Open letter to the European Central Bank's Governing Council

The ECB needs to revise minimum reserve requirements to address banks' windfall profits

Brussels, 24 January 2024

Dear members of the Governing Council,

Today, the deposit facility rate in the euro area is at its highest level since the inception of the euro in 1999. Simultaneously, commercial banks' reserves held with the national central banks and the European Central Bank (ECB) stand at €3.7 trillion as a legacy of unconventional monetary policy operations.[1] This combination has given rise to a situation in which euro area banks are earning substantial risk-free windfall profits exceeding €140 billion annually, merely by depositing funds with the Eurosystem.[2] These unconditional transfers from central banks to banks in the euro area compare with the EU total expenditure of €169 billion in 2023. In light of these circumstances, we urge you, Member of the Governing Council, to consider a revision of the minimum reserve requirements.

While banks revel in these extraordinary profits, it is crucial to recognize the inherent incompatibility of such transfers with the realities of the ongoing monetary policy tightening cycle for households and firms in Europe. It is disconcerting to note that bank stocks have grown at an annual rate of 18.8%[3] and that banks' net interest income (NII) has increased by 20%[4] on a yearly basis, while the rest of society continues to suffer from a major shock to their purchasing power.

The lack of conditions attached to the receipt of these windfall profits, and the lack of transparency regarding their distribution to bank customers, pose a direct threat to the effectiveness and public acceptance of the ECB's monetary policy. It is highly concerning that while banks have received 4% on their reserves with the Eurosystem, their customers receive a minimal remuneration on their savings, averaging 0.35% across the euro area.[5] As a result, ordinary households are not reaping the benefits of the high interest rates set by the ECB, while bearing the costs of higher interest payments on their loans and mortgages.

Notably, in 2012, the ECB reduced its minimum reserve requirement from 2% to 1%, establishing a precedent that underscores the adaptability of policies in response to monetary policy demands and macroeconomic conditions. In the current tightening cycle, the ECB has already taken a step towards curbing excess profits by introducing 0% remuneration on minimum reserves in July 2023. However, the minimum reserve

---

[1] As of November 2023.
[2] De Grauwe and Ji (2023), Fighting inflation more effectively without transferring central banks' profits to banks, CESifo, Working Paper, https://www.cesifo.org/en/publications/2023/working-paper/fighting-inflation-more-effectively-without-transferring-central.
[3] https://www.marketwatch.com/investing/index/sx7p?countrycode=xx
[4] EBA, https://www.eba.europa.eu/eueea-banks-benefits-rising-interest-rates-are-stabilising-eba-says.
[5] This refers to overnight deposits, which constitute two-thirds of deposits in the euro area.

remuneration, set at 0, only applies to 1% of reserves. This nominal imposition makes but a small dent in the extraordinary transfers that banks receive today.

Research has shown that the remuneration of bank reserves reduces the effectiveness of the transmission of monetary policies.[6] Thus, by reducing the size of the remuneration (through higher reserve requirements), the transmission process can in fact be made more effective. Higher unremunerated reserve requirements increase both fairness and efficiency.

A number of voices have been raised inside the Governing Council recently to address these glaring issues. The Governor of the Österreichische Nationalbank, Robert Holzmann, has called for an increase in the non-remunerated minimum reserves of commercial banks to 10%, while the President of the Deutsche Bundesbank, Joachim Nagel, has called for raising minimum reserve requirements.

Given the excess liquidity in the banking system and persistence of high interest rates, banks will continue to benefit from extraordinary transfers from the Eurosystem. These circumstances necessitate a prompt and deliberate increase in the banks' non-remunerated minimum reserves that is in line with current monetary policy aims, and that contributes to a more stable and equitable financial system in Europe.

Respectfully,

List of signatories

- Prof. Yuemei Ji, University College London
- Prof. Paul De Grauwe, London School of Economics
- Prof. Sebastian Diessner, Leiden University
- Prof. Andrea Roventini, Scuola Superiore Sant'Anna
- Philipp Heimberger, Vienna Institute for International Economic Studies
- Uuriintuya Batsaikhan, Positive Money Europe
- René Repasi, MEP
- Philippe Lamberts, MEP
- Olivier De Schutter, UN Special Rapporteur
- Bas Eickhout, MEP
- Henrike Hahn, MEP
- Paul Tang, MEP
- Evelyn Regner, MEP

[6] De Grauwe and Ji (2023), Fighting inflation more effectively; Fricke, D., Greppmair, S. & Paludkiewicz, K. (2023), Excess Reserves and Monetary Policy Tightening, Discussion Paper, Bundesbank, Frankfurt.