



Decision memorandum

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DEPARTMENT: Monetary Policy Department

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■ Changes in the difference between the repo rate and the interest rates in the standing facilities

Proposed decision

It is proposed that the Executive Board decide that:

- The difference between the repo rate and the interest rates in the standing facilities should be restored to the level applying prior to 22 April 2009. This means that the deposit rate will be the repo rate minus 0.75 of a percentage point, and that the lending rate will be the repo rate plus 0.75 of a percentage point.

Background

The Riksbank's interest rate management system contains several components for managing the shortest interest rate of all, what is known as the overnight rate. Firstly, the Riksbank supplies so-called standing facilities. This means that the banks can borrow money from, or deposit money with, the Riksbank overnight. The interest a bank receives when it deposits money with the Riksbank overnight is known as the Riksbank's deposit rate. Correspondingly, the bank pays the Riksbank's lending rate if the bank borrows money from the Riksbank overnight.¹ The deposit rate is the "floor" and the lending rate is the "ceiling" in what is known as the interest rate corridor, which is tied to the repo rate with the addition/subtraction of 0.50 of a percentage point (with effect from 22 April 2009). The interest rate corridor sets an upper and a lower limit for the overnight rate, as a bank that needs to borrow can always borrow from the Riksbank at the lending rate, and a bank that needs to deposit money can always deposit its surplus with the Riksbank at the deposit rate. As there is a difference between the deposit and lending rates, the banks have an incentive to agree on an interest rate that lies between the rates they would pay to or receive from the Riksbank.

Secondly, the Riksbank uses the repo rate to signal where the overnight rate should lie. The repo rate is the interest rate that is received for the Riksbank Certificates the Riksbank issues once a week.² Thirdly, the Riksbank implements fine-tuning operations

¹ All lending is against collateral.

² As a result of the Riksbank's loans to the banks at longer maturities, the bank system as a whole has a liquidity surplus, which the Riksbank drains by issuing Riksbank Certificates. If the bank system instead has a need to borrow money, the Riksbank satisfies this by buying securities with an agreement to sell them back, what is known as a repo transaction. In both cases, the interest rate the banks receive or pay is equal to the repo rate.

every day to stabilise the overnight rate. This is achieved by the bank system as a whole being able to borrow or deposit in the Riksbank at the repo rate plus/minus 0.1 of a percentage point, depending on whether the bank system as a whole has a surplus or deficit towards the Riksbank at the end of the day. As a result, the overnight interest rate is kept inside a band that is narrower than the interest rate corridor and contributes to a more effective implementation of monetary policy.

The width of the interest rate corridor was for many years, and up to April 2009, 1.50 percentage points, that is, the deposit rate was 0.75 of a percentage point below the repo rate and the lending rate was 0.75 of a percentage point above the repo rate. The width of the corridor can be regarded as a balance between two things. On the one hand, the need for clear monetary policy signalling indicates that the corridor should be very narrow. On the other hand, a wide corridor creates good conditions for an efficient overnight market, in that it creates strong incentives for the banks to trade with one another.

When the Riksbank cut the repo rate to 0.50 per cent in April 2009, the interest rate corridor was also adjusted. There was then concern over the possible negative effects of a negative deposit rate. The assessment made was that a slightly narrower corridor would not essentially reduce the incentive for the banks to trade overnight with one another. When the repo rate was cut to 0.25 per cent in July 2009, the assessment was that a further reduction could weaken these incentives. The corridor was therefore kept at the same width, and the Riksbank's deposit rate has since then been negative, without any operational problems.

Considerations

The experiences of both a corridor width of 1.50 percentage points, and a corridor width of 1.0 percentage points over the past year, have been good. There is now reason to return to what is, historically, a normal width for the interest rate corridor. This measure can be regarded as part of the process of normalising monetary policy.