

## ARTICLE – The Riksbank's operational framework needs to be adjusted to new conditions

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The Riksbank's policy rate decisions are put into practice via the Riksbank's operational framework for the implementation of monetary policy. With the aid of the operational framework, the Riksbank ensures that the shortest market rates are stabilised close to the policy rate. Developments in the world around the Riksbank mean that the operational framework needs to be adapted. The most important drivers of change are the increased number of monetary policy counterparties, new categories of actors wishing to become counterparties to the Riksbank, and developments in the payment field that will make it possible to make transactions 24/7. The Riksbank is therefore considering changing the operational framework so that it can continue to affect market rates effectively. The operational framework needs to become simpler and more automated to remain robust. The main changes the Riksbank is considering making are to abandon the daily fine-tuning transactions and to reduce the difference in interest rates for the standing lending and deposit facilities. In this way, the Riksbank can ensure that the overnight rate remains close to the policy rate, even without daily operations. The weekly market operations at the policy rate will remain. The proposed adjustments to the Riksbank's operational framework for monetary policy are of a technical nature and are not intended to have any monetary policy effects. The Riksbank will decide on the design of the new operational framework following a consultation procedure during the period 3 July to 30 September to gather the views of interested parties. After that, the changes to the operational framework can begin in October 2019.

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### The Riksbank steers the overnight rate

The Riksbank influences interest rates in the economy in order to fulfil the inflation target. The Riksbank's main tool for conducting monetary policy is the policy rate. The Executive Board takes decisions on the Riksbank's policy rate – the repo rate – at the monetary policy meetings. In practice, these decisions are realised with the use of the Riksbank's operational framework, which specifies which actors have the opportunity of lending or depositing money at the Riksbank and at which interest rate.

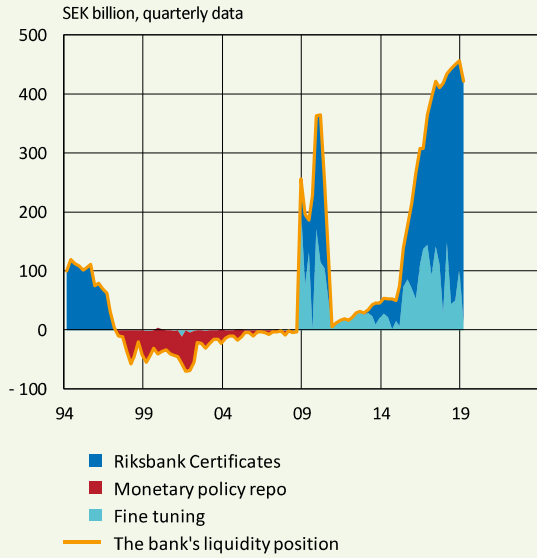
The repo rate is an important benchmark for the interest rates applied to the banks' deposits to and loans from the Riksbank. Any deficit or surplus the banks have on their accounts in the Riksbank's payment system, RIX, at the end of the day are automatically managed as loans or deposits overnight at the repo rate plus/minus 0.75 percentage points. As one alternative to lending and deposits at the Riksbank is for the banks to borrow money from one another, the Riksbank's lending and deposit rates will be set to give the banks strong incentives to agree on an interest rate that is within the Riksbank's corridor of plus/minus 0.75 percentage points around the repo rate for overnight loans between one another. Ultimately, this also affects the interest rates that the banks' customers, that is to say companies and households, will face.

### Daily market operations at present

To stabilise the overnight rate around the Riksbank's repo rate, the Riksbank offers to accept deposits of the banking system's daily investment needs after the banks have evened out their deficits and surpluses between themselves. This is performed at the repo rate minus 0.10 percentage points and is known as the fine-tuning rate for deposits. If the banking system has a borrowing requirement at the end of the day, the Riksbank can, instead, lend the corresponding amount at the repo rate plus 0.10 percentage points (the fine-tuning rate for lending). This fine-tuning contributes to the overnight rate mostly being close to the Riksbank's repo rate.

The banking system's daily deposit or borrowing requirement after the banks have evened out their daily deficits and surpluses with each other form the banking system's liquidity position in relation to the Riksbank. Over time, the banking system has had both significant surpluses and deficits in relation to the Riksbank (see Figure 1:13). Nevertheless, the Riksbank's operational framework has succeeded in stabilising the overnight rate well. This is a quality that a new operational framework must also possess.

**Figure 1:13. The banks' liquidity position in relation to the Riksbank**



Source: The Riksbank

**Changed conditions**

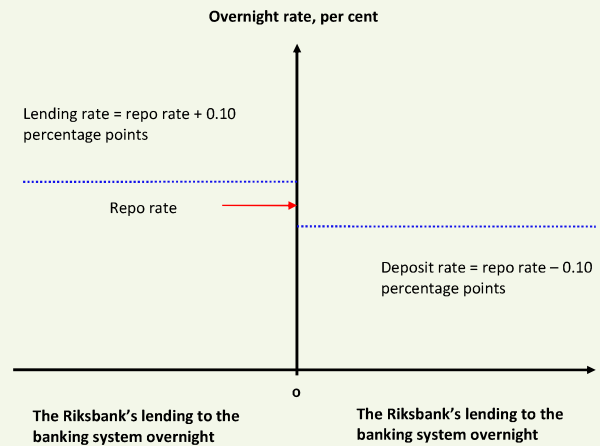
In the near future, it is primarily changes in the area of payments that justify the need for adjusting the operational framework. Rapid changes have been taking place in the payment area for a number of years. There is a trend towards it being possible to make payments around the clock, seven days a week. In 2021, the Riksbank intends to supply a new service that gives the banks the possibility to make payments in central bank money in the Riksbank's system every day of the year.<sup>10</sup> To facilitate the development of instant payments 24 hours a day in central bank money, the Riksbank intends to abandon the daily market operations in the form of fine tuning transactions.

Another imminent change is that, as of 14 October 2019, RIX will shut one hour later than at present. This will mean that the fine-tuning transactions need to be made an hour later than they are today. As the fine-tuning involves several manual elements, it would mean that both the Riksbank and the banks would need to increase the resources required to manage the fine tuning. The number of monetary policy counterparties has increased and is expected to continue to increase. This means that more counterparties can be involved in the manual administration that fine-tuning entails. The consequences of this would be an increase in operational risks.

**The operational framework for monetary policy needs to be adjusted**

The Riksbank has concluded that the operational framework for monetary policy needs to be adjusted so that manual routines such as fine-tuning transactions can be replaced, to a

greater degree, by automated procedures. This would make the system more robust with respect to changes. The Riksbank is therefore considering dropping the daily fine-tuning transactions as a way of adapting to the changed conditions in the payment area. At the same time, this would mean that the lending and deposit rates were changed from the current repo rate plus/minus 0.75 percentage points to the repo rate plus/minus 0.10 percentage points (see Figure below).



The difference between the Riksbank's lending or deposit rates will thus be significantly less than it is today. This means that the overnight rate will be less sensitive to how the liquidity in the banking system is divided between the banks at the end of the day. If an imbalance arises and one bank deposits while another borrows in the standing facilities, they will deposit/borrow at interest rates close to the policy rate. A narrow corridor is also expected to promote activity on the interbank market. A bank should become more willing to lend money from one day to the next if, in the event of a deficit at the end of the day, it knows it can borrow from the Riksbank at an interest rate of 0.10 percentage points over the policy rate. In this way the Riksbank can ensure that the overnight rate remains close to the repo rate.

With this system, lending and depositing at the end of the day will be automatic, without the elements of manual processing currently linked to fine-tuning. The banks will no longer need to call the Riksbank and deposit or lend money in fine-tuning transactions. The balances that may remain on the banks' RIX accounts after they have borrowed or lent to one another will automatically enter the Riksbank's lending or deposit facilities. As manual processing will cease, the operational risks for both the Riksbank and the monetary policy counterparties will decrease and monetary policy can be implemented more efficiently.

<sup>10</sup> See "Riksbank planning for instant payments", news item on [www.riksbank.se](http://www.riksbank.se) published on 11 June 2019.

The proposed adjustments to the Riksbank's operational framework are not intended to have any monetary policy effects. In practice, the operational framework will be adjusted to what the Riksbank is already doing. As a consequence of the Riksbank's comprehensive purchases of Swedish government securities, the banking system has had and will have a large liquidity surplus for the foreseeable future. The monetary policy counterparties invest this liquidity surplus either in Riksbank Certificates with a maturity of one week at the Riksbank's repo rate or deposit it overnight at an interest rate 0.10 percentage points below the Riksbank's repo rate.

#### **Transaction-based overnight rates allow the possibility of evaluation and follow-up**

The Riksbank needs to have access to transaction-based overnight rates to be able to evaluate how efficiently monetary policy is being implemented – which is to say that the Riksbank is stabilising the overnight rate close to the policy rate. The Riksbank has therefore introduced into the new Terms and Conditions for RIX and Monetary Policy Instruments that started to apply as of 1 April of this year incorporated reporting requirements for the monetary policy counterparties. This reporting will mean that the Riksbank can calculate transaction-based overnight rates for the shortest maturities in Swedish krona on a daily basis.

#### **Consultation on the Riksbank's new operational framework for monetary policy**

The Riksbank will decide on the final form for the adjusted operational framework for monetary policy and the road ahead after a consultation procedure to inform of the proposed changes and gather views from RIX participants, monetary policy counterparties and other interested parties. The consultation procedure will take place during the period 3 July to 30 September 2019 and take up several questions, including how interest rate setting and the banks' liquidity management will be affected. Questions concerning which securities may be used as collateral for credit and the role of Riksbank Certificates will also be addressed.

The changes to the operational framework will be made in two stages. In stage one, which is proposed to be implemented at the beginning of October, the Riksbank is considering:

- ceasing its daily manual fine-tuning transactions
- setting the deposit rate on the standing deposit facility at the policy rate minus 0.10 percentage points
- allowing the lending rate to remain at, or close to, the policy rate plus 0.75 percentage points

If the daily manual administration is abandoned, the operational framework will become automatic. The interest rate corridor will be narrower than it is today, which means

that the overnight rate should continue to be close to the policy rate.

In the second stage, the lending rate on the standing lending facility will be set at the policy rate plus 0.10 percentage points, at the same time as some changes are being considered with regard to collateral requirements. This is proposed to be done within two years of the operational framework becoming automated.

In September, the Riksbank will also conduct a further consultation procedure focusing on the Riksbank's possible administration responsibility for a reference rate for the very shortest maturities in Swedish krona. The Riksbank's work on producing transaction-based overnight rates provides many of the conditions required to administer and publish a reference rate.