



BANK OF ENGLAND

News release

Press Office

Threadneedle Street

London EC2R 8AH

T 020 7601 4411

F 020 7601 5460

press@bankofengland.co.uk

www.bankofengland.co.uk

22 July 2004

Reform of the Bank of England's Operations in the Sterling Money Markets

The Bank of England is today announcing the result of its review of its official operations in the sterling money markets. The Bank will initiate a new system based on averaging with voluntary reserves remunerated at the Bank's repo rate. A timetable for the changes will be announced after further consultation with the market. The Governor said:

"These proposals represent a big step forward for the Bank and for the sterling money markets. I am grateful to all those who have responded so thoughtfully and constructively to our consultation. The new framework will, I believe, make our money market operations more open, accessible, transparent and effective, and bring the market itself more closely in line with best international standards."

Commenting, Paul Tucker - Executive Director, Markets - said:

"The planned reforms are profound; not in our objectives but in how we will achieve them. Averaging with remunerated reserves will be a big change. Together with a narrow corridor on the final day of a monthly maintenance period, it will help to stabilise the overnight interest rate, and so promote healthy sterling money markets. The new framework will also give more banks access to the Bank of England, which will improve the banking system's ability to cope in stressed conditions."

The reformed scheme will have the following features:

1. Scheme banks will choose a target level of positive balances (voluntary reserves) that they will be required to hold with the Bank on average over a maintenance period lasting from one MPC meeting to the next. A wide range of banks will be able to join the system.
2. Such reserves held will be remunerated at the Bank's repo rate (with ceilings on the amount each scheme-member bank can hold).
3. There will be standing lending and deposit facilities, available on demand to a wide range of banks. The rates on these standing facilities will be the MPC's repo rate +25 basis points on the final day of the maintenance period, and will be at a wider spread to the repo rate on all other days.

4. The Bank will conduct weekly open market operations at a maturity of one week at the MPC's repo rate. As a matter of routine, there will also be an overnight fine-tuning repo on the final day of the maintenance period.

In the early autumn, the Bank will issue a paper setting out the proposed changes more fully and consulting on the details. This paper will also cover, and consult on, the timetable for the new framework's introduction. In particular, the Bank will explore with the market whether some elements can be introduced in stages in order further to stabilise the overnight rate before the full scheme is in place.

Notes to Editors

1. The Bank published a consultative paper 'Reform of the Bank of England's Official Operations in the Sterling Money Markets' (pdf file) on 7 May. It outlined two possible structures: one based on a same-day maintenance period and one based on averaging.

2. The purpose of the Bank's operations in the sterling money markets is to implement the Monetary Policy Committee's (MPC) interest rate decision while meeting the liquidity needs, and so contributing to the stability, of the banking system as a whole. This will not change. In its consultative paper the Bank set out its objectives more fully. In summary:

- **Objective 1:** Overnight market interest rates to be in line with the MPC's repo rate, so that there is a flat money market yield curve, consistent with the official policy rate, out to the next MPC decision date, with very limited day-to-day or intra-day volatility in market interest rates at maturities out to that horizon.
- **Objective 2:** An efficient, safe and flexible framework for banking system liquidity management - both in competitive money markets and, where appropriate, using central bank money - in routine and stressed or otherwise extraordinary conditions.
- **Objective 3:** A simple, straightforward and transparent operational framework.
- **Objective 4:** Competitive and fair sterling money markets.

The current operational framework leaves sterling overnight rates considerably more volatile than in other countries. The Bank wants to influence overnight market interest rates more closely in order to reduce day-to-day and intra-day volatility and so help, through greater stability of financing costs, to promote broad participation and liquidity in sterling money markets.

3. The Bank currently conducts daily open market operations at a maturity of around two weeks to supply the market with the funds needed by the banking system to meet the requirement for settlement banks to maintain a minimum balance of zero on their accounts at the Bank of England at the end of each day. The May 2002 paper "The Bank of England's operations in the sterling money markets" provides a full description of the Bank's current money market operations.

Further information on the Bank's current open market operations can be found at: our Open Market Operations page.

Key Resources

Reform of the Bank of England's Operations in the Sterling Money Markets

Consultative Paper, 7 May 2004

<http://webarchive.nationalarchives.gov.uk/20100114080129/http://www.bankofengland.co.uk/markets/money/smmreform040507.pdf>

Speech by the Governor Announcing a Review of the Bank's Operations in the Sterling Money Markets

East Midlands Development Agency/Bank of England Dinner in Leicester, 14 October 2003

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2003/speech204.pdf>