Box 1

The monetary policy operational framework of the Eurosystem: a brief introduction

In order to achieve its monetary policy objectives, the Eurosystem conducts open market operations, offers standing facilities and requires credit institutions to hold minimum reserves on accounts with the national central banks. Open market operations play an important role in the monetary policy of the Eurosystem for the purposes of steering short-term interest rates, managing the liquidity situation in the money market and signalling the stance of monetary policy. Standing facilities are aimed at providing and absorbing overnight liquidity and at providing a general signal regarding monetary policy intentions over the medium term. The minimum reserve system primarily serves the purpose of stabilising money market interest rates and creating (or enlarging) a structural liquidity shortage.

Among the open market operations, the "main refinancing operation", i.e. a weekly tender with a two-week maturity, plays a pivotal role in the Eurosystem's monetary policy framework. Indeed, it is mainly through this operation that the Eurosystem steers movements in short-term market interest rates and refinances the banking system. In addition, the Eurosystem also regularly conducts "longer-term refinancing operations". These are monthly tender operations which have a three-month maturity. By contrast with the weekly tender, in the monthly tender the Eurosystem does not, as a rule, intend to send signals to the market. Other types of open market operations which the Eurosystem could conduct, when deemed necessary, include fine-tuning operations, which are aimed, in particular, at smoothing the effects of unexpected liquidity fluctuations in the market. Furthermore, the Eurosystem has the possibility of using open market operations (such as the issuance of ECB debt certificates) to adjust the structural position of the Eurosystem vis-à-vis the financial sector. Since the start of Stage Three the ECB has not, however, seen any need to carry out such "structural" operations.

While open market operations are conducted on the initiative of the Eurosystem, in the case of the standing facilities the initiative lies with those credit institutions which are the Eurosystem's counterparties. Eligible counterparties have access to two standing facilities of the Eurosystem: the marginal lending facility allows them to obtain overnight liquidity from the national central banks and the deposit facility allows them to make overnight deposits at the national central banks. Under normal circumstances there is no limit on access to the standing facilities (with the exception that access to the marginal lending facility, as for all credit operations of the Eurosystem, has to be backed by sufficient eligible collateral). As a consequence, fluctuations in the overnight market interest rate are bounded by the corridor set by the interest rates applied to these standing facilities.

In addition, each credit institution located in the euro area is subject to a reserve requirement. This requirement is determined by applying a reserve ratio to selected liabilities of the balance sheet of credit institutions. The reserve ratio was set at a level of 2% as from the start of Stage Three. A credit institution complies with its obligations under the Eurosystem's minimum reserve system if its average daily reserve holdings, as computed over a reserve maintenance period normally running from the 24th day of each month to the 23rd day of the following month, is at least equal to its reserve requirement. Holdings of required reserves are remunerated at the rate of the Eurosystem's main refinancing operation. The mechanism for the fulfilment of the reserve requirement over a period longer than one day – a period of precisely one month in the case of the Eurosystem's minimum reserve system – is known as the averaging provision. As the averaging provision provides flexibility in the banking system's management of its liquidity, credit institutions will be able to accommodate day-to-day changes in the provision of liquidity and to exploit short-term arbitrage possibilities in the money market. In this way, the averaging provision can be expected to contribute to a stabilisation of the overnight rate over the course of the maintenance period.

Finally, as regards the inception of the Eurosystem's operations, the standing facilities have been accessible to credit institutions as from 4 January 1999, the first business day of Stage Three. The first weekly tender was settled on 7 January 1999 and the settlement date of the first monthly tender was 14 January 1999. With a view to contributing to a smooth transition to the Eurosystem's monetary policy framework, participating national central banks agreed to let the open market operations they conducted towards the end of Stage Two mature gradually in the course of the first half of January 1999. Furthermore, as a transitional provision for the Eurosystem's minimum reserve system, the first maintenance period will run from 1 January 1999 until 23 February 1999.

A detailed description of the Eurosystem's monetary policy framework is presented in the ECB report entitled "The single monetary policy in Stage Three: General documentation on ESCB monetary policy instruments and procedures" (September 1998).