Sterling market liquidity over the Y2K period

Statement by the Bank of England

The Bank of England has been making active preparations to promote orderly market conditions over the Y2K period. The successful testing of the key sterling market systems—CGO, CMO, CREST and RTGS—reported in the Bank's *Blue Book* series gives assurance to market participants that the infrastructure will operate normally. In parallel, the Bank has taken a number of steps to ensure that sterling market participants who have made proper preparations for Y2K can obtain adequate liquidity over the period to enable them to maintain normal business activity.

This statement summarises the arrangements that will operate over the period.

Liquidity for the whole financial system. The Bank of England has made clear from the outset that it will at all times ensure that it provides fully adequate liquidity to meet the needs of the financial system as a whole, as it does every day. This will primarily be provided through the Bank's normal daily open market operations, conducted in two-week repo against eligible collateral with the Bank's sterling money-market counterparties, who are the main active participants in the sterling money markets. The Bank's counterparties in turn distribute the liquidity provided by the Bank around the financial system as a whole. The Bank has carefully reviewed the system's prospective need for liquidity over the Y2K period, and is satisfied that it is both able and ready to supply the necessary liquidity throughout the period.

Liquidity management by market participants. To ensure that the liquidity provided by the Bank is distributed smoothly round the financial system, the Bank, working with the Financial Services Authority, has maintained close liaison with a wide range of sterling market participants, in order to monitor their plans for the Y2K period. These discussions have covered market participants' plans for management of their liquidity, their holdings of eligible collateral, credit limits, relationships with customers, correspondents and counterparties, and business activity over the Y2K period. The picture that emerges from these discussions is that, although the markets may be thinner than normal, as indeed is typically the case at the end of any year, market participants are well advanced with making sensible plans to maintain business largely as normal over the period. From the review of these plans taken as a whole, the Bank sees no reason why there should be any material disturbance to the orderly functioning of markets. The Bank will, however, in conjunction with the Financial Services Authority, continue to monitor market participants' plans closely, and will be ready to respond if undue strains should arise in the markets.

Adequate availability of collateral. A key requirement for the orderly conduct of business over the Y2K period is that market participants should equip themselves with adequate marketable collateral, which they can then mobilise if necessary to obtain liquidity in the market. To ensure that there is adequate collateral available for this purpose, the Bank has over the past year progressively extended the range of collateral eligible to be used on repo to obtain liquidity from the Bank in its daily open market operations. In the latest step in this process, which was implemented on 31 August, the pool of eligible securities was enlarged by some £2 trillion—a six-fold increase—to include government securities issued in euro by the European Economic Area countries. Details of eligible collateral now accepted by the Bank are given in the box below. Market participants have indicated that this extensive range makes ample collateral available for firms to manage their liquidity on an orderly basis through the Y2K period. This extension of the range of collateral taken by the Bank is permanent. The Bank has also held discussions with participants in the stock lending and repo markets and is satisfied that, there too, participants are planning to maintain orderly trading activity through the Y2K period.

Securities eligible for repo operations with the Bank of England

The following securities are eligible for use by the Bank's counterparties in repo operations with the Bank of England, both in the Bank's daily open market operations to provide two-week liquidity and in the new longer-term repo facility for (initially) three-month repos:

- Gilts (including gilt strips).
- Sterling Treasury bills.
- Bank of England euro bills.
- Eligible bank bills.
- Eligible local authority bills.
- UK government non-sterling marketable debt.
- Sterling-denominated securities issued by European Economic Area (EEA) governments and major international institutions.(1)
- Securities (including strips) denominated in euro, issued by the central governments and central banks of the EEA and major international institutions, which are eligible as Tier 1 collateral for use in ESCB monetary policy operations.(1)

(1) Eligible securities in these categories are listed on the 'Eligible securities' page on the Bank's web site (www.bankofengland.co.uk/eligsec.htm).

Longer-term repos

The longer-term repo facility will be available from Wednesday 13 October 1999 through to the early months of 2000 and will be operated once each week. Applications to utilise the facility will be invited on the Wednesday of each week and proceeds will be made available to successful applicants on the Thursday and Friday of the same week, with the amounts spread equally between the two days in order to smooth the impact on the daily pattern of money-market shortages. Liquidity provided under the facility will be in the form of repo against the full range of collateral eligible for use in the Bank's normal daily open market operations, which provide two-week liquidity and will continue unchanged in parallel with the new longer-term repo facility.

Ahead of each week's activation of the new facility, the Bank may set a maximum amount to be provided under the facility that week in order to avoid undue fluctuations in the daily profile of money-market shortages. In the event that market demand exceeds the maximum, the Bank would endeavour to increase the amounts available under the facility in succeeding weeks in order to meet the market's needs in full over the period.

Repos under the facility will initially be offered for three months' maturity, ie across the end of the year. After October, repos may also be offered for two months, and possibly also for one month; the precise pattern of maturities available will be determined in the light of experience with the use of the facility. The rate of interest charged on amounts taken under the facility will be the Bank's repo rate, but will vary so that, if the Bank's repo rate is changed during the life of a longer-term repo, interest from that point will be charged at the new repo rate.

The new facility will be available to firms who are the Bank's counterparties in its daily open market repo operations. It is the Bank's intention that the facility should also provide an opportunity for market participants who are not counterparties of the Bank to obtain longer-term liquidity from the Bank's counterparties for periods ranging across the Y2K date change, against collateral which the Bank's counterparties can in turn use to obtain equivalent-term liquidity from the Bank. The Bank is encouraging its counterparties to make active use of the new facility for this purpose.

Longer-term repos. To provide further help to market participants in planning their liquidity management over the Y2K period as a whole, the Bank is putting in place a temporary facility, for longer-term repos with its counterparties, to run from October 1999 through to the early months of 2000. This facility will enable the Bank's counterparties to obtain liquidity from the Bank, on repo against eligible collateral, for periods of up to three months. It will run in parallel with the Bank's normal daily open market operations under which it provides liquidity against eligible collateral for two-week periods. Details of the longer-term repo facility are given in the box above.

Distribution of liquidity across the financial system. The longer-term repo facility will be of particular interest to market participants who are not counterparties of the Bank. It will provide an opportunity for them to obtain liquidity from the Bank's counterparties for periods ranging across the Y2K date change, against collateral which the Bank's counterparties can in turn use to obtain equivalent-term liquidity from the Bank. The Bank is encouraging its counterparties to make active use of the new facility to distribute liquidity to other market participants against eligible collateral, as is the case already for the Bank's normal daily two-week repo operations. The Bank will be monitoring the process closely and, if appropriate, will be prepared to put in place arrangements to enable non-counterparties who hold eligible collateral to obtain liquidity against that collateral direct from the Bank.

Contingency preparations. The Bank is confident that the careful planning of operations over the Y2K period undertaken by market participants, and the facilities the Bank has put in place to assist the market, as described above, should ensure that orderly market conditions are maintained over the period. Market participants are well advanced with planning orderly conduct of their business activities over the period. The structure of market rates is consistent with this view: while unsecured rates for the period over the year-end have tightened somewhat, though less than in some overseas markets, secured money rates in the repo market for liquidity obtainable against marketable collateral show no material end-year effect. This indicates that an adequate supply of collateral is available and that liquidity can freely be obtained against it. Nevertheless, the Bank is alert to the possibility that conditions could change, and has undertaken contingency preparations to enable it to respond quickly, in a variety of different ways as necessary, if strains should emerge at any time. These preparations include discussions with overseas central banks to ensure that relevant cross-border developments can if necessary be addressed quickly. The Bank will stand ready to put these contingency preparations into operation if the need should arise.

Market participants are encouraged to remain in close contact with the Bank of England throughout the Y2K period if they have any questions about the arrangements described in this paper or wish to communicate or seek clarification on developments in markets or in their own operations.