



Operating Framework for the Implementation of Monetary Policy at the Effective Lower Bound for the Overnight Interest Rate

As part of the Bank of Canada's [interest rate decision on 21 April 2009](#), there are two key changes to the operating framework for the implementation of monetary policy¹:

- i) the operating band has been narrowed to 25 basis points compared to 50 basis points previously; and
- ii) the target for the overnight rate is the bottom of the 1/4 to 1/2 per cent operating band rather than the midpoint of the band.

With these changes, the Bank is setting an effective lower bound (ELB) of 25 basis points on the overnight interest rate in order to preserve the effective functioning of markets in a low interest rate environment.

Overnight Interest Rate:

The Bank of Canada's primary influence on the overnight interest rate is through its operating band, the limits of which are established by the interest rates on its Standing Facilities for deposits and overdraft loans. In the operating framework at the ELB, overnight purchase/repurchase operations will also reinforce these limits.

In addition, the Bank will provide excess settlement balances to create the incentives for the overnight rate to trade at the bottom of the operating band, i.e., the target rate. By providing significantly more aggregate balances than required by participants in the Large Value Transfer System (LVTS participants), overnight funds are expected to trade at 1/4 per cent – the rate that the Bank of Canada pays on deposits.

Operating Band in the ELB framework

The operating band is 1/4 to 1/2 per cent.

The upper limit, 1/2 per cent, is the Bank Rate reinforced by:

- **The Standing Liquidity Facility (SLF):** Access to overdraft loans at Bank Rate at the Bank of Canada for LVTS participants, the large-

¹ For a detailed description of the Bank's standard operating framework, see "[A primer on the Implementation of Monetary Policy in the LVTS Environment.](#)"

deposit-taking institutions who settle directly on the books of the Bank of Canada.

- **Purchase and Resale Agreements (PRAs):** Primary Dealers, the main market-makers in Government of Canada securities and the Bank of Canada's counterparties in routine buyback operations, will have access to a new standing Purchase and Resale Agreement facility at Bank Rate.(see [Terms and Conditions](#))²

The lower limit, 1/4 per cent, is the deposit rate, reinforced by:

- **The standing deposit facility:** LVTS participants have access to a standing deposit facility on which they will earn the deposit rate.
- **Sale and Repurchase Agreements (SRAs):** The Bank of Canada will conduct Sale and Repurchase Agreements (SRAs) intraday at 1/4 per cent with Primary Dealers if required.

Settlement Balances:

The Bank of Canada will target a daily level of settlement balances in the financial system at \$3 billion effective 21 April.³ Therefore, any participant in the LVTS with a surplus position is aware that they can earn the deposit rate and so will not lend below this rate. Any participant in a deficit position will be aware that there are surplus funds available in the system and that competition is likely to drive the overnight rate to the bottom of the band.⁴

Note that the transfer of government deposits between the government's account at the Bank of Canada and the financial institutions through daily auctions will continue to be the primary mechanism to achieve the targeted level of settlement balances (see Terms and Conditions governing [morning](#) & [afternoon](#) auctions of Receiver General cash balances)

The Bank of Canada will continue to publish the target and actual level of settlement balances on [its website](#) daily by 16:30

The table on the following page highlights the key differences between the standard operating framework and that at the ELB.

² Unlike Special PRA, this new standing PRA facility can be accessed at the discretion of each Primary Dealer rather than an offer at the discretion of the Bank of Canada.

³ The Bank of Canada will preannounce any changes in this target level.

⁴ If, however, the overnight rate does not trade at the lower end of the operating band the Bank of Canada reserves the right to enter into overnight Special PRAs to put downward pressure on that rate.

Operating Framework for the Implementation of Monetary Policy

	Standard	Effective Lower Bound (ELB)
Operating Band	The upper limit is the Bank Rate, the rate at which the Bank of Canada provides overdraft loans under its Standing Liquidity Facility (SLF) at the end of LVTS settlement.	The upper limit is the Bank Rate, the rate at which the Bank of Canada provides overdraft loans (SLF) at the end of LVTS settlement and, in addition, at which a standing PRA facility is available to Primary Dealers (PDs).
	The lower limit is the rate paid on deposits by the Bank of Canada at the end of LVTS settlement.	The lower limit is the deposit rate, the rate paid on deposits by the Bank of Canada at the end of LVTS settlement and where SRAs are offered to PDs if the overnight rate is trading below the lower end of the band.
Target for the Overnight Rate	The <u>midpoint</u> of the operating band. The Bank of Canada uses the rate on overnight general collateral as its guide to conditions in the overnight market.	The <u>bottom</u> of the operating band. The Bank of Canada uses the rate on overnight general collateral as its guide to conditions in the overnight market.
	The use of open market buyback operations at the mid-point of the operating band to reinforce the target rate. Special PRAs are offered if the overnight rate is above the target rate and. SRAs are offered if the overnight rate is below the target rate.	Excess settlement balances create the incentives for the overnight rate to trade at the bottom of the band; i.e., the target rate.
Buyback operations	Used to reinforce <u>the mid-point</u> of the operating band	Used to reinforce <u>the limits</u> of the operating band.
Settlement Balances (Cash Setting)	The Bank will typically target a small positive amount of settlement balances. Any LVTS participant with a surplus position is aware that there is at least one other participant with an offsetting deficit.	The Bank will target \$3 billion settlement balances effective 21 April 2009. Any LVTS participant with: 1) a surplus position is aware that they may earn 1/4 per cent at the BoC, and 2) a deficit is aware that there are excess balances and competition should drive rates to the lower end of the band.
	The level of settlement balances is achieved through the transfer of government balances from/to the Bank of Canada to/from LVTS and other participants in government auctions.	The level of settlement balances is achieved through the transfer of government balances from/to the Bank of Canada to/from LVTS and other participants in government auctions.