national component system, the debit and credit entries on the TARGET2 accounts of the commercial banks involved in the transaction would net each other out. National and cross-border transactions generate the same accounting process in the commercial banks’ ledgers.

³ See Article 6 (2) of the Guideline of the European Central Bank of 5 December 2012 on a Trans-European Automated Real-time Gross settlement Express Transfer system (TARGET2) (recast) (ECB/2012/27).

Origin of TARGET2 balances





Evolution

Historically, the evolution of TARGET2 balances can be broken down into four phases. In phase one, monthly TARGET2 balances were highly volatile at a low level, frequently fluctuating between positive and negative figures. Germany's current account surpluses were matched by a similar volume of capital exports by private actors (eg interbank loans), balancing out the Bundesbank's TARGET2 transactions overall. The onset of the financial crisis in 2007 prompted a sharp rise in Germany's TARGET2 balance. While banks domiciled in Germany continued to attract substantial safe haven flows from abroad, the crisis of confidence reduced the volume of credit transfers to foreign institutions in crisis-hit countries to a trickle. The evolution of TARGET2 balances in phase two was a symptom of the crisis.⁴ Conditions in financial markets eased in mid-2012, not least after ECB President Mario Draghi pledged to do "whatever it takes" to preserve the euro and the Eurosystem announced its outright monetary transactions (OMT) programme. This initially sent TARGET2 balances broadly lower at the beginning of phase three, before they embarked, in phase four, upon a steady in-

crease when the expanded asset purchase programme (APP) was launched. This fresh upturn in TARGET2 balances starting in 2015 can largely be put down to the effects stemming from the technical settlement of the purchase programmes given that, for the most part, these programmes are currently giving rise to cross-border transactions in TARGET2. Since the APP is to be extended beyond 2017, TARGET2 balances are likely to continue rising, all other things being equal.⁵

⁴ These effects are outlined in detail in Deutsche Bundesbank, The dynamics of the Bundesbank's TARGET2 balance, Monthly Report, March 2011, pp 34-35.

⁵ The implications of the APP for TARGET2 balances are discussed in greater detail inter alia in Deutsche Bundesbank, The impact of Eurosystem securities purchases on the TARGET2 balances, Monthly Report, March 2016, pp 53-55; and in European Central Bank, TARGET balances and the asset purchase programme, Economic Bulletin, Issue 7/2016, pp 20-23.