

**Box I****Monetary policy operations and liquidity conditions in the third maintenance period**

This Box discusses the Eurosystem's monetary policy operations and developments in the banking system's liquidity position during the third reserve maintenance period, which ran from 24 March to 23 April 1999. A more detailed study focusing on the results of the first three reserve maintenance periods since the start of Stage Three of EMU is provided in a separate article in this ECB Monthly Bulletin entitled "The operational framework of the Eurosystem: description and first assessment".

**Open market operations**

The Eurosystem conducted four main refinancing operations and one longer-term refinancing operation during the third reserve maintenance period. All the main refinancing operations were again carried out as fixed rate tenders. Against a background of growing expectations of an interest rate cut by the ECB, the amount of bids submitted by counterparties fell considerably in the first two main refinancing operations, which were carried out at a rate of 3.0%. The total amounts of bids submitted in these operations were €118.7 billion on 30 March and €67.4 billion on 6 April, and the number of counterparties was 403 and 302 respectively (compared with an average amount of bids of €720 billion and an average number of counterparties of around 920 in the first two reserve maintenance periods). The resulting allotment ratios were 32.9% and 100% respectively. Moreover, on the occasion of the latter of these two operations, the allotment amount fell short of the liquidity needed for the smooth fulfilment of the credit institutions' reserve requirements, with the result that the counterparties' aggregated reserve holdings on the days following the settlement of the operation were far below the required average. After the Governing Council had decided to lower interest rates on 8 April, the Eurosystem conducted two main refinancing operations, both of which were carried out as fixed rate tenders at a rate of 2.5%. As a result of the low allotment amount in the preceding operation, a considerable liquidity deficit had accumulated by the time of the allotment of the main refinancing operation of 13 April. Against this background, the total amount of bids submitted increased sharply to €781.7 billion and the allotment ratio fell to 8.6%, while the number of counterparties participating in the operations again reached 841. The last main refinancing operation of the reserve maintenance period was conducted under more balanced liquidity conditions. Bids amounting to €612 billion were submitted and an amount of €50.0 billion was allotted (viz. an allotment ratio of 8.2%).

**Contributions to the banking system's liquidity**

(EUR billions)

Daily average during the reserve maintenance period from 24 March to 23 April 1999

	<i>Liquidity providing</i>	<i>Liquidity absorbing</i>	<i>Net contribution</i>
<b>(a) Monetary policy operations of the Eurosystem</b>	<b>175.8</b>	<b>0.3</b>	<b>+175.5</b>
Main refinancing operations	130.1	-	+130.1
Longer-term refinancing operations	45.0	-	+45.0
Standing facilities	0.7	0.3	+0.4
Other operations	0.0	0.0	0.0
<b>(b) Other factors affecting the banking system's liquidity</b>	<b>338.4</b>	<b>412.8</b>	<b>-74.4</b>
Banknotes in circulation	-	331.0	-331.0
Government deposits with the Eurosystem	-	42.9	-42.9
Net foreign assets (including gold)	338.4	-	+338.4
Other factors (net)	-	38.9	-38.9
<b>(c) Credit institutions' holdings on current accounts with the Eurosystem (a) - (b)</b>			<b>101.1</b>
<b>(d) Required reserves</b>			<b>100.1</b>

In the longer-term refinancing operation that was carried out on 24 March 1999, the multiple rate auction procedure was used for the first time since the start of Stage Three of Economic and Monetary Union. The allotment volume was pre-announced as €15 billion and resulted in a marginal interest rate of 2.97%, leaving the amount of outstanding longer-term refinancing operations unchanged at €45 billion (see the table above). The number of counterparties participating in this operation was 269, compared with 417 in the previous longer-term refinancing operation, which was conducted using the single rate procedure.

### Use of standing facilities

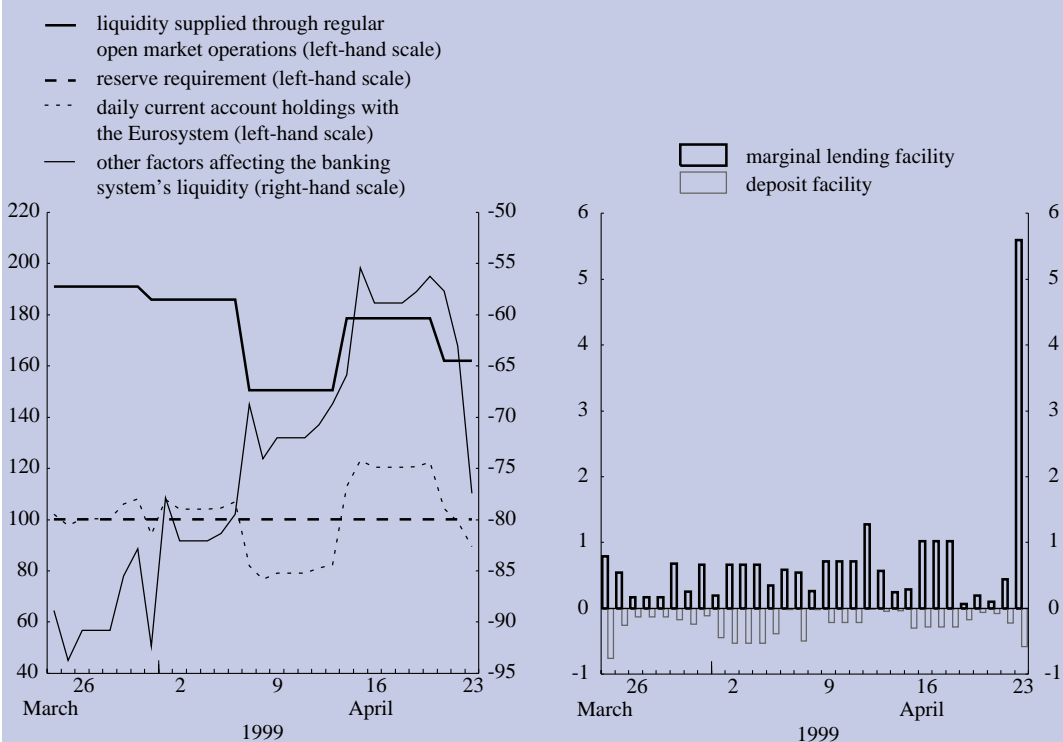
Compared with the previous reserve maintenance period, the average use of the deposit facility declined considerably, from a daily average of €1.4 billion to only €0.3 billion. The use of the marginal lending facility increased somewhat, from a daily average of €0.4 billion to €0.7 billion. However, a considerable part of the recourse to the marginal lending facility took place on the last day of the period (€5.6 billion) and reflected the need of some credit institutions for additional funds to cover their reserve requirement (see the charts below).

### Liquidity factors not related to monetary policy

The sum of other factors affecting the banking system's liquidity (item (b) in the table above) – the “autonomous factors” – was -€74.4 billion on average, the negative sign indicating that in net terms these factors absorbed liquidity. This amount was, in absolute terms, €3.8 billion lower than during the previous reserve maintenance period. The sum of autonomous factors fluctuated between -€55.4 billion and -€93.7 billion, with the most volatile item being the balances of government accounts with central banks, which ranged from €31.5 billion to €63.6 billion. Reflecting normal seasonal patterns, the amount of banknotes in circulation reached a peak of €335.4 billion during late March and early April in connection with Easter.

### Factors contributing to the banking system's liquidity during the third maintenance period

(EUR billions; daily data)



Source: ECB.

### **Current account holdings of counterparties**

During the third reserve maintenance period the average current account holdings were €101.1 billion and the required reserves amounted to €100.1 billion. Compared with the second reserve maintenance period, the difference between average current account holdings and reserve requirements declined from €1.6 billion to €1.0 billion. The current account holdings of counterparties which do not effectively have to hold minimum reserves declined from €0.7 billion to €0.4 billion and the excess reserve holdings of counterparties subject to positive reserve requirements declined from €0.9 billion to €0.6 billion (see pages 12 and 13 of the April 1999 issue of the ECB Monthly Bulletin for a detailed analysis of the sources of these differences between current account holdings and reserve requirements).