

THE EXECUTIVE BOARD

19 October 2008
CONFIDENTIAL

POSSIBLE SWAP AGREEMENT BETWEEN THE ECB AND THE DANMARKS NATIONALBANK

Following a request of Danmarks Nationalbank, the possibility of establishing a foreign exchange swap agreement has been explored by the ECB's and the Danmarks Nationalbank's market operations, risk management and legal departments.

A swap line with the ECB would provide Danmarks Nationalbank with the ability to distribute euro liquidity to its counterparties without having a negative impact on its reserves.

The following points may be noted as regards this possible swap agreement:

- This swap line would be similar, in its purposes, to the existing swap agreements in place between major European central banks and the Federal Reserve concerning the US dollar liquidity, or between the ECB and the Swiss National Bank concerning the Swiss franc liquidity.
- Danmarks Nationalbank has a similar agreement with the Federal Reserve for the purpose of redistributing US dollar liquidity to its counterparties. The size of the swap line is USD 15 billion.
- The swap with Danmarks Nationalbank would add itself to a number of swaps to which the ECB is currently a party.
- The swap line is not requested from the Danmarks Nationalbank to carry out interventions.
- Danmarks Nationalbank proposes that the maximum amount which could be drawn from the requested swap line would be EUR [REDACTED] billion. In exchange for the euro amounts it would receive under the swap agreement, Danmarks Nationalbank would provide a Danish krona amount to the ECB.
- Danmarks Nationalbank would like to make public that it has concluded with the ECB such a foreign exchange swap agreement. Making this swap agreement public may obviously invite other countries to ask for similar agreements from the ECB.

Furthermore, the following remarks may be made as regards the possible follow up:

- Denmark is a member of the ERM II. The ECOFIN has formally agreed that the Danish krona (DKK) participates in the ERM II with a narrower band of +/- 2.25%. The ECB is, as a signatory to this agreement, obliged to intervene at the margin of +/- 2.25% for the EUR/DKK. Short positions arising

from intervention sales (at the margin but also on some conditions and with limitations within the margins) can be financed through the use of the Very Short-Term Financing (VSTF) facility. Foreign exchange swaps should be considered a “fourth line of defence” for the central parity of a currency participating in ERM II on an ad hoc basis in very exceptional circumstances. Appropriate sound macroeconomic policies should always be the first line of defence, followed by the appropriate use of foreign reserve holdings and the VSTF facility as subsequent lines of defence (ERM II Manual of Procedures). The ceiling for the intramarginal use of the VSTF for Danmarks Nationalbank is 670 million. At the margins the VSTF is automatically available and unlimited in amount.

- Danmarks Nationalbank indicated that it would like the swap agreement, once agreed, to be actually signed, as it was done with other central banks, in contrast with the approach followed in cases when swap agreements were prepared in order to be ready in case of need but not signed in advance.
- If a decision was made to sign the swap agreement, it would be advisable, similarly to what was decided for other swap agreements, to also decide to delegate responsibility for implementation decisions to the Executive Board member to whom DG/M reports. This would include decisions to authorise draw downs under the swap agreement.
- In case the swap agreement was activated and some euro amounts were drawn by Danmarks Nationalbank, such amounts would be taken into account in the ECB’s liquidity management.
- The effect of the arrangement on the balance sheet of the ECB would be similar to that of other swap arrangements executed in the past. As long as the arrangement is not activated, there would be no impact for the ECB balance sheet and no requirement to record the arrangement as an off-balance sheet item. In the case of a drawing under the arrangement, however, the ECB’s foreign reserve holdings, as recorded in the balance sheet, would increase and the net claims within the Eurosystem would be impacted by the spot leg of the euro side of the transaction. The forward leg would be recorded off balance sheet.

The Governing Council is invited to:

- decide that the ECB will agree to establish the swap agreement requested by Danmarks Nationalbank only after this Bank will have had recourse to the VSTF;**
- decide whether the size of this agreement should be [REDACTED] billion euro;**
- delegate, in case of a positive decision, to the Executive Board the responsibility for the finalisation, signature and implementation of a corresponding swap agreement, with the possibility that the Executive Board may further delegate this competence among its members;**
- approve that Danmarks Nationalbank makes public the existence of an agreement with the ECB once this will have been agreed.**

