



Memorandum – decision background

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SVERIGES RIKSBANK
SE-103 37 Stockholm
(Brunkebergstorg 11)

Tel +46 8 787 00 00

DNR

■ Changes in the Riksbank's SEK facilities

Background

Since autumn 2008 the Riksbank has regularly held auctions for loans in SEK, both against the collateral the Riksbank normally accepts, and against newly-issued commercial papers with a slightly poorer credit rating than those normally accepted as collateral. The allocation of loans among the Riksbank's monetary policy counterparties has been done by means of auctions where the Riksbank has stated a minimum interest rate corresponding to the repo rate applying at the time of the auction plus an supplement. At most the borrowing in Swedish krona amounted to around SEK 265 billion at the turn of the year 2008/2009, and then on 7 February it had fallen to around SEK 205 billion.

One purpose of the Riksbank's lending has been to facilitate the banks' funding and the functioning of the markets when market financing dried up. The lending has had the intended effect in that it has contributed to ensuring the banks' short-term financing, and to a fall in interbank rates. The scope of the lending against newly-issued commercial paper has not been as extensive as expected, but it has nevertheless had some positive effect on companies' opportunities to issue commercial paper.

Interest in the Riksbank's auctions has recently shown a significant decline, and at some auctions no bids have been received. This could be a positive sign and may reflect that conditions in the financial markets are more stable now than they were in the autumn. But at the same time, it should be noted that the situation in the financial markets is far from normal, which is clear for instance from the differential between interbank rates with a slightly longer maturity and expectations of future policy rates (the so-called basis spread). Nor has the commercial paper market made a complete recovery, and the effects of the decline in market borrowing now risk also having a much clearer negative effect on the non-financial companies than before. In international terms the financial crisis has not been resolved and there is reason for the Riksbank to continue to maintain a high level of preparedness.

The weak interest in the Riksbank's auctions may also be connected to the fact that the loans are perceived as relatively expensive. Compared with other central bank, the Riksbank has had relatively expensive lending in that the interest rate has been set at the monetary policy rate plus a supplement. In addition, lending has been at a fixed interest rate, the repo rate plus a supplement, which in times of expectations of repo rate cuts may have contributed to the loans being perceived as even more expensive.

The situation in the world's financial markets is far from normal and measures are regularly being taken by governments and central banks. In Sweden there are signs that the supply of credit to non-financial companies has deteriorated. Borrowing in the market has been made more difficult – particularly at longer maturities – and larger

■ companies have therefore been forced to rely to a greater extent on funding from the banks. Reports imply that this has limited the scope for the banks' financing to small and medium-sized companies.

This means that it is important that the Riksbank continues to offer credit in SEK. Given the fact that the interest rate expectations may have contributed to the low interest in the auctions, there is reason to review the principles for interest-rate setting. In addition, there are also reasons to consider longer maturities for the loans, in that these both improve the banks' liquidity situation and allow more long-term funding, partly and also facilitate the banks' possibilities to grant longer loans to companies.

Considerations

There are strong reasons why the Riksbank should continue to supply loans with a 3-month and 6-month maturity in SEK. These are needed both to support the banks' funding and the functioning of the markets, and to promote granting of loans to Swedish companies. At the same time, it can be noted that interest in the Riksbank's most recent loan was very weak. The Riksbank's assessment is that one reason for the lack of interest may have been the market expectations of repo rate cuts. A changeover to a variable interest rate would mean that such expectations did not affect future auctions of loans.

In addition to the variable interest rate a minimum supplement should be set. It is difficult to establish exact maturities and credit risk premiums, but a possible starting point is the average observed difference between interbank rates - rates on loans without collateral - and the expected policy rate. The average during the period January 2003 to June 2007 was approximately 0.15 percentage points at 3, 6 and 12 months ahead. The Riksbank's loans are always granted against collateral, which calls for a lower supplement. The supplements of 0.25 and 0.40 percentage points applied to earlier loans were set when the repo rate was much higher. A lower interest rate may justify a lower supplement. Given the above, the supplements for the loans granted against ordinary collateral should be set at 0.15 percentage points regardless of maturity.

For loans granted against commercial paper, loans should be granted at 3-month, 6-month and 12-month maturities in order to ensure that companies will be able to finance themselves at longer maturities. With regard to the interest supplement for these loans, a further premium of 0.05 percentage points should be set in that the collateral is in this case slightly poorer.

The changeover to a variable interest rate means that the auction bids will be made in the form of supplements at an average repo rate not known at the time of the auction, and not as now, at a particular interest rate. However, this does not entail any problems in the implementation of the auctions. The auctions will instead be held with the supplement as auction variable.

It is difficult to determine suitable volumes for these auctions in advance and some flexibility may be needed in the final formulation of the auctions. It is therefore suggested that the Executive Board delegate to the Head of the Monetary Policy Department to adjust the scope of the auctions, within these guidelines, according to the prevailing market conditions and the bids received. The maximum amount that the Riksbank has lent at a particular point in time may not exceed an amount that has been set by the Executive Board. However, the Riksbank is prepared to supply the liquidity necessary to maintain the stability of the financial system.

■ Proposed decision

It is proposed that the Executive Board decide that:

- 1 The Riksbank will continue to offer loans in SEK against normal collateral to the Riksbank's monetary policy counterparties at maturities of three and six months. Auctions of loans with a three-month maturity will be held approximately once a fortnight and loans with a six-month maturity approximately once every four weeks.
- 2 The minimum interest rate on these loans granted against normal collateral will be set at the average repo rate during the maturity of the loan plus a supplement. The supplement will be 0.15 percentage points for all maturities.
- 3 The Riksbank shall continue to offer loans in Swedish krona against commercial paper to the Riksbank's monetary policy counterparties. In addition to the three-month loans already granted, auctions will also be held for loans with maturities of six months and twelve months. The auctions will be held approximately once a fortnight.
- 4 The minimum interest rate on the loans granted against collateral in the form of newly-issued commercial paper will be set at the average repo rate during the maturity of the loan plus a supplement. The supplement will be 0.20 percentage points for all maturities.
- 5 The loans will be offered through auctions held up to the end of August 2009.
- 6 The Head of the Monetary Policy Department or a person he nominates in his stead is given the task of determining the more detailed terms for the loans. A decision in accordance with this delegation may not entail that the outstanding volume of the Riksbank credits referred to under points 1 and 3 above exceeds SEK 600 billion.