Market Review
2001-E-4

Money Market Operations in FY2000

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In FY2000, the Bank of Japan changed the level of its interest rate target on two occasions, and switched its operating target from the overnight call rate to the aggregate balance of current account deposits held at the Bank. Furthermore, facing a major change to the settlement system with the introduction of RTGS (real-time gross settlement) for current accounts at the Bank and JGSs, the Bank realized the importance for the Bank's market operations to be both timely and flexible as ever before. Against this background, the Bank sought to effectively implement the Guidelines for money market operations as determined at the Monetary Policy Meetings of the Policy Board, underpinned by a review of its operation tools and thorough monitoring.

Guidelines for money market operations in FY2000

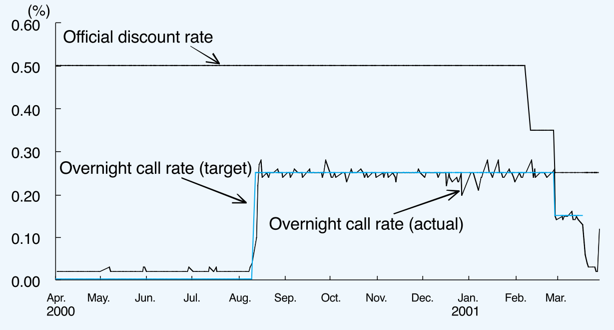
With respect to money market operations, the Bank of Japan implemented Guidelines for money market operations as adopted by the Policy Board in its Monetary Policy Meetings in FY2000. In light of such Guidelines, it is possible to identify four phases: (1) the so-called `zero interest rate policy´ period (until the middle of August 2000); (2) the period when the operating target was set at maintaining the uncollateralized overnight call rate at 0.25% (until the end of February 2001); (3) the period when the operating target was set at maintaining the uncollateralized overnight call rate at 0.15% (from the beginning to the middle of March 2001); and (4) the period when the operating target was set at maintaining the aggregate balance of current account deposits at ¥5 trillion (`current account targeting´, from the end of March 2001). In this paper, market operations in FY2000 are reviewed, focusing on the Sources of Changes in Current Account Balances at the Bank of Japan (hereafter Sources of Changes in CAB Statistics, detailing the supply and demand of funds in money markets), money market operations, and trends in current account balances and reserve balances (for details of the Bank's market operations, see the Financial Markets Department's Working Paper Series 00-E-3 *A Guide to Bank of Japan's Market Operations*).

Sources of Changes in CAB Statistics - FY2000 saw a significant shortfall in funds supply

Looking back at Sources of Changes in CAB Statistics[1] in FY2000, there was a significant shortfall of ¥34.3 trillion in the supply of funds, which ranked second after the ¥37.6 trillion shortfall reported in FY1999, when public tender for financing bills (FBs) was introduced.[2] A breakdown shows that the deficit in the "Treasury Funds and Others" category, most notably JGSs and FBs (i.e., the amount issued exceeding redemption), was the main factor behind this development.

Making comparisons with FY1999, it is notable that while the net issuance of FBs declined following the complete shift to public tender for FBs since April 2000, the funds surplus shrank in the "Net Fiscal Payments (net fund flow of treasury accounts other than that relating to the issuance/redemption of government securities)" category. This reflects an increase in the fund-raising activities of the government sector in financial markets including sales of JGBs with repurchase agreements by the Fiscal Loan Fund (formerly Trust Fund Bureau) and borrowings by the Local Allocation Tax Special Account, which have the effect of reducing net fiscal outlays.

[Exhibit 1] Trends in the major rates



Understanding the deficit in "Treasury Funds and Others" - the maintenance of higher cash balances by the government

In FY2000, there was a major funds shortage, caused largely by a deficit in the "Treasury Funds and Others" category. A surplus or shortage in this category arises from the difference between receipts and disbursements of funds between the government (more specifically government deposits held at the Bank of Japan) and the market (current account deposits of private financial institutions at the Bank). When the receipt of funds from the market by the treasury (tax revenue, issuance of JGSs and FBs, for example) exceeds disbursements to the market (payments for public works expenses and social security, and JGS and FB redemptions, for example), government deposit balances will rise temporarily whereas current account balances will decline, resulting in a shortfall of funds appearing under "Treasury Funds and Others." In fact, funds at the disposal of the government at the Bank (the sum of government deposits and sales of JGBs to the government under repurchase agreements) [3] have risen by more than ¥20 trillion over the past year.

The main factors behind this include: (1) in view of the large volume of postal saving term deposits maturing, the Fiscal Loan Fund maintained a large amount of funds to meet repayment obligations; and (2) the switch to public tender for FB issuance induced major changes in the management of the government's cash position.

[Exhibit 2] Sources of changes in current account balances at the Bank of Japan

(trillion yen, outstanding at end-month)

	FY1999	FY2000	Year-on-year change
Banknotes	-5.8	-1.6	+4.2
Treasury funds and others	-31.8	-32.7	-0.9
Net fiscal payments	36.3	16.2	-20.1
JGSs	-37.8	-45.5	-7.7
FBs	-36.7	-10.5	+26.2
Foreign exchange and others	6.4	7.1	+0.7
Funds surplus/shortfall	-37.6	-34.3	+3.3

In response to this shortfall, the amount of funds supplied by the Bank of Japan through its market operations increased by roughly ¥16 trillion in FY2000.

[Exhibit 3] Bank of Japan's dealings with the government

(trillion yen, outstanding at end-month)

	Mar.00	Jun.	Sep.	Dec.	Mar.01
Government deposits	13.0	6.4	8.9	9.4	22.1
Repo transactions between the Bank and the government	6.5	8.8	13.9	18.0	20.8
Total	19.6	15.2	22.8	27.4	42.9

Money market operations in FY2000

Outright purchases of JGBs-carried out at a pace corresponding to the increase in banknotes

Outright purchases of JGBs during FY2000 were, as previously, carried out based on the understanding that they should correspond to the increase in banknotes from a long-term perspective. This increase in long-term assets in line with the steady increase in the Bank of Japan's liabilities in the form of banknotes, enables the Bank of Japan to maintain the amount outstanding of short-term operations (operations other than the outright purchases of JGBs) at a level suitable for offsetting seasonal fluctuations in government deposits at the Bank and banknotes in circulation. (Please refer to Box 1 for details of Sources of Changes in CAB Statistics and amount outstanding of the outright purchases of JGBs and of short-term operations).

Based on this understanding, the amount to be purchased each month was set at roughly ¥400 billion (in terms of face value; twice a month, each amounting to ¥200 billion). As a result, in terms of actual amount of funds provided (instead of the face value of JGBs purchased), some ¥5.3 trillion worth of JGBs was purchased during FY2000.

Short-term operations - in response to the shortfall in funds, the amount outstanding of short-term operations rose sharply, reaching a record high level

The amount outstanding of short-term market operations (operations other than outright purchases of JGBs) rose throughout FY2000. In particular, there were significant increases from end of the year 2000 to the end of the fiscal year in March, when shortfalls are seasonally the greatest. In January 2001, the amount outstanding of short-term operations (net, i.e., amount of funds provided minus funds absorbed) exceeded ¥50 trillion for the first time, and continued to reach a peak of ¥58.2 trillion on March 29, 2001. This was a record high level, greatly exceeding the figure at the end of 1999 (¥46.5 trillion), when the Bank injected a large volume of funds into the current account balances to deal with the so-called `Y2K problem.´

As discussed earlier, as most of the demand due to the increase in banknote circulation is addressed by outright purchases of JGBs, the increase in the amount outstanding of short-term operations was mainly caused by growth in liabilities other than banknotes, most notably government deposits (for the background to increase in the amount outstanding of short-term operations during FY2000, please see Box 2).

Selection of market operation tools - borrowing of JGBs and purchases of bills rose sharply

The Bank of Japan employs a variety of market operation tools. All such tools are used in order to supply the necessary level of current account balances, and are not intended to directly influence interest rate developments in the markets where these operations are carried out (namely, the TB/FB, the repo, and the CP markets). When choosing an operation tool, care is taken, as much as possible, to avoid distortions to natural interest rate developments in the market in question, utilizing information obtained through market monitoring by Financial Markets Department.

In FY2000, the amount outstanding of short-term operations rose sharply, but, a breakdown by type of operation shows there were significant increases in the borrowing of JGBs against cash collateral (repo operations) and the outright purchases of bills. On the other hand, the amount outstanding of purchases of TBs/FBs under repurchase agreements and purchases of CPs under repurchase agreements remained more or less the same. Specific changes related to each operation tool were as follows.

Purchases of TBs/FBs under repurchase ageerments

Purchases of TBs/FBs under repurchase agreements rose sharply during FY1999, reflecting the rapid expansion of the TB/FB market accompanying the switch to public tender for FB issuance. In FY2000, the amount outstanding remained stable at around ¥25-30 trillion. In general, where the central bank's presence in a market becomes substantial, it is highly likely that rate development in that market will be distorted. Experience shows that, in the ¥70-80 trillion (by amount outstanding) TB/FB market, up to ¥25-30 trillion in operations outstanding can generally be accommodated without distorting the market. TBs and FBs are government securities, offering reliability and high liquidity, making them attractive instruments for market operations. However, these attributes mean there is high demand for these instruments in the market, which should be taken into account when undertaking market operations.

Borrowing of JGBs against cash collateral (JGB repos)

After rising sharply around the end of the year (from ¥8.1 trillion at the end of September, to ¥18.4 trillion at the end of December), when the shortfall in funds is seasonally large, JGB repos remained at a high level of just under ¥20 trillion, making this the next most effective method to supply funds to the market after purchases of TBs/FBs under repurchase agreements. A wide range of institutions are involved in the repo market, including banks, securities dealers, and institutional investors. As a result, market participants' motives for trading (a means of raising collateralized funds, or financing cash bond positions, for example) and trading period preferences vary widely. This enables the Bank to channel funds into the market through market operations, even within a changing market environment.

Box 1: Relationship between Sources of Changes in CAB Statistics and operation amounts outstanding from a balance-sheet perspective

The balance-sheet approach

\`Sources of Changes in CAB Statistics´ is issued by the Bank on a daily and monthly basis (so-called supply and demand of funds in money markets). It explains, from the standpoint of the flow of funds (the amount of change on a daily or monthly basis), the impact of a funds shortfall or surplus (resulting from banknote factors and treasury funds and others factors) and also that of market operations on current account balances at the Bank of Japan. This relationship can be expressed by the following equation;

Funds shortfall/surplus (banknote factors and treasury funds and others factors) + Market operations (funds supply/absorption) = Rise/fall in current account balances

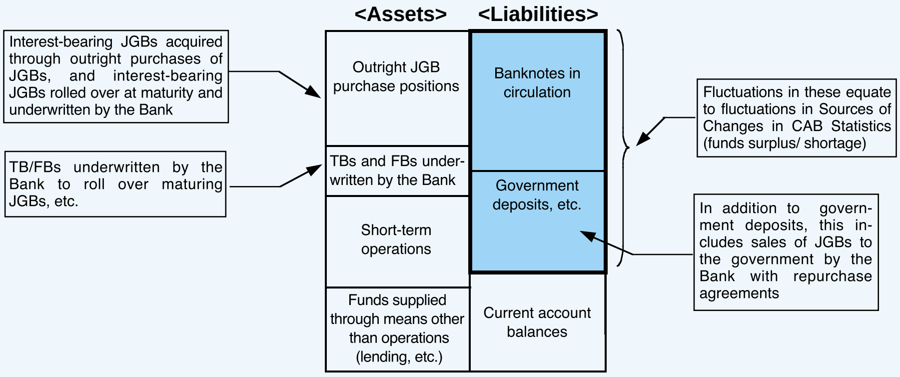
This approach, which is based on \`flows´, is appropriate for understanding market operations over a relatively short period of time, namely daily or monthly. However, in order to understand structural changes, such as trends in the amount outstanding of operations over a somewhat longer period of time, a \`stock´ approach, based on the Bank of Japan's balance sheet, is more useful.

Structure of the Bank of Japan's balance sheet

Setting aside technical details, the Bank's balance sheet comprises: on the liabilities side, (1) banknotes in circulation, (2) government deposits (deposits held at the Bank by the government), and (3) current account balances (accounts held at the Bank by private financial institutions); and, on the assets side, (1) outright JGB purchase positions,[1] (2) TBs and FBs underwritten by the Bank,[2] (3) short-term operations,[3] and (4) funds supplied through means other than market operations (lending, etc.)[4] (see chart below[5]). Among these, changes captured by Sources of Changes in CAB Statistics (funds shortfall/surplus) correspond to changes in banknotes in circulation and government deposits etc. (both of which are included under liabilities). Through its market operations, the Bank is able to respond to rises or falls in liabilities by raising or lowering its financial assets through short-term operations or outright JGB purchases, thereby supplying appropriate levels of current account balances (= making its assets and liabilities balance).

The size of the Bank's balance sheet is largely determined by the size of its liabilities in the form of banknotes and government deposits, etc. Of course, the Bank can increase the levels of current account balances through market operations, and thereby expand its balance sheet by that amount. Nevertheless, current account balances (¥5.8 trillion <end-March 2001>) are clearly much smaller than banknotes in circulation (¥58.7 trillion <end-March 2001>) and government deposits, etc. (¥42.9 trillion <end-March 2001>). Furthermore, while from a longer term perspective, demand for banknotes and government deposits, etc., is influenced by the level of interest rates, in the short term these cannot be controlled directly by the Bank, and in its daily market operations the Bank conducts operations assuming that these factors are given.

In addition, this illustrates that the level of the amount outstanding of short-term operations is determined by the difference between the size of liabilities in the form of banknotes and government deposits, etc., and the size of assets in the form of the Bank's outright JGB purchase positions and TBs and FBs underwritten by the Bank.



Notes

1. This refers to interest-bearing JGBs acquired through JGB purchase operations and interest-bearing JGBs rolled over at maturity and underwritten by the Bank (amount outstanding of sales of JGBs to the government under repurchase agreements is added back).
2. This refers to FBs underwritten by the Bank and TBs issued to roll over maturing JGBs and underwritten by the Bank. Following the switch to public tender for FB issuance, the underwriting of FBs by the Bank is permitted in limited and exceptional circumstances, such as to provide temporary financing for the government (for example, temporary financing for foreign exchange intervention), and to provide yen-denominated investment facilities for foreign central banks.
3. This refers to the net amount outstanding of short-term operations, deducting the amount outstanding of short-term fund absorption operations from the amount outstanding of short-term fund provision operations. Sales of bills generate liabilities for the Bank, but in order to understand the relationship between Sources of Changes in CAB Statistics and operation amounts outstanding, for example, it is easier to think of the net amount outstanding of short-term operations as an asset.
4. Aside from lending under Article 33 of the Bank of Japan Law (bill discounting and secured lending as ordinary business), and lending under Article 38 of the same law (so-called special lending), this includes lending to the Deposit Insurance Corporation under the Deposit Insurance Law. For convenience, the rise or fall in lending to the Deposit Insurance Corporation is reported in Sources of Changes in CAB Statistics as a "Treasury funds and others factor."
5. The calculation of these individual factors is given in detail in the *Monetary Base and the Bank of Japan's Transactions* published on the 6th business day of each month.

[Exhibit 4] Amount outstanding of short-term operations

(trillion yen, outstanding at end-month)

	Mar.00	Jun.	Sep.	Dec.	Mar.01	29th Mar.
Provision of short-term funds	43.6	33.1	36.7	50.7	57.7	61.0
Purchases of TBs/FBs under repurchase agreements	28.9	24.3	25.5	24.8	26.9	27.5
Borrowing of JGBs against cash collateral	7.9	6.2	8.1	18.4	18.5	19.0
Outright purchases of bills	1.5	0.0	1.7	4.0	9.8	11.9
Outright purchases of bills (backed by corporate debt, etc.)	0.5	0.5	0.1	0.0	-	-
Purchases of CPs under repurchase agreements	3.9	1.9	1.2	3.6	1.6	1.6
Outright purchases of TBs/FBs	0.8	0.2	0.0	0.0	0.9	0.9
Absorption of short-term funds	-5.9	-5.7	-2.2	-3.2	-4.4	-2.8
Outright sales of bills drawn by the Bank of Japan	-3.8	-5.1	-2.2	-2.8	-4.4	-2.8
Sales of TBs/FBs under repurchase agreements	-2.1	-0.6	0.0	-0.4	0.0	0.0
Net amount outstanding of short-term operations	37.7	27.5	34.4	47.5	53.3	58.2

Outright purchases of bills

As the procedures for the outright purchases of bills were improved ahead of the shift to RTGS (real-time gross settlement) for current accounts at the Bank of Japan and also JGS settlement, the capacity to supply funds has risen sharply. To be more precise, the Bank (1) introduced the direct purchase of bills, in place of purchases through *Tanshi* companies (money market brokers) (July 2000), (2) facilitated more efficient use of collateral by introducing `pooled collateral´[4] which can also, for example, be used for daylight overdrafts (January 2001), and (3) expanded the scope of collateral by integrating former bill purchasing operations utilizing corporate bonds, with new outright purchases of bills (January 2001).

The amount outstanding of outright purchases of bills increased gradually following the introduction of direct purchases in July 2000, and has remained at around the ¥10 trillion level since the beginning of this year. This method now ranks 3rd behind purchases of TBs/FBs under repurchase agreements and borrowing of JGBs against cash collateral as a major means of supplying funds.

Purchases of CPs under repurchase agreements

Although the outstanding balance of purchases of CPs under repurchase agreements temporarily climbed to nearly ¥10 trillion at the end of 1999, during FY2000 it remained at around the ¥1-2 trillion level on the whole, with the exception of the end of the year when it reached ¥3.6 trillion. The main reason behind this was that as it became possible to inject more funds through both JGB repos and purchases of bills, the need to make use of CP operations declined. In addition, the amount of funds that can be supplied through CP operations is greatly influenced by the stance of the CP issuers and underwriters. In the case of last fiscal year, it was considered difficult to supply a large amount of funds through CP operations in view of the generally small amount of CP submitted to the Bank for evaluation of collateral eligibility.

Outright purchases of TBs/FBs

After a pause from May 2000, the outright purchases of TBs/FBs were re-introduced following the Monetary Policy Meeting held on February 9, 2001 when "the active utilization of outright purchases of TBs/FBs" were included under "improvements in the way of liquidity provision." Whereas in the past this operation generally involved purchasing issues with less than three months remaining until maturity, following its re-introduction, issues with more than four months remaining until maturity, including newly-issued TBs (6 months and one year), were purchased in comparison with other operations, this was utilized as a means of supplying somewhat longer term funds. Following its re-introduction in February 2001, this operation was carried out four times, with ¥900 billion in total being purchased.

Trends in current account balances and reserves[5]

Trends in current account balances and reserves are greatly influenced by the Bank's market operations under Guidelines for money market operations. In addition, in FY2000, the introduction of RTGS (real-time gross settlement) somewhat influenced the patterns of holding current account balances by financial institutions. Below we look at trends in current account balances and their component parts, excess reserves, and current account balances held by institutions not subject to reserve requirements (hereafter referred to as `exempted institutions´), in four phases; (1) the zero interest rate policy phase (until mid-August 2000); (2) from the lifting of the zero interest rate policy until the switch to RTGS (until the end of December); (3) from the introduction of RTGS until the switch to current account targeting (from the beginning of January 2001 until the middle of March); and (4) following the switch to current account targeting (from late March onwards).

The zero interest rate policy phase - a large volume of excess reserves and current account balances held by exempted institutions

Under the zero interest rate policy, in order to maintain the uncollateralized call rate (the overnight call rate) close to zero, the supply of funds to current accounts greatly exceeded the required reserves (around ¥4 trillion).

As a result of this abundant supply of funds, there were significant amounts of excess reserves and current account balances held by exempted institutions. Since city banks, which account for a large share of outstanding reserve balances, adhered to their practice of not holding excess reserves wherever possible, the bulk of excess reserves were held by foreign banks, whose required reserves were low in comparison with the working balance necessary for settlement. Much of the funds supplied to the market in excess of required reserves was also held by exempted institutions, most notably *Tanshi* companies.

From the lifting of the zero interest rate policy until the switch to RTGS - both excess reserves and current account balances held by exempted institutions more or less disappeared

Following the lifting of the zero interest rate policy, funds necessary to maintain the overnight call rate at around its new target (0.25%) were supplied. As a result, the average current account balances during this period was around ¥4 trillion, more or less in line with the amount of required reserves, and excess reserves and current account balances held by exempted institutions remained low, at around ¥100 billion in total.

[Exhibit 5] Current account balances and reserves

(hundred million yen)

	Current account balances (a) = (b) + (c)	Reserves (b)	Excess reserves	Current account balances of exempted institutions (c)
2000 Apr.	52,620	44,671	4,931	7,965
May.	50,883	43,164	3,469	7,721
Jun.	51,626	43,151	3,754	8,474
Jul.	52,428	41,977	2,668	10,463
Aug.	40,351	39,048	680	1,303
Sep.	39,671	38,875	925	796
Oct.	38,938	38,438	474	517
Nov.	39,258	38,658	420	598
Dec.	49,402	42,397	2,993	7,041
2001 Jan.	44,004	40,013	609	4,008
Feb.	42,376	39,608	550	2,800
Mar.	49,832	44,866	3,748	6,558

Following the introduction of RTGS – precautionary demand for current account balances to settle funds and securities positions emerged, mainly from securities dealers

Following the introduction of RTGS, a trend emerged among exempted institutions, mainly securities dealers, to hold a certain level of current account balances for the purpose of settling funds, in order to secure smooth fund and securities settlement under the new settlement regime. This precautionary demand for current account balances was particularly prominent on days when settlement was concentrated, for example days on which JGBs were issued, but it gradually declined as participants became more familiar with the RTGS system, settling at around the ¥200-300 billion level in February.

On the other hand, there were no major changes in the current account holding stance of institutions subject to reserve requirement, including banks, and excess reserves remained at a very low level. This is believed to reflect the fact that the need to hold current account balances in excess of the reserve requirement (= excess reserves) for the purpose of fund settlement did not emerge as (1) under the existing reserve requirement ratios, the amount of legally required reserves usually exceeded the balance deemed necessary for fund settlement and (2) regarding the demand for daylight liquidity, sufficient collateral had been pledged in the Bank of Japan in advance so that daylight overdrafts granted could cover potential deficits in current accounts at the Bank.

As for market operations during this period, the Bank injected an adequate amount of funds to achieve its target overnight call rate (0.25% <until the end of February> or 0.15% <from the beginning of March >), taking into account information concerning

Box 2: Factors behind the rise in the amount outstanding of short-term operations in FY2000 observed from changes in main balance sheet items

The amount outstanding (net) of short-term operations rose by ¥15.6 trillion during FY2000 (from ¥37.7 trillion at the end of March 2000 to ¥53.3 trillion at the end of March 2001). The amount outstanding of short-term operations as of the end of March 2000 increased significantly through the implementation of market operations to increase current account balances (¥18.3 trillion) in response to fears of computer malfunction as a result of the `Y2K problem.´ If, for argument's sake, current account balances at the end of March 2000 had been at the same level as they were at the end of March 2001 (¥5.8 trillion), then the amount outstanding of short-term operations would have stayed at around ¥25.2 trillion. That being the case, the increase in the amount outstanding of short-term operations during FY2000 would have amounted to ¥28.1 trillion.

Looking at the background factors, the bulk of the increase in the amount outstanding of short-term operations during FY2000 was attributable to a sharp rise in government deposits, etc. (the total of government deposits plus sales of JGBs to the government by the Bank with repurchase agreements), which increased by ¥23.3 trillion (from ¥19.6 billion at the end of March 2000 to ¥42.9 billion at the end of March 2001).

End of March 2000

(trillion yen)

Outright purchases of JGBs	43.3	Banknotes	57.1
TBs/FBs underwritten by the Bank	11.1	Government deposits, etc.	19.6
Short-term operations (net)	37.7 (25.2)*	Current account balances	18.3 (5.8)*
Lending, etc. 1.7	1.7		
Total assets (including others)	101.4	Total liabilities (including others)	101.4

End of March 2001

(trillion yen)

Outright purchases of JGBs	46.2	Banknotes	58.7
TBs/FBs underwritten by the Bank	4.6	Government deposits, etc.	42.9
Short-term operations (net)	53.3	Current account balances	5.8
Lending, etc.	1.5		
Total assets (including others)	113.2	Total liabilities (including others)	113.2

Notes:

1. Figures in ( ) denote the amount outstanding of short-term operations assuming that current account balances had been ¥5.8 trillion.
2. In order to make it easier to understand the relationship between short-term operations and rises/falls in items included under liabilities, we have based our calculations on a different method from that used for the formal balance sheet of the Bank of Japan. For this reason, total assets and liabilities shown above differ somewhat from those in the Bank's balance sheets for FY1999 and FY2000.

precautionary demand for current account balances among exempted institutions acquired through careful monitoring.

Following the switch to current account targeting - excess reserves and current account balances held by exempted institutions have risen sharply again

After the target for monetary operations was set at "current account balances of around ¥5 trillion," at the Monetary Policy Meeting held on March 19, 2001, market operations were conducted in accordance with this Guideline. As the reserve requirement remained at around the ¥4 trillion level, the measure resulted in approximately ¥1 trillion in excess reserves and current account balances held by exempted institutions. Against this background, whilst there are some similarities with the zero-interest rate policy period leading up to August 2000, the main differences are (1) current account balances held by *Tanshi* companies are declining compared with the zero-interest rate period, and (2) the holding of excess reserves is spreading from foreign banks to regional banks.

Market operations topic - introduction of a "Complementary Lending Facility "

At the Monetary Policy Meeting held on February 9, the Policy Board decided to introduce a `Lombard-type´ lending facility, and at a subsequent meeting held on February 28, it laid down the outline of a "Complementary Lending Facility" (standby lending facility). This facility was launched on March 16, 2001.

With the Complementary Lending Facility, the Bank of Japan extends loans at the request of counterparties based on conditions pre-specified by the Bank. This system is similar to the European Central Bank's "Marginal Lending Facility." Under the former framework for market operations, the supply of liquidity to the financial markets had been carried out entirely through market operations offered by the Bank of Japan, but under this system, there were concerns that when an unexpected need for funds arose in the financial markets, the Bank would not always be able to respond in a flexible and timely manner. In addition, it was believed that even when sufficient funds were supplied through market operations from a macro standpoint, while some financial institutions held a large amount of funds, others might not be able to secure sufficient funds, causing distortions in the development of interest rates. By dealing with this problem, the Complementary Lending Facility contributes to stable development of market interest rates.

As the Complementary Lending Facility is, in principle, effected at the official discount rate (currently 0.25%), the official discount rate marks the upper limit of fluctuations in the overnight call rate, and thus performs a new function of maintaining stability in short-term market interest rates.

In fact, on March 30, the final business day of FY 2000, reflecting an increase in demand for funds for settlement purposes, the uncollateralized overnight call rate showed signs of strengthening towards the afternoon. Nevertheless, as market participants became acutely aware of the existence of the Complementary Lending Facility, the increase in the rate stopped at around 0.25%, giving a weighted average of 0.12% (on that day, complementary lending totalled ¥200 billion).

Future issues

In FY2001, under the new market operation procedures where current account balances have been made the main operating target, the most important issue is to maintain a stable supply of funds, taking into account the needs of market participants and market characteristics. Furthermore, reform of the Fiscal Investment and Loan Program and the postal savings systems will result in a flow of treasury funds completely different from past patterns, necessitating the accurate understanding and forecasting of the flow of funds and conduct of appropriate market operations. Moreover, with the amount outstanding of market operations expected to remain at record high levels, the Bank aims to continue its efforts to improve the functioning of its market operations.

Notes

1. Sources of Changes in CAB Statistics elucidates factors other than the Bank of Japan's market operations that influence the balances of current account deposits held at the Bank by financial institutions. To be more precise, these are divided into "Banknotes" (issuance and withdrawal of banknotes in circulation), and "Treasury Funds and Others" (receipt and payment of treasury funds, for example).

2. In the past, the Bank of Japan had underwritten almost all FBs issued.

3. The receipt and payment of funds between the government and private financial institutions is carried out through deposit accounts at the Bank by the government. The government's deposits comprise its current account, which is non-interest bearing, and its domestic designated deposit, which earns interest under a certain rule.

4. In the past, for outright purchases of bills, each bill was tied to specific collateral. Under the current framework, however, counterparties do not need to specify which assets are the collateral for a particular bill purchased by the Bank of Japan, and, as long as the total amount of collateral exceeds the total amount of bills sold, the substitution of collateral can take place at any time. In addition, under the new framework, collateral for outright purchases of bills can also be used as collateral to cover exposure stemming from treasury agency business and from daylight overdrafts through the "Credit and Collateral Management System," resulting in the more efficient use of collateral.

5. Financial institutions hold current account deposits at the Bank of Japan. Of these deposits, those held by financial institutions subject to reserve requirements (banks, long-term credit banks, shinkin banks with outstanding deposits exceeding a certain level, and Norinchukin Bank) in accordance with the "Law Concerning the Reserve Deposit Requirement System", are called reserve deposits. Of reserve deposits, amounts in excess of the legally required levels are excess reserves. Financial institutions that hold current accounts at the Bank and are not subject to the reserve requirement system include securities dealers, securities finance companies, *Tanshi* companies, and some government-affiliated financial institutions.

"The Bank of Japan's outstanding JGB holdings by issue" is now available

At a meeting held by the Bank of Japan's Financial Markets Department to exchange views with financial institutions involved in its market operations, the importance of preparing information related to market liquidity by individual issue in the JGB market was highlighted. Based on these discussions, the Bank decided to publish monthly figures for its outstanding JGB holdings by issue from June this year, aimed at contributing to improved market liquidity. The figures are available under "Reports and Statistics" on the Bank of Japan's home page (http://www.boj.or.jp/siryo/siryo_f.htm).

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Comments and questions as well as requests for hard copies should be addressed to Tokiko Shimizu, Manager, Financial Markets Department (tokiko.shimizu@boj.or.jp). *Market Review E-series and Financial Markets Department Working Papers E-series* can be obtained through the Bank of Japan's Web site (http://www.boj.or.jp/).