Box 3 Unpacking special liquidity measures in response to the COVID-19 pandemic

With the advent of the coronavirus disease 2019 (COVID-19) pandemic, the South African Reserve Bank (SARB) introduced special liquidity measures[1] to support the domestic money market. Uncertain market conditions late in the first quarter of 2020 resulted in private sector banks initially taking up as much liquidity as possible through the supplementary liquidity facilities which the SARB provided, in addition to that already available at the main weekly repurchase (repo) auction.[2] This resulted in an almost immediate doubling in March 2020 of total accommodation provided to private sector banks,[3] to well above the actual liquidity requirement.[4] Both these measures subsequently declined to below pre-COVID-19 levels as banks' participation in the repo auctions[5] decreased significantly to well below the amounts offered by the SARB.[6] The excess liquidity spilled over to the end-of-day utilisation of the standing facilities[7] before stabilising at a lower level, though still above pre-COVID-19 levels.

The purpose of this box is to discuss the evolution of the special liquidity measures taken by the SARB in reaction to the COVID-19 pandemic from the introduction of these measures in March 2020 to the discontinuation thereof a year later. The developments in total accommodation provided to banks, the actual daily liquidity requirement as well as the daily utilisation of standing facilities and related penalty rates[8] are also discussed.

Prior to March 2020, the actual daily liquidity requirement and total accommodation provided to banks both fluctuated at around R56 billion.[9] The gap between accommodation provided and liquidity required reflected the SARB's willingness to provide liquidity compared to banks' demand for liquidity. The SARB reduced the amounts offered at the weekly main repo auctions amid a reduction in money market liquidity required,[10] with the amount offered at the weekly main repo auctions[11] lowered to R45.0 billion soon after the announcement of the COVID-19-related national lockdown restrictions in March 2020 to assist with money market liquidity. Amid the uncertainty at the time, banks' demand for liquidity rose sharply to above the maximum allocation of R56.0 billion provisioned by the SARB in April 2020 before declining in the subsequent months.

During March 2020, the actual daily liquidity requirement of private sector banks averaged R57.1 billion, inclusive of a high of R75.5 billion on 28 March 2020, when banks made use of the implemented special liquidity measures which offered special weekly long-term repo financing with maturities of 91 days[12] and special daily supplementary repo auctions.[13] The total accommodation granted to banks in March 2020 averaged R64.9 billion, inclusive of a weekly high allocation of R101.1 billion, from R56.0 billion previously. The increase in accommodation to banks reflected R45.0 billion offered at the main weekly refinancing auctions, R20.0 billion offered through the special weekly long-term repo auctions, and R36.1 billion offered through the special daily supplementary repo auction on 31 March 2020.

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1 The special liquidity measures comprised special daily supplementary repurchase (repo) auctions and special weekly long-term repo auctions with a maturity of 91 days. Over and above the measures discussed in this box, the SARB also introduced other facilities, such as the purchasing of government securities in the secondary market, which added liquidity into the money market (refer to the 'Note on South Africa's liquidity measures in response to the COVID-19 pandemic' in the June 2020 edition of the *Quarterly Bulletin*).

2 Bids received at the main weekly repo auction are offers made by private sector banks to purchase rand liquidity from the SARB at the repo rate for seven days.

3 The total accommodation to banks is the aggregate liquidity provided by the SARB to banks through the weekly main refinancing auctions *plus* any other supplementary repo auctions, if applicable.

4 The actual liquidity requirement is commercial banks' required balances at the SARB to, among other things, enable the daily settlement of transactions between banks.

5 A repo auction is a short-term agreement to sell rand liquidity to banks against eligible collateral with the commitment to repurchase it after seven days at the repo rate.

6 The amount offered by the SARB is the maximum amount that the SARB is willing to make available for banks to bid for at its auctions.

7 The utilisation of standing facilities is the end-of-day clearing process where banks deposit surplus funds at the SARB at the repo rate *less* 100 basis points, or when the SARB provides overnight liquidity funding to banks at the repo rate *plus* 100 basis points. Funding is required when lending and borrowing in the interbank market is not efficient.

8 The penalty rate is imposed by the SARB to support and stimulate interbank funding and to discourage banks from hoarding cash. The upper band is activated when banks obtain funding from the SARB for the end-of-day square-off, whereas the lower band is activated when banks place surplus funds on deposit at the SARB.

9 Since the introduction of the refinancing, or repo, system in March 1998, it has been refined from time to time. A revision in 2013 provided for the level of the money market shortage, which assists with the transmission of repo rate changes to the lending and deposit rates of banks, to expand in line with the growth in notes and coin in circulation as well as the required cash reserve balances of private sector banks held at the central bank. In September 2016, the money market shortage reached R56.0 billion, and at the time it was decided to maintain the shortage at this level.

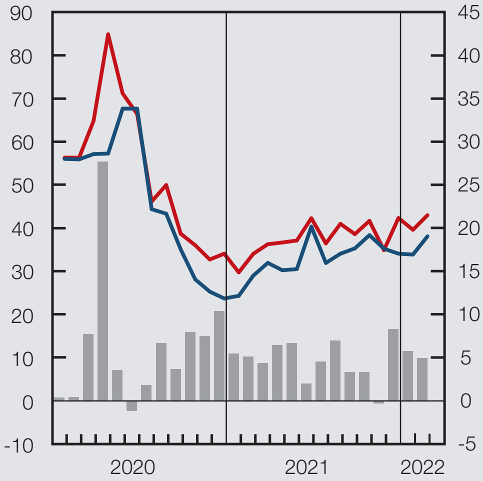
10 The liquidity requirement of banks is a consequence of the money market shortage created through the regulatory requirement specifying that banks need to hold 2.5% of their total liabilities on deposit at the SARB. Notes and coin in circulation, together with reverse repo transactions and the issuance of debentures, are some of the additional factors which influence the shortage. The SARB refinances the shortage by providing funding to banks at the repo rate.

11 The main weekly repo auctions, which take place on Wednesdays, offer seven-day financing.

12 Special weekly long-term refinancing auctions enabled banks to access liquidity from the SARB on Wednesdays for 91 days at the repo rate *plus* 30 basis points, with the intention to increase liquidity in the market.

13 Special daily supplementary repo auctions enabled banks to access liquidity on a daily overnight basis at the repo rate to meet daily liquidity requirements.

Accommodation provided to banks and the actual daily liquidity requirement*

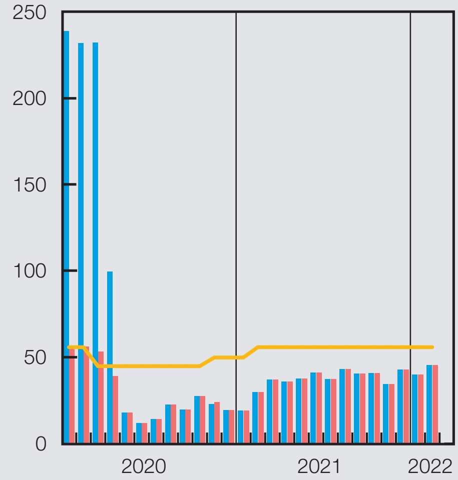


Total accommodation to banks
Actual daily liquidity requirement
Difference** (right-hand scale)

* Monthly average
** Total accommodation to banks *minus* actual daily liquidity requirement

Source: SARB

Main weekly repurchase auctions*



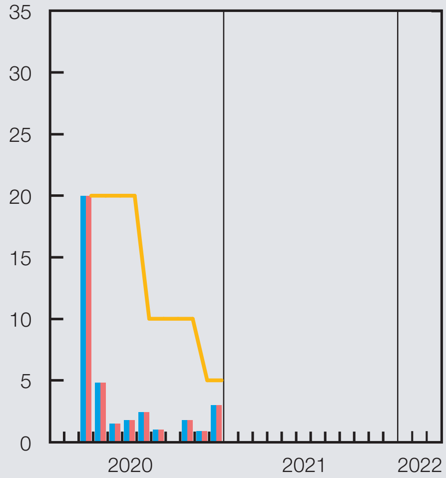
Amount on offer from the SARB**
Bids received from private banks
Amounts allotted by the SARB

* Monthly average

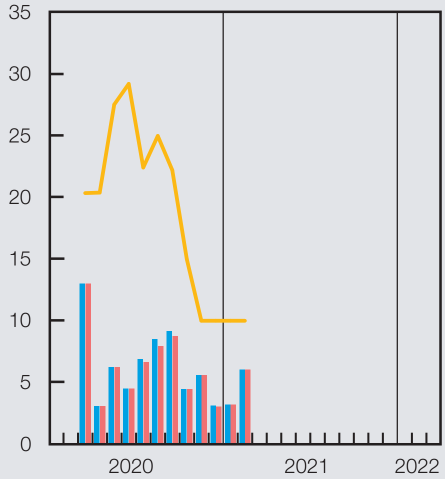
** The amount offered is synonymous with the SARB's preferred level of the money market shortage.

When introduced, the special weekly long-term refinancing auctions were initially fully allotted. However, private sector banks' participation in these auctions dwindled from a monthly average of R20.0 billion in March 2020 to only R875 million in November 2020 as banks' liquidity needs were much lower than initially anticipated. Hence, the SARB reduced the amount on offer from R20.0 billion in March 2020 to R5.0 billion in November 2020 before discontinuing the facility from January 2021, with the last instruments in issue having expired in February of that year.

Special weekly long-term repurchase auctions*



Special daily supplementary repurchase auctions*



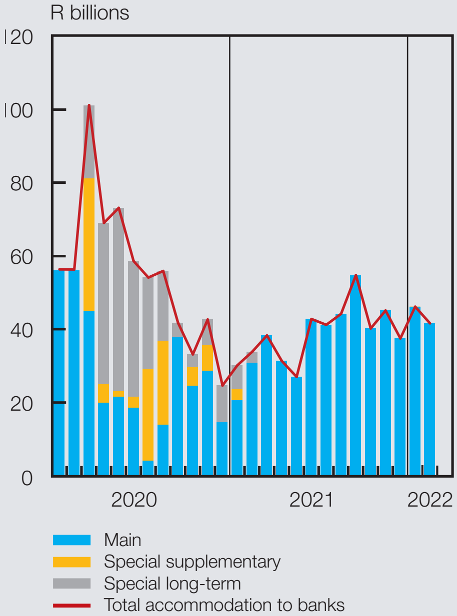
Amount on offer from the SARB
Bids received from private banks
Amounts allotted by the SARB

* Monthly average

Source: SARB

Similarly, the special daily supplementary refinancing auctions were mostly undersubscribed on a monthly average basis as private sector banks generally had more than adequate liquidity. Banks only sporadically required additional liquidity when they were short of funds to match the end-of-day square-off requirements within the national payment system.[14] The special daily supplementary refinancing auctions were discontinued from 3 February 2021 as the SARB preferred to return to normal operations amid reduced stress in the money market.

Contribution of the repurchase auctions to total accommodation*

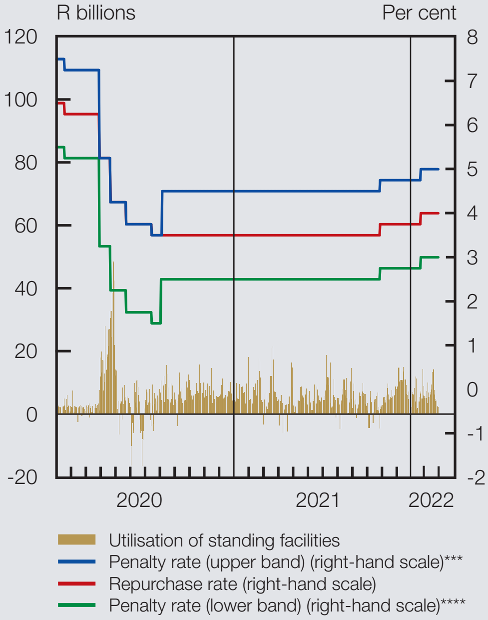


* At month-end

*** Upper band: from 2 January 2020 to 19 March 2020, repo rate *plus* 100 basis points; from 20 March to 19 August 2020, *equal to* repo rate; from 20 August, repo rate *plus*100 basis points

Source: SARB

Utilisation of standing facilities**



** Daily

**** Lower band: from 2 January 2020 to 19 March 2020, repo rate *less* 100 basis points; from 20 March 2020 to 17 August 2020, repo rate *less* 200 basis points; from 18 August 2020, repo rate *less* 100 basis points

The additional sources of liquidity in March 2020 almost doubled the total accommodation provided to private sector banks, to R101.1 billion from R56.0 billion in February 2020, as at month-end. Initially, the special daily supplementary repurchases added the most, whereafter the special long-term repurchases dominated, before the use of both these facilities dwindled, with the last instruments expiring in February 2021.

Banks' initial elevated liquidity positions, together with lower domestic economic activity and a moderation in credit extension, caused the money market to be in surplus for an extended period of time. With limited deposit options, some of the surplus cash was deposited in the standing facilities at the SARB. Hence, such deposits spiked during March 2020 before stabilising at a lower level as banks wanted to avoid the penalty rate. These end-of-day surplus cash balances contributed to the decline in banks' participation in the main and special supplementary auctions, while the maturing special liquidity measures contributed to the decline in total accommodation. At the start of the pandemic, banks escalated their uptake of liquidity to allow for unexpected occurrences. However, as the pandemic became less severe and economic activity recovered, the demand for liquidity stabilised and settled below its pre-COVID-19 level.

14 The South African Multiple Option Settlement (SAMOS) system is a real-time gross settlement (RTGS) system owned and operated by the SARB. The SAMOS system facilitates the settlement of domestic individual high-value payment transactions, retail transaction batches, and bond and equity market settlement obligations. It is an automated system that settles obligations in real time or in a delayed settlement arrangement. Each settlement participant has an account with the SARB from which interbank settlement obligations are settled. Participants must provide enough funds to ensure that the settlement system functions smoothly. If a bank has insufficient funds available in its settlement account, the SAMOS system will automatically grant a loan to the bank against acceptable collateral and settlement will then take place.