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Money Market Operations in FY2002

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Market Review

In FY2002, the Bank of Japan (hereafter, the Bank) continued to provide ample liquidity under the high target level for current account balances held at the Bank. In the short-term money markets, the uncollateralized O/N call rate remained close to 0%, and for financial institutions, the opportunity cost of holding current account deposits at the Bank was negligible. As a result, demand for current account deposits at the Bank fluctuated widely, and a decrease in demand gave rise to under-bidding for fund providing operations, while an increase prompted greater needs for such operations. The Bank, bearing in mind these wide fluctuations in demand for current account deposits, sought to effectively implement the guidelines for money market operations and maintain stability in the money markets through the enhancement of operational tools and attentive market monitoring.

1. Sources of Changes in Current Account Balances at the Bank (hereafter, Sources of Changes in CABs)

Private financial institutions hold current account deposits at the Bank. The aggregate balance of these current accounts deposits fluctuates in accordance with changes in the issuance of banknotes and the supply of treasury funds, and money market operations. Here, we refer to changes in banknotes and treasury funds and others as "sources of changes in CABs" (Exhibit 1).

Since March 2001, the Policy Board of the Bank has used the current account balances at the Bank as the main target for its money market operations. Money market operations are undertaken on a daily basis in order to achieve the target level of current account balances, taking into account fluctuations in the sources of changes in CABs.

Chart 1: Sources of Changes in CABs

Banknotes	Net issuance (Where the value of banknotes issued by the Bank to private financial institutions is greater than the value of banknotes redeemed)	Net redemption (Where the value of banknotes issued by the Bank to private financial institutions is less than the value of banknotes redeemed)
Treasury funds and others	Net receipts (Where payments made by the Government and others to private financial institutions are less than the value of receipts)	Net payments (Where payments made by the Government and others to private financial institutions are greater than the value of receipts)
	⇩	⇩
Effect on current account balances at the Bank	CAB declines	CAB increases

Looking at the sources of changes in CABs in FY2002, there was a small overall net shortage of Y3.5 trillion (Exhibit 2).

A Y3.2 trillion net issuance of banknotes exerted downward pressure on current account balances. However, the scale of the issuance was smaller than in FY2001 (Y9.2 trillion). This was partly a reaction to the sharp rise in demand for cash accompanying the lifting of the blanket guarantee for time deposits at the end of FY2001 (April 2002). On the other hand, treasury funds changed little during FY 2002.

Chart 2: Sources of changes in CABs (adjusted for outright purchases of TB/FB operations, note 1)

(trillion yen)

	FY2001	FY2002
Banknotes	▲9.2	▲3.2
Treasury funds and others	+3.9	▲0.3
Net fiscal payments	+55.5	+52.1
JGBs	▲55.4	▲60.9
FBs	+0.8	▲0.1
Foreign exchanges and others	+2.9	+8.6
Sources of changes in CABs	▲5.3	▲3.5

Notes Banknotes : ▲shows Net issuance.
Treasury funds and others : ▲ shows Net receipts, while + shows Net payments.
Sources of changes in CABs : ▲ shows Net shortage.

2. Money Market Operations in FY2002

With the sources of changes in CABs showing just a small net shortage in FY2002, the Bank's money market operations primarily focused on supplying sufficient funds to meet its high current account balances target, bearing in mind the fluctuations in demand for current account deposits.

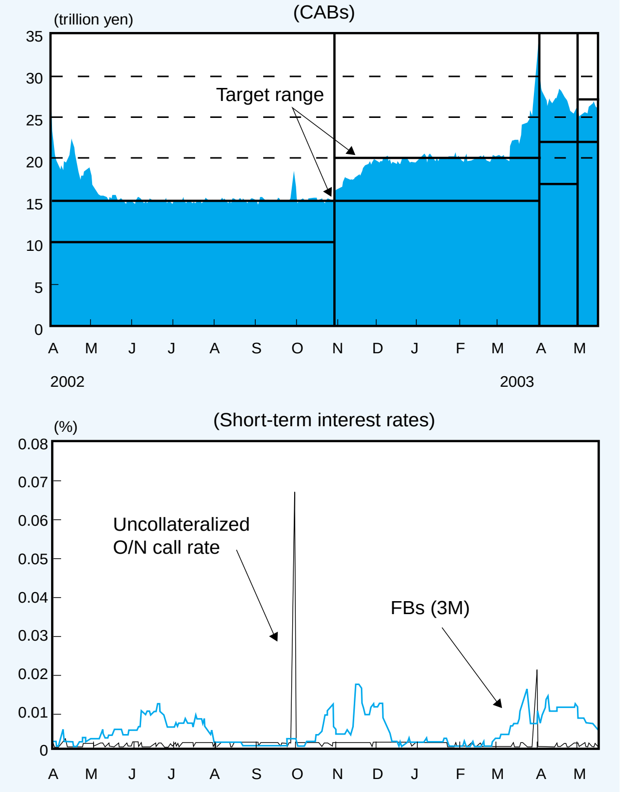
Below we will look at changes in demand for current account deposits during FY2002, and the Bank's response in the form of money market operations (Exhibit 3; for a breakdown by operational tool, see section 4 of this report).

(1) Continuing high demand for current account deposits in April

From 19 December 2001, the target for current account balances was set at around Y10~15 trillion. However, in March 2002, the Bank provided a large volume of funds, under the contingency clause (note 2) in the guidelines for money market operations in order to meet the growth in demand for current account deposits in connection with the end of the fiscal year. As a result, the current account balances increased to Y27.6 trillion at the end of March.

Moving into April, as demand for current account deposits at the Bank dropped with the end of the fiscal year, the Bank carefully absorbed funds and current account

Chart 3: CABs and short-term interest rates



balances temporarily fell to the Y18~19 trillion level. However, reflecting the malfunctions of computer system encountered by a bank at the beginning of April, there was increasing tendency to hold large current account deposits at the Bank. As a result, in order to maintain stability in the money markets, the Bank conducted operations to keep current account balances above Y15 trillion.

Following the May Golden Week holidays, market concerns over the effects of the malfunctions of computer system at a bank receded, and demand for current account deposits declined. Thus market operations were adjusted to reduce current account balances to around the Y15 trillion mark, and subsequently to maintain this level.

(2) Abundance of funds, and decrease in demand for current account deposits at the Bank (August to mid-September).

In summer, without any special factors to push up demand for current account deposits, there was a growing sense of an abundance of funds in the short-term money markets. As a result, from August, for fund providing operations, situations where the aggregate bids fall short of the offered amount occurred.

Against this background, the Bank endeavoured to keep current account balances at around the Y15 trillion level by making active use of outright purchases of TBs/FBs and bills (through all Bank offices) to provide longer term funds.

(3) Increase in demand for current account deposits at the end of September

At the end of the first half of the fiscal year, the previous strong atmosphere over funds abundance reversed. Demand for current account deposits sharply increased, and the weighted average of the uncollateralized O/N call rate rose to 0.067%. This was attributable to fund needs related to the concentration of settlement at the end of the first half of the fiscal year, and also market participants' needs under capital adequacy requirements. Under current rules, while uncollateralized O/N call investments carry a risk weighting of 20%, the risk weighting for current account deposits held at the Bank is 0%. As a result, in order to control their risk weighted asset amounts under the capital adequacy requirements, market participants with a excess funds held back from the market on that day, keeping their funds at current account deposits at the Bank.

Under these market conditions, based on the contingency clause in the guidelines for money market operations, the Bank carried out operations designed to boost current account balances on that day. As a result of these operations, current account balances at the Bank grew to Y18.5 trillion.

(4) Drop in stock prices of major banks and increase in demand for current account deposits at the Bank

(From mid-October to the end of October)

Moving into October, uncertainty over the outlook for the financial system grew and a sharp fall in stock prices, centred on the leading banks occurred. Market participants became more risk averse in the money markets. Market participants with a fund shortage took steps to procure funds, while those with fund surpluses held back from investments in the money markets, choosing instead to hold their funds at the Bank. On the interest rate front, while the uncollateralized O/N call rate remained stable at 0.001~0.002%, future date settlement transactions rate and the rate of term transactions such as repo and TB/FB transactions rose slightly.

In response to this situation, the Bank stepped up its fund providing operations so as to enhance stability in the financial markets. At the same time, the Bank also conducted fund absorption operations to maintain current account balances at around the Y15 trillion level.

(From the end of October to the end of the year)

At the 30 October Monetary Policy Meeting of the Policy Board (hereafter, MPM), based on the aforementioned situation in the money markets and economic and financial considerations, it was decided that, in order to maintain the smooth functioning and stability of financial markets, the target range for current account balances should be raised to "around Y15~20 trillion".

Initially the Bank's operations were focused on maintaining current account balances in the middle of this target range. As a result, the TB/FB rate and the repo rate, which rose somewhat towards the end of October, temporarily settled down.

However, in mid-November, the stock prices of leading banks tumbled again, and in the money markets, the repo rate and TB/FB rate increased. Against this background, at the MPM held on 18 and 19 November, it was decided that current account balances should be brought as close as possible to the upper end of the target range at Y20 trillion. As a result of the subsequent increase in fund providing operations, interest rates declined.

(5) Increase in demand for current account deposits reflecting moves to secure funds beyond the fiscal year-end and growing tension in Iraq

(From the beginning of the year to the beginning of March)

In the money markets, there was hardly any rush to secure funds beyond the end of the fiscal year. The main factors behind this were; (1) the Bank had started much earlier than in the past to provide ample funds that would mature beyond the fiscal year-end, and (2) due to a reduction in the funding needs of leading financial institutions, who traditionally are the main raisers of funds in the short-term money markets. The funding positions of leading banks had improved through the inflow of deposits and reduction in assets.

However, reflecting uncertainty on the outlook of the nonperforming loan problem and weak stock prices, market participants with excess funds maintained a very cautious attitude toward providing funds beyond the March fiscal year-end. Against this background, from February to early March, the Bank maintained an ample supply of funds through aggressive fund providing operations as financial institutions began to actively procure funds beyond the end of the fiscal year.

(From the beginning of March to the March-end close of the fiscal year)

With the situation regarding Iraq becoming increasingly tense, early March saw growing instability in the money markets, with, for example, stock prices falling to their lowest level in the post-bubble period. In order to respond to this situation, under the contingency clause in the guidelines for money market operations, the Bank undertook Y1 trillion worth of outright purchases of bills starting on 11 March, bringing current account balances up to Y21.6 trillion.

Following on from this, with the start of military action by the US and allied forces on 20 March, the Governor of the Bank made public his intention to take all necessary steps including the provision of funds to ensure stability in the financial markets. An ample supply of funds was maintained, with the Bank, for example, undertaking purchases of JGSs under repurchase agreements worth Y1 trillion. Furthermore, on 25 March, an ad hoc MPM was convened in order to review the severe economic and financial conditions including the effect of military action against Iraq and to consider necessary steps with respect to monetary policy operations.

As mentioned above, the Bank was on the whole able to maintain an ample supply of funds, and the leading banks met their targets for procuring sufficient funds beyond the March fiscal year-end well in advance. As a result, on the final trading day of March the call market was much calmer than it was at the end-September 2002, and the weighted average of the uncollateralized O/N call rate rose to just 0.021%. Current account balances reached a historically high level of Y30.9 trillion on the final trading day of the fiscal year.

(6) Moving into the new fiscal year ~ responding to the inauguration of The Japan Post, for example

On 1 April 2003, The Japan Post was inaugurated. At its predecessor, the Postal Services Agency, the settlement of funds for all of its business had been conducted using the government current account deposits at the Bank, but with The Japan Post, this is now conducted using its own current account deposits at the Bank. The Japan Post is not subject to reserve requirements. However, in order to maintain stability in the overall demand for current account deposits at the Bank as well as to make it predictable, and to maintain a fair competitive environment with other private financial institutions, The Japan Post and the Bank have entered into an agreement which would require The Japan Post to hold a certain level or more of current account deposits at the Bank, under a scheme similar to the reserve requirement system (note 3). As a result of this, at the MPM held on 4 and 5 March, it was decided that from April, the current account balances target should automatically be raised by Y2 trillion, roughly equivalent to the deposits required by The Japan Post, to around Y17~20 trillion.

Moving into April, in the money markets, the demand for current account deposits in relation to the end of the fiscal year in March subsided. However, on 1 April, current account balances at the Bank swelled to Y33.8 trillion, in part reflecting the addition of funds related to The Japan Post. Furthermore, due to weak stock prices and other factors, market participants continued to favour holding a large portion of their funds in current account deposits at the Bank. As a result, in order to maintain stability in the financial markets, the Bank's monetary operations were geared to taking current account balances substantially above the upper limit of its Y17~22 trillion target range.

At the subsequent MPM held on 30 April, the Bank raised its current account balances target to "around Y22~27 trillion." Prompted by uncertainty regarding the economic and financial situation, this move was aimed at maintaining financial market stability, thereby strengthening support for an economic recovery.

3. Current account deposits and trading activity

Current account deposits at the Bank are held not only by depository institutions, such as banks, which are subject to reserve requirements (reserve-holding institutions), but also, for example, by securities firms and Tanshi (money market brokers) which are not subject to reserve requirements (exempt institutions).

During FY2002, current account balances at the Bank greatly exceeded the required reserves of the reserve-holding institutions and a large number of both the reserve-holding institutions and exempt institutions continued to hold a high volume of current account deposits at the Bank (Exhibit 4). This contrasted with the period when short-term interest rates were positive, and reserve-holding institutions continued to favour keeping non-interest bearing current account deposits at the Bank at around the same level as required reserves.

Chart 4: CABs and reserves

(hundred million yen)

Reserve maintenance period	CABs (a)=(b)+(C)	Reserves (b)	Required reserves	Excess reserves	CABs of exempted institutions (c)
2002/Apr	178,400	163,700	45,200	118,500	14,700
May	151,300	138,500	44,700	93,800	12,800
Jun	149,700	135,000	42,800	92,200	14,700
July	150,200	135,600	42,900	92,700	14,600
Aug	151,400	135,400	42,600	92,800	16,000
Sep	152,700	138,300	42,700	95,600	14,400
Oct	161,800	146,900	42,600	104,300	14,900
Nov	193,800	175,300	42,400	132,900	18,500
Dec	199,200	180,900	42,800	138,100	18,300
2003/Jan	201,100	184,600	42,800	141,800	16,500
Feb	204,600	184,000	42,700	141,300	20,600
Mar	262,700	237,900	49,800	188,100	24,800

Note: The figures of CABs and Reserves in March 2003 include the current account deposit held by The Japan Post

While current account deposits at the Bank are not interest-bearing, they have finality for settlement purposes, and can be freely drawn, and moreover they carry a zero percent risk weighting under the capital adequacy requirements. On the other hand, if a market participant with a fund surplus were to invest Y10 billion in the uncollateralized O/N call market with an interest rate of 0.001%, this would generate just Y273 in revenue per day. In fact, the cost of the transaction itself and the creditworthiness of the counterparty would also need to be taken into consideration. Consequently, when short-term interest rates are close to zero, there is an increasing tendency for money market participants to hold greater volumes of their funds in current accounts at the Bank. This can be said to reflect the lower opportunity costs involved in holding current account deposits at the Bank, or an increase in the relative appeal of these current account deposits as an investment vehicle.

Under these circumstances, there is little incentive to actively manage investment and funding operations reflecting even the slightest change in interest rates. Many market participants share the view that if surplus funds are created as a result of daily fund trading, these should be left in current accounts at the Bank.

This has the following implications with regard to demand for current accounts deposits held at the Bank.

- When concerns related to the financial system grow, this combines with the above-mentioned scenario and results in a sudden surge in demand for current account deposits at the Bank.
- Furthermore, the above-mentioned standpoint also helps to explain why foreign banks place the yen funds raised with minus interest rates in the foreign currency swap market at current account deposits at the Bank(note 4).
- On the other hand, for example, when concerns over the financial system subside and demand for current account deposits at the Bank declines, the scale of the decline also tends to be larger.

(Changes in the flow of funds in the short-term money markets)

Traditionally, market participants with a fund shortage have tended to procure funds from participants with a fund surplus, for example, in the call market.

However, in the short-term money markets, when the opportunity cost of holding current account deposits at the Bank declines and moreover when the number of risk averse market participants increases, those with a fund shortage may not be able to fully cover their funding needs solely through the market. This was demonstrated very clearly in overnight trading on the final business day in September. It was particularly apparent in longer term transactions during the period from October onwards, when the stock prices of the leading banks were in decline, and in relation to the securing of funds beyond the fiscal year-end.

On occasions when sufficient funds did not flow from participants with surplus funds to participants with a fund shortage via the market, the Bank's money market operations played a very important role, with the Bank acting as a so-called "short-term money market broker." In more concrete terms, while the Bank's fund providing operations satisfied the funding needs of those short of funds, current account deposits at the Bank and Bank's fund absorption operations also became a means of fund management for those with surplus funds. This brought about changes in the flow of funds in the short-term money markets (Exhibit 5).

At the same time, under these conditions the arbitrage of the interest rate arbitrage function between markets becomes less effective. For example, when the sources of changes in CABs are showing a surplus, in the past, the desire by those with excess funds to invest their funds would exert downward pressure on short-term interest rates. However, more recently, in such circumstances participants now seem to consider the possibility that fund providing operations could be reduced, and this has actually pushed interest rates on operations higher. On the other hand, when the sources of changes in CABs are showing a shortage, participants now consider the possibility that fund providing operations could increase, and this has on occasions pushed interest rates on operations lower.

4. Money market operations in FY2002 by type of instrument

During FY2002, the Bank of Japan maintained an ample supply of funds. In order to meet the fund procurement needs of market participants with a fund shortage, longer-term operations played the pivotal role in the Bank's operations. Here we take a closer look at the Bank's fund providing operations during FY2002 by operation instrument (Exhibit 6).

(1) Outright purchases of JGBs

Regarding outright purchases of JGBs, it was announced

Chart 5: The relationship between market trading and the Bank's money market operations (exhibited by the Balance Sheet)

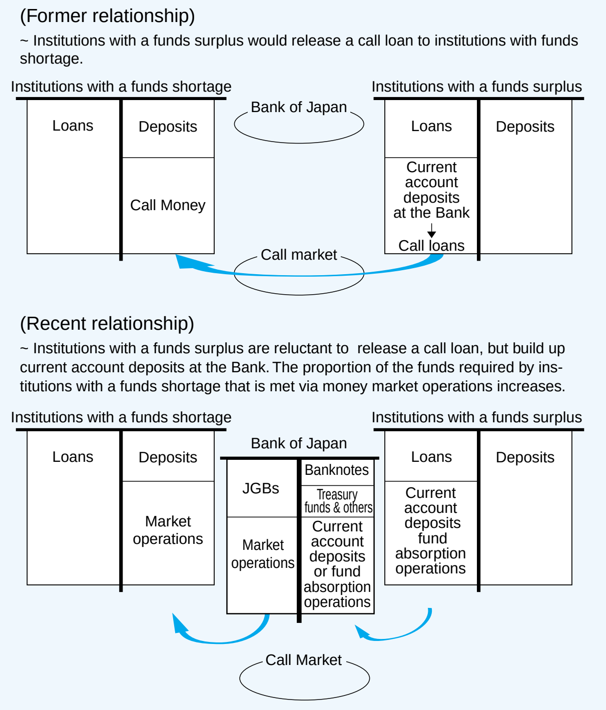


Chart 6: Amount outstanding of Market operations

(trillion yen,outstanding at end-month)

	2002/Mar	Jun	Sept	Dec	2003/Mar
Net amount outstanding of short-term operations	72.7	52.2	56.8	56.7	66.0
Provision of short-term funds	72.7	58.7	61.4	58.4	66.0
Borrowing of JGBs against cash collateral	8.5	3.7	3.5	0.0	—
Purchases of JGSs under repurchase agreement	—	—	—	3.7	8.3
Outright purchases of bills	29.5	23.7	28.0	28.0	29.1
At head office	14.4	5.8	8.0	8.1	9.8
At all offices	15.1	18.0	20.0	19.9	19.3
Purchases CPs under repurchase agreement	3.5	3.3	2.6	3.8	3.9
Outright purchases of TBs/FBs	31.2	28.1	27.4	22.8	24.7
Absorption of short-term funds	0.0	▲6.6	▲4.6	▲1.7	0.0
Outright sales of bills drawn by the Bank	0.0	▲6.6	▲4.6	▲1.7	0.0
Sales of JGSs under repurchase agreement	—	—	—	0.0	0.0
JGBs	49.0	51.9	52.8	55.6	58.0

Note: JGBs include the amount outstanding of JGBs purchases outright and those rolled over at maturity and underwritten by the Bank.

at the March 2001 MPM, when the principal operating target was switched to current account balances at the Bank, that (1) the Bank will increase the amount of its outright JGB purchases if it considers this necessary to facilitate the smooth supply of liquidity, but (2) subject to the limitation that the outstanding amount of JGBs held by the Bank be kept below the outstanding balance of banknotes issued. Under this policy, monthly purchases of JGBs ran at around Y1 trillion from March 2002, but at the MPM held on 30 October, this was raised to Y1.2 trillion. As a result, outstanding JGB holdings stood at Y58 trillion at the end of March.

(2) Borrowing of JGBs against cash collateral (JGB repos); purchases of JGSs under repurchase agreements

From 11 November, the Bank's borrowing of JGBs against cash collateral (JGB repos) operations, along with purchases of TBs/FBs under repurchase agreements, was switched to purchases of JGSs (JGBs, TBs/FBs) under repurchase agreements. This reflects the fact that in the market, the April 1999 abolition of the tax on securities trading has prompted a shift among fund traders using JGBs as collateral, from “borrowing of JGBs” to “purchases JGBs under repurchase agreements (gensaki).” At the same time, the Bank has made improvements to its operation framework through the completion of RTGS (note 5) and the introduction of substitutions (whereby participants can substitute the JGSs they have transferred to the Bank at any time).

The outstanding amount of these operations remained low until December, reflecting the under-biddings seen during the summer. However, moving into the new year, in order to provide sufficient funds beyond the fiscal year-end, the Bank, making full use of the improved manoeuvrability under the new operation framework, actively used this instrument. As a result, the amount outstanding reached Y8.3 trillion at the end of March.

(3) TBs/FBs operations

Operations used to supply funds through purchases of TBs/FBs can be either outright purchases, or purchases under repurchase agreements.

While the amount outstanding of outright purchases was down slightly compared with the previous year, it nevertheless remained at a high level. Under this method, if, for example, the Bank purchases outright TBs with a remaining maturity of one year, this has the same effect as the Bank providing funds for one year. Therefore these operations have the benefit of providing longer-term funds. Outright purchases of TBs/FBs, together with outright purchases of bills, were used most heavily by the Bank for the provision of short-term funds.

On the other hand, as mentioned in (2) above, purchases of TBs/FBs under repurchase agreements were unified with purchases of JGBs under repurchase agreements which was introduced in November 2002.

(4) Outright purchases of bills

The amount outstanding of outright bill purchases remained high during FY2002, standing at Y29.1 trillion at the end of March. Outright bill purchases formed the mainstay of the Bank’s provision of short-term money market operations. The main factors behind this include; (1) these operations are very convenient, as, for example, the counterparties are able to use pooled collateral; (2) for counterparties, outright bill purchases can be used to remedy longer-term funding needs; (3) the Bank aggressively used these operations in order to satisfy such funding needs; and (4) at the MPM held on 30 October, the maximum maturity for bills purchased in bill purchasing operations was extended from six months to one year, making it possible to use this tool to supply funds over a longer period of time.

Outright bill purchase operations are subdivided into two types. One type is those which are conducted only at head office of the Bank, and another type is those which are conducted at all offices of the Bank, covering a wider range of financial institution. The “all offices-type” operations were introduced in July 2001 with the aim of strengthening the Bank’s capacity to supply funds. At present, there are more than 130 counterparties for the “all offices-type” operations. When the Bank started much earlier than in the past to provide ample funds that would mature beyond the fiscal year-end, the Bank actively offered outright purchases at all offices for with longer term.

(5) Purchases of CPs under repurchase agreements

The outstanding balance of CPs purchased under repurchase agreements remained within the Y2.5~4 trillion range. While the Bank maintained an ample supply of funds, in the CPs market, investor demand was strong, and therefore the funding needs of financial institutions dealing in CPs were weak. As a result, bidding for purchases of CPs under repurchase agreements did not increase to any great extent, causing frequent under-bidding.

The Bank eased the conditions regarding eligibility for asset-backed commercial paper (ABCPs) from 9 January (refer to 6.(3) (2)). In practice, most of the ABCPs in the market have a relatively short time-scale from issue date to maturity. From around the end of February, bearing in mind the need to provide funds that would mature beyond the fiscal year-end in March and also the aforementioned conditions in the ABCPs market, in addition to the traditional two-month instruments, the Bank began offering one-month instruments also (the outstanding balance of purchases of ABCPs stood at Y1.1 trillion at the end of March).

5. The Bank’s balance sheet

As a result of the previously discussed sources of changes in CABs and the Bank’s money market operations, at the end of FY2002, the Bank’s balance sheet grew by Y2.6 trillion compared with the previous year, to reach a record level of Y141.2 trillion (Exhibit 7).

On the liabilities side, with the outstanding balance of banknotes issued growing by Y3.2 trillion compared with the end of FY2001, and current account balances increasing by Y3.3 trillion, a record high level was recorded. On the other hand, government deposits, etc. declined somewhat (Exhibits 7,8).

Chart 7: The Bank’s balance sheet (end-March 2003)

(trillion yen)

JGBs	58.0 (+9.0)	Banknotes	71.1(+3.2)
Short-term money market operations (net)	66.0(▲6.7)	Governmnet deposit, etc	32.1(▲3.0)
		CABs	30.9(+3.3)
Total assets (including others)	141.2 (+2.6)	Total liabilities (including others)	141.2(+2.6)

Note: JGBs include the amount outstanding of JGBs purchases outright and those rolled over at maturity and underwritten by the Bank.

Chart 8: The Bank’s transactions with the government

(trillion yen, at end-month)

	2002/Mar	Jun	Sept	Dec	2003/Mar
Government deposits	12.9	6.7	8.3	6.3	14.6
Repo transactions between the Bank and the Government	22.2	20.8	19.0	14.4	17.5
Total	35.1	27.5	27.4	20.8	32.1

On the assets side, the outstanding balance of JGBs grew by Y9 trillion. Although the outstanding amount of short-term money market operations reached a high of Y66.0 trillion during FY2002 (Exhibit 6), this was Y6.7 trillion down from the end of the previous fiscal year. Although the Bank was aggressive with its short-term money market operations in order to maintain an ample supply of funds, the other items on the liabilities side other than current account balances either declined or rose only slightly, and with Outright purchases of JGBs operations steadily being stepped up, the outstanding balance of short-term money market operations declined.

6. Measures implemented on the operations and collateral fronts (note 6)

During FY2002, the Bank implemented the following measures to ensure the smooth functioning of its money market operations.

(1) The introduction of purchases/sales of JGSs under repurchase agreements (decided 18 September, implemented 11 November; refer to 4.(2)).

(2) Extension of maturities for bill purchases (decided 30 October, implemented the same day; refer to 4.(4)).

(3) Measures to facilitate smooth corporate financing

(i) Acceptance of a broader range of loans on deeds as eligible collateral (decided 17 December; implemented 27 December)

Regarding loans on deeds, in addition to devising a more detailed range of collateral value ratios according to type of debtor and original maturity, the Bank decided to accept loans on deeds with original maturity of more than five years and up to ten years as eligible collateral.

These measures were aimed at improving collateral efficiency for financial institutions, and giving a greater incentive to use loans on deeds as collateral. This would make it easier for financial institutions to refinance via the Bank through , for example, bill purchase operations thereby facilitating smooth corporate financing.

(ii) Relaxation of standards for ABCPs as eligible collateral (decided 17 December; implemented 9 January)

Effective until the end of FY2004, the Bank decided to accept ABCPs guaranteed by its counterparty financial institutions as eligible collateral and as eligible asset for the Purchases of CPs under repurchase agreements.

As this greatly increased the volume of eligible ABCPs (around 90% of the ABCPs market as a whole, compared with 5% previously), and made it easier for the financial institutions accepting CPs to refinance via the Bank through purchases of CPs under repurchase agreements and bill purchasing operations, corporate financing is enhanced.

(4) Accepting STRIPS government securities as eligible collateral (decided 17 December; implemented 6 January)

The Bank decided to accept STRIPS government securities as eligible collateral from their introduction. As the size of the market, for example, needs to be ascertained, STRIPS government securities has not been eligible assets for market operations.

(5) Accepting dematerialized CPs as collateral (decided 14 February, introduced 31 March)

On 31 March, based on the laws relating to the transfer of corporate bonds, the Japan Securities Depository Center began transfers of dematerialized CPs. Dematerialized CPs differs from physical certificates of CPs in that it is not a bill in legal terms and no physical certificate is issued, and the transfer of rights is carried out through account transfers at the Depository Center. However, it performs the same economic functions as physical certificates of CPs. For this reason, it was decided that dematerialized CPs should be accepted as eligible collateral from the very beginning, based on the same standards as physical certificates of CPs.

In June, the Bank also added dematerialized CPs to the list of eligible assets for Purchases of CPs under repurchase agreements.

7. In conclusion

During FY2002, demand for current account deposits at the Bank fluctuated widely. Keeping a close watch on such trends in the money markets, the Bank endeavoured to maintain stability in the money markets through an ample supply of funds.

The Bank of Japan aims to ensure the smooth conducting of the guideline for money market operations and to maintain stability in the financial markets by pursuing more adequate operations, while maintaining a careful dialogue with market participants (note 7).

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[1] In order to make it easier to understand the relationship between the item "treasury funds and others" and rises/falls in current account balances at the Bank of Japan, we have adjusted the fiscal year basis figures published by the Bank. To be more precise, we have modified the figures for the Bank's outright purchases of TBs/FBs. When the government issues TBs/FBs in the market, the payments the government receives from the market cause a shortage under "treasury funds and others". Then, when the TBs/FBs mature, the payments from the government cause a surplus under "treasury funds and others". For this reason, when the total value of the TBs/FBs is redeemed in the private sector, the amount issued/redeemed has in overall a neutral impact. However, where, as has been seen recently, the Bank of Japan has purchased TBs/FBs outright in the market and holds it until maturity, the redemption payment for the portion bought outright is paid by the government to the Bank, and that money reduces the payments from the government to the market and the size of the surplus under "treasury funds and others". Compared with the situation where the total value of the TBs/FBs issued reaches maturity in the market, this results in a shortfall in terms of total issues/redemptions. In this table, we aim to review trends in "treasury funds and others", and in order to remove its effects, we regard the redemption value of TBs/FBs bought outright by the Bank as redeemed in the market, and then add this figure to "treasury funds and others".

[2] Under the guidelines for money market operations, while the target for the current account balances held at the Bank is set, the Bank can inject additional funds, in certain circumstances, based on the contingency clause.

[3] From the standpoint of money market operations, current account deposits held by The Japan Post perform the same function as reserve deposits, and therefore they are treated the same as reserves in the "Sources of Changes in Current Account Balances at the Bank and Market Operations" and "Figures on Reserves." (For details, please refer to the Bank of Japan homepage (www.boj.or.jp), "Statistics" → "Bank of Japan" → "Sources of Changes in Current Account Balances and Market Operations at the Bank of Japan" → "Notices of changes and other releases" → "Information about the treatment of The Japan Post on the statistics compiled by the Bank of Japan, March 18, 2003".

[4] For example, foreign banks held current account deposits at the Bank worth roughly Y4 trillion at the end of December 2002.

[5] When RTGS (Real Time Gross Settlement) for the settlement of JGSs and current accounts at the Bank was introduced at the beginning of 2001 the following was introduced, with regard to settlement of JGBs relating to borrowing of JGBs against cash collateral (repo) operations. While RTGS was introduced for trading where the Bank delivers the JGBs (end trading), for trading where the Bank receives JGBs (start trading), the aim was to introduce RTGS later, during FY2002 (please refer to the schedule for the implementation of additional measures relating to the introduction of RTGS for JGB settlement, released on 24 April 2001).

[6] For information regarding the collateral accepted by the Bank of Japan, please refer to "The Bank of Japan's Eligible Collateral Framework and Recently Accepted Collateral," Market Review 2003-E-1.

[7] A useful tool for understanding the Bank of Japan's monetary policy can be accessed via the Bank's homepage (www.boj.or.jp) under "monetary policy" → "issue papers on monetary policy."

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