



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

18 May 2006

Launch of New Framework to Modernise Sterling Money Markets

The Bank has today launched its new framework for the implementation of monetary policy.

This modernisation brings a fundamental change to the way interest rate decisions made by the Monetary Policy Committee are implemented and to the way that banking system liquidity is managed.

From today, for the first time in its history the Bank is paying interest on reserve balances held by banks and building societies. They now target average balances with the Bank over the periods between the MPC's monthly interest rate decisions rather than having to 'square up' every day. The Bank has moved from daily to weekly short-term open market operations.

In total, 41 reserve scheme participants have targeted reserves averaging some £23 billion over the period from today until 7 June – the day before the MPC is due to announce its next interest rate decision. Another 17 banks and building societies (so 58 in total) now have access to the standing deposit and lending facilities.

The new system is designed to ensure that very short-term market interest rates are stable and in line with the decisions of the MPC, and to enhance banking system liquidity management. By reducing volatility and bringing many more banks into the system, it creates an efficient, flexible and simple framework for banks to manage their day-to-day liquidity.

Commenting, Mervyn King – Governor of the Bank of England – said:

“These important reforms are a big step forward. They provide the same transparency and clarity for the implementation of monetary policy as we already have for the MPC's decisions. They give the Bank a more effective and efficient system for providing liquidity to the banking system, and improve our ability to contain any future crises.”

Notes to Editors

1 The new framework for the Bank's operations and how the Bank expects it to meet the objectives below is set out in a paper published on 15 May 2006, 'The framework for the Bank of England's operations in the sterling money markets' (also known as the 'Red Book'). It is available at, www.bankofengland.co.uk/markets/money/publications/redbook0506.pdf (see Key Resources below).

2 The objectives of the new system are:

- Overnight market interest rates to be in line with the Bank's official 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.
- 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.
- A simple, straightforward and transparent operational framework.
- Competitive and fair sterling money markets.

In pursuit of these objectives, the new framework is based on a system of voluntary remunerated reserves with a period-average maintenance requirement. In addition, standing deposit and (secured) facilities are available on demand, in unlimited amounts, to a wide range of banks and building societies. The Bank's short term open market operations are now weekly operations for one-week maturity. A routine overnight fine-tuning operation is conducted on the final day of the maintenance period.

3 Reserves (or bankers' balances) with the Bank have increased from £45 million to, in the first month, around £23 billion. This has increased significantly the size of the Bank's balance sheet and, therefore, the amount it needs to lend in its open market operations (OMOs). To reduce the size of the weekly short-term OMOs, monthly long-term repo OMOs were introduced in January 2006. These provide financing at market rates, at maturities of three, six, nine and twelve months. The Bank will also in due course provide reserves through outright purchases of high-quality bonds in regular OMOs.

4 The Bank completed the first of its new weekly short-term OMOs yesterday, providing some £36 billion to finance the provision of banknotes and reserves. The trades will be settled today. The weekly short-term OMOs will normally take place each Thursday for same-day settlement.

5 Banks and building societies which are required to place Cash Ratio Deposits with the Bank are eligible to be reserves scheme members and to have access to the standing facilities. There are 41 reserve scheme members and 58 standing facilities participants. This has substantially extended participation in the Bank's sterling market operations. These institutions comprise the major part of the UK banking system by size of balance sheet, with reserve-scheme members alone accounting for around 90% of sterling bank liabilities.

The number of counterparties in the Bank's open market operations has also increased significantly. The relationships between each of the Bank's facilities are illustrated in the diagram below.

6 Normally, a maintenance period will run from the day of one scheduled MPC interest rate decision to the day before the next scheduled decision. However, as a transitional measure, the first maintenance period started on a Thursday that was not an MPC decision day. The first maintenance period is therefore shorter than usual, running for three weeks.

7 The Bank introduced some interim reforms in March 2005. These technical changes to the previous framework for the Bank's operations stabilised short-term market interest rates within a 50bp corridor ahead of the introduction of the new framework.

Diagram: Access to the Bank's facilities

http://webarchive.nationalarchives.gov.uk/20100114080129/http://www.bankofengland.co.uk/publications/news/2006/055_image.jpg

Key Resources

The framework for the Bank of England's operations in the sterling money markets (The 'Red Book') - May 2006

<http://webarchive.nationalarchives.gov.uk/20100114080129/http://www.bankofengland.co.uk/markets/money/publications/redbook0506.pdf>

Documentation for the Bank of England's Operations in the Sterling Money Markets

Full and definitive details of the Bank's framework.

<http://webarchive.nationalarchives.gov.uk/20100114080129/http://www.bankofengland.co.uk/markets/money/documentation/051222full.pdf>

List of Reserve Scheme Members and Standing Facilities Participants

<http://webarchive.nationalarchives.gov.uk/20100114080129/http://www.bankofengland.co.uk/markets/money/documentation/participants060515.pdf>