



# New framework for sterling market operations

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# Outline

- Purposes, reasons for change and new framework
- Objective 1: stable overnight rates in line with policy rate
- Objective 2: banking system liquidity management
- Objective 3: simple
- Objective 4: competitive money markets
- Changes to Bank's balance sheet



# Purpose

- Two purposes:-
  - Implement the MPC's interest rate decision (*monetary policy*)
  - Meet the banking system's liquidity need – its demand for sterling central bank money (cash) - in routine and stressed conditions (*financial stability*)



# Reasons for change

- Overnight rates more volatile than desirable
- Limited access to central bank money
  - number of institutions
  - flexibility of facilities



# New framework

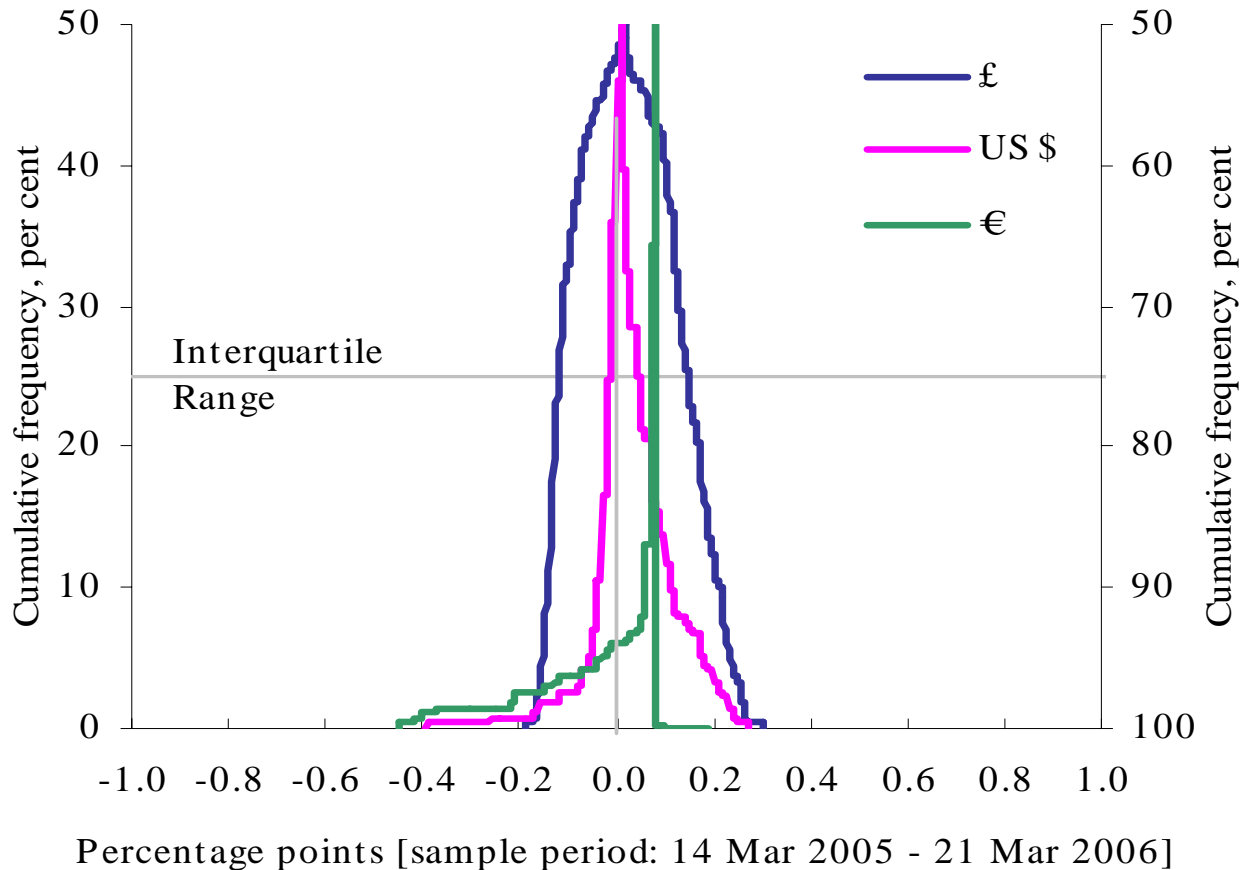
- Reserve averaging scheme
- Standing facilities
- Open market operations – weekly one-week repos, long-term repos
- Implementation by MPC month



# Objective 1: stable rates

- Flat and stable money market curve, consistent with policy rate, to next MPC meeting
- Bank can control market rates because it is monopoly supplier of sterling central bank money; by allowing banks to arbitrage between transacting in market and with Bank

# Volatility of overnight rates – £ too volatile





# Objective 1: stable rates

- Bank controls market rates on final day of MP through (i) 50 bp standing facility corridor and (ii) range around targets within which reserves remunerated at policy rate
- Averaging ensures markets rates earlier in MP stay in line with rates expected on final day; requires:
  - sufficient aggregate reserves
  - broad participation in reserve scheme
  - active reserve management in response to market rates



# Objective 1: stable rates

- Remuneration at policy rate (i) to attract sufficient reserves for averaging to work effectively (ii) revenue neutral (iii) allows range to work on final day
- Short-term OMOs used to ensure Bank lends right amount of money at policy rate to allow banks to hold reserves close to target levels (well within range)
- Fine-tuning OMO on final day of MP to get reserve supply as right as possible



# Objective 1: stable rates

- Bank expects market rates to be consistent with policy rate, with limited volatility in value of money
- But overnight interbank rates likely to be a bit higher o/a credit risk, cost of collateral
- Overnight gilt GC repo rates likely to be a bit lower o/a value of gilt collateral, which can vary over time
- Bank repos against gilts and euro/£ bonds issued by EEA governments and supras



# Objective 2: banking system liquidity management

- For individual banks/building societies
  - Aim to provide more flexible access to central bank money for banks' £ liquidity planning (alongside plans to raise funds in markets)
  - Reserve balances can be drawn on routinely to meet liquidity needs intra-day and day-to-day
  - Reserve targets can be varied monthly
  - Regulatory liquid asset (but tension with using the liquidity day to day)
  - Standing lending facility provides liquidity back-stop (against eligible collateral)



## Objective 2: banking system liquidity management

- For system-wide problems eg with payment system or money market
- Increased demand for central bank money eg fall in velocity o/a payment system or money market not working; or substitution of central for commercial bank money



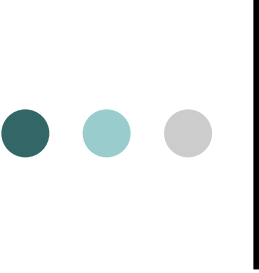
## Objective 2: banking system liquidity management

- Can intermediate across standing facilities, including narrowing interest rate ‘corridor’ – more likely if markets ‘closed’
- Can intermediate through increased reserves and OMOs - more likely if markets ‘open’ but disrupted



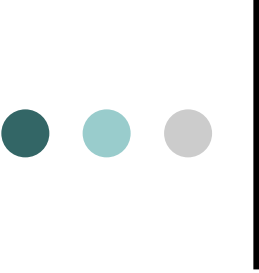
## Objective 3: simplicity

- Aim is that framework delivers objectives not discretionary operations – transparent and predictable
- Operationally straightforward
  - Fewer, if bigger, operations
  - End of day squaring up monthly not daily



## Objective 4: competitive markets

- Wide access to banks' facilities; will publish lists of settlement banks, reserve scheme participants and standing facility banks/building societies (but not OMO counterparties)
- Remove market power in overnight market; level playing field for everyone
- All those with access to Bank facilities expected to behave in a way consistent with competitive markets ie as price takers



## Objective 4: competitive markets

- Hope will encourage trading of money market instruments eg SONIA swaps, and wider participation of intermediaries and end-users in money market eg money funds, corporates
- Stable overnight rates close to policy rate should also encourage liquidity of longer-maturity instruments
- Bank considering a survey of market participants (including end-users)



# Bank's balance sheet

- Central bank money (Bank' liabilities) = final settlement asset
- Most money these days is commercial bank money
- But remaining importance of central bank money:
  - Banknotes
  - Settlement asset for payment system (banker to banks)
  - Substitute for commercial bank money in a crisis (LOLR)



# Bank's balance sheet

- Bank's liabilities = largely demand driven
- Assets = choice
  - Consistent with rate-setting framework (OMOs = at policy rate to next meeting; at market rates at longer maturities)
  - Minimal credit risk (repo, govt bonds etc)
  - Match to maturity and interest rate characteristics of liabilities
  - Simple, transparent, non-discretionary (rules-based, OMOs)



# Current balance sheet (£ only)

## Banking

Capital & CRDs	Bonds
Other eg HMG balances	Short-term reverse repo lending in OMOs
Intra-day deposits by settlement banks	Intra-day reverse repo lending to settlement banks

## Issue

Bank Notes	Short-term reverse repo lending in OMOs
	Long-term reverse repo lending in OMOs
	Ways & Means advance to HMG

# Future balance sheet

(arrows indicate likely change in size; red = new)

## Banking

Capital & CRDs	Bonds
Other eg HMG balances	Short-term reverse repo lending in OMOs ↑
<b>Reserves</b>	
Intra-day deposits by settlement banks ↓	Intra-day reverse repo lending to settlement banks ↓

## Issue

Bank Notes	Short-term reverse repo lending in OMOs
	Long-term reverse repo lending in OMOs
	<b>Bonds (under consideration)</b>
	Ways & Means advance to HMG



# Some key dates

- Thursday 11 May – publication of aggregate reserve target for 1<sup>st</sup> MP
- Monday 15 May – planned publication of new Red Book and initial lists of reserve scheme and SF participants
- Wed 17 May – final day of daily OMOs; 1<sup>st</sup> round of bidding for 1<sup>st</sup> weekly OMO
- Thur 18 May – launch of reserve-averaging scheme and SFs; 2<sup>nd</sup> round of bidding and settlement of 1<sup>st</sup> weekly OMO
- Thur 25 May – 2<sup>nd</sup> weekly OMO of 1<sup>st</sup> MP
- Thur 1 June – 3<sup>rd</sup> weekly OMO of 1<sup>st</sup> MP
- Wed 7 June – final day of first MP, overnight fine tuning OMO, SF corridor narrows to  $\pm 25$  bp
- Thur 8 June – interest paid on 1<sup>st</sup> MP reserves, MPC decision, 1<sup>st</sup> day of 2<sup>nd</sup> MP, 1<sup>st</sup> weekly OMO of 2<sup>nd</sup> MP



End

○ Any questions?