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What happens after Governing Council sets the target for the policy interest rate

Inside the implementation framework that makes monetary policy work

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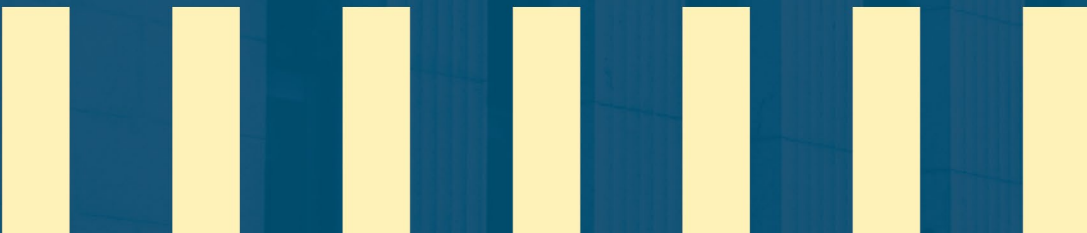
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Abstract

What happens after Governing Council sets the target for the policy interest rate? Setting the target rate is the most visible part of monetary policy, but it is only the first step in transmitting the rate decision to the Canadian economy. This paper explains how the Bank of Canada uses its monetary policy implementation framework (MPI) to ensure that the rate decision is reflected in financial markets by keeping short-term interest rates close to the target policy rate.

Interest rate control is shaped by the structure of the overnight money market in Canada. The Bank assesses interest rate control primarily through the Canadian Overnight Repo Rate Average (CORRA), a secured overnight repo rate. As a result, implementing monetary policy depends not only on the supply of central bank reserves (or settlement balances) but also on conditions in the repo market where CORRA is determined. Imbalances in the repo market can move CORRA away from the target policy rate even when the overall level of reserves is within the estimated range of steady-state demand. The Bank therefore uses targeted tools to respond when pressures threaten effective rate control, while allowing some deviations from target to preserve useful market signals and incentivize market participants to manage their own liquidity and to trade with each other.

The design and use of these tools reflect the trade-offs at the core of the MPI framework: maintaining interest rate control, preserving market incentives and keeping the Bank's balance sheet no larger than necessary. The Bank's tools and standing facilities support an approach of supplying just enough reserves—enough liquidity for efficient payment settlement, market functioning and monetary policy implementation, without supplying more than necessary. When market pressures warrant a response, the Bank relies on targeted and discretionary operations rather than on a larger supply of reserves.

The Bank has refined its tools as market conditions have evolved in recent years. Examples include the introduction and more active use of the two-week term repo and the January 2025 adjustment to the deposit rate. These changes show how the Bank can adapt its tools to maintain effective interest rate control while preserving market incentives.

From policy decision to market reality: How the Bank of Canada implements monetary policy

When the Bank of Canada changes the target for its [policy interest rate](#), Canadians see the effects through changes in mortgage rates, borrowing costs, investment returns and, over time, in economic activity and inflation. Yet setting the target for the policy interest rate is only one part of monetary policy. The Bank must also ensure that financial markets operate in a way that allows monetary policy decisions to influence these borrowing and lending conditions throughout the economy.

This is the role of the Bank's monetary policy implementation (MPI) framework, a key part of the Bank's broader [framework for market operations and liquidity provisions](#). The MPI framework is the set of tools, facilities and operations the Bank uses daily to help keep short-term market interest rates sufficiently close to the policy rate.

Like all central banks, the Bank faces important trade-offs when designing its MPI framework:

- Should the Bank keep short-term market rates very close to the policy target, or tolerate more variation to preserve market price signals and incentives to trade?
- Should the Bank supply a larger reserve buffer, or rely more on targeted operations when liquidity pressures arise? ¹
- Should the opportunity cost of holding reserves remain low, or rise to encourage institutions to redistribute liquidity through markets?

The answer to each question depends on how policy-makers choose to balance competing objectives.

Different central banks have adopted different approaches based on the structure of their financial systems and money markets and on how policy-makers weigh competing objectives and trade-offs. This paper explains how the Bank's MPI framework helps keep short-term market rates close to the target policy rate while balancing reserve supply, market incentives and balance sheet size.

¹ Central bank reserves are the deposits commercial banks hold at the central bank and serve as the ultimate means of settlement of transactions in the economy. The terms *liquidity*, *cash*, *settlement balances* and *reserves* are used interchangeably throughout this paper.

Putting monetary policy into action: How MPI frameworks control short-term interest rates

Central banks influence economic activity primarily through changes in short-term interest rates. In Canada, the Bank sets a target for the overnight interest rate, with the ultimate goal of achieving the [inflation-control target](#). When the Bank announces a decision about its target policy rate, short-term market rates normally adjust right away. But announcing the policy interest rate is only the first step. The Bank also needs an MPI framework—the set of tools, operations and incentives that help keep short-term market rates aligned with the policy decision, even when funding pressures or market imbalances push them away from the policy interest rate.

Although all central banks seek to control short-term interest rates, their approaches differ. Central banks can use a range of MPI frameworks to guide short-term rates, including floor (ample reserve) systems, corridor (scarce reserve) systems and tiered reserve systems. The labels are useful, but they do not capture all the design choices that shape how monetary policy is implemented in practice.

Floor systems are a good example. Canada implements monetary policy through a floor system, meaning there are ample reserves in the financial system.² But floor systems can be designed in different ways. A key difference is how a central bank supplies and manages reserves. Some MPI frameworks focus more on setting the **quantity** of reserves in the system, while others focus more on setting the **price** of reserves and letting financial institutions decide how much to hold.

This distinction is better viewed as a spectrum rather than a strict choice. At one end are **supply-driven floor systems**, where a central bank largely determines the quantity of reserves and typically provides a large buffer in excess of the markets' demand for reserves to keep the overnight rate close to the policy rate. This can help institutions absorb liquidity shocks and support interest rate control, but it requires a central bank to have a larger balance sheet. At the other end are **demand-driven floor systems**, where the central bank sets the price of reserves, often through regular repurchase (repo) operations, and allows the supply of reserves to adjust with demand for them from financial institutions. This can support a lower quantity of reserves than a supply-

² Canada operated a corridor system before the COVID-19 pandemic, with a symmetric 50-basis-point operating band and scarce reserves. The Bank shifted to a floor system as large-scale asset purchases increased reserves. For a discussion of this transition and its implications for monetary policy implementation, see T. Gravelle, R. Morrow and J. Witmer, "[Reviewing Canada's Monetary Policy Implementation System: Does the Evolving Environment Support Maintaining a Floor System?](#)" Bank of Canada Staff Discussion Paper 2023-10 (May 2023).

driven approach but typically requires larger and more frequent operations to keep the overnight rate aligned with the policy rate.

In practice, most central banks that have adopted an ample reserve system sit somewhere between these two approaches. A supply-driven framework may include standing or ceiling tools that allow a central bank to add liquidity quickly at a set price above its policy rate. Similarly, a demand-driven framework may provide a structural or base level of reserves through tools such as fixed-size, fixed-term repo operations.³ Where a framework sits on this spectrum depends on the structure of a country's financial system, money markets and payment system, as well as how policy-makers weigh competing objectives.

What the MPI framework needs to do: Keeping market rates close to the target policy rate

Once Governing Council sets the target for the policy interest rate, the MPI framework helps put that decision into practice. The Bank's primary operating objective is **interest rate control**: keeping short-term market interest rates sufficiently close to the target policy rate that they reflect the desired stance of monetary policy.

The ability to keep short-term rates close to the target is shaped by both the MPI framework and the market environment in which it operates. Relevant factors include the size and composition of the Bank's balance sheet and the degree of access eligible participants have to it, the design and pricing of its tools and facilities, general repo market conditions and participants' demand for reserves for payment efficiency and precautionary liquidity.⁴ Together, these factors influence short-term funding rates and the broader functioning of the financial system.

Interest rate control requires judgment rather than a mechanical response to every movement in short-term rates. Some variation around the target policy rate can provide useful signals about market conditions and encourage institutions to trade and redistribute liquidity. The Bank must therefore assess whether rate pressures are temporary and informative, or whether they are large or persistent. When the latter is the case, the Bank can use targeted tools to keep short-term rates close to the policy

³ See P. Cavallino, M. Drehmann, R. Finlay and J. Remache, "[Monetary policy operational frameworks — a new taxonomy](#)," *BIS Quarterly Review*, Bank for International Settlements (September 2025), for more details on supply- and demand-driven frameworks.

⁴ See T. Gravelle, R. Morrow and J. Witmer, "[Reviewing Canada's Monetary Policy Implementation System: Does the Evolving Environment Support Maintaining a Floor System?](#)" Bank of Canada Staff Discussion Paper No. 2023-10 (May 2023), for a discussion about how Canada's evolving payment system, market structure, regulatory environment and central bank balance sheet affect the design of the Bank's MPI framework.

target. Across its framework, the Bank aims to use tools that are simple and clear so market participants can understand and rely on them in different operating conditions.

To support effective interest rate control, the Bank also aims to:

- encourage financial institutions to manage liquidity actively and prudently, including by redistributing reserves to support robust repo and money markets
- communicate and transact with financial market participants in a fair and transparent way

Getting the balance right: Key trade-offs in the MPI framework

Achieving interest rate control requires central banks to make three related choices, each involving trade-offs:

- how much deviation in short-term market rates from the policy target is acceptable
- how many reserves to supply
- how the MPI framework influences institutions' demand for reserves

These choices require judgment because stronger interest rate control, a smaller balance sheet and market discipline cannot all be maximized at once.

How these trade-offs are balanced depends on each central bank's priorities and the structure of its financial system, money markets and payment systems. Together, these choices shape a central bank's role in money markets. They also determine where an MPI framework sits on the spectrum between supply-driven and demand-driven implementation in ample reserve systems.

How much deviation from the target policy rate is acceptable?

Central banks need to decide how much deviation and volatility in short-term market rates are acceptable. Some movement in short-term rates around the target policy rate can encourage financial institutions to trade with each other rather than relying on the central bank. But if market rates persistently move too far from the policy interest rate or become too volatile, monetary policy transmission can weaken because borrowing and lending conditions may no longer reflect the intended policy stance.

Central banks can set their tolerance for deviation and volatility in advance or apply it as pressures arise. Setting the tolerance in advance means building it into the framework

through ceiling or standing facility pricing. A fixed spread between lending and deposit rates defines how far market rates can move before borrowing from the central bank becomes attractive. Applying it as pressures arise means relying on discretionary operations, which allow the central bank to assess the source and persistence of a pressure before intervening. This approach can support market discipline, but it requires judgment about how much volatility is consistent with effective interest rate control.

How many reserves should be supplied?

Deciding how many reserves to supply involves trade-offs. First, the estimated demand from financial institutions for reserves provides a starting point for assessing the minimum amount of reserves that need to be supplied. A higher structural or base level of reserves supplied in relation to the overall demand for reserves can support interest rate control by helping financial institutions absorb payment flows and liquidity shocks without immediate effects on markets. Because reserves can be used at face value with no settlement, counterparty or market risk, they also support efficient payment system functioning, financial stability and financial institutions' needs for high-quality liquid assets (HQLA). Supplying more reserves moves the framework closer to the supply-driven end of the spectrum of frameworks.

But supplying a large buffer of reserves also has disadvantages.⁵ It can reduce interbank and money market trading, weaken incentives for institutions to actively manage liquidity and encourage greater reliance on reserves held at the central bank as a form of HQLA. Over time, trading capacity can atrophy: institutions that trade and redistribute liquidity less often may lose some of the relationships and practical experience needed to manage liquidity through markets.⁶ As a result, the central bank may need to intervene more forcefully during periods of stress to restore liquidity and support market functioning. Large reserve buffers can also reduce use of routine standing or market-based ceiling facilities. When a facility is rarely used, institutions may be more reluctant to use it when it is needed.

Supplying fewer reserves can help preserve market discipline and limit the size of the central bank's balance sheet. It can also support deeper interbank and money markets by encouraging institutions to more actively manage liquidity. But with fewer reserves, a central bank may depend more on repo or ceiling facilities for interest rate control when pressures arise. This reliance is characteristic of a more demand-driven framework. But

⁵ For a discussion of central bank operating frameworks and the implications of floor systems, see C. Borio, [“Getting up from the floor”](#) (remarks delivered to the workshop “Beyond unconventional policy: Implications for central banks’ operational frameworks,” Amsterdam, Netherlands, March 10, 2023).

⁶ See Bank for International Settlements Markets Committee, [“Large central bank balance sheets and market functioning”](#) (October 2019), for a discussion of the effects of large central bank balance sheets on market functioning.

fewer reserves can increase the central bank's footprint in money markets by making it a frequent, and potentially preferred, counterparty. If access to these facilities is costly or stigmatized, or their use is constrained by market structure, overnight rates may become more volatile or deviate further from the policy target than the central bank is willing to accept.

How should the framework influence the demand for reserves?

Pricing incentives also influence institutions' demand for reserves. Central banks can increase the opportunity cost of holding reserves by, for example, setting the deposit rate below the target policy rate. This can encourage institutions to hold fewer reserves for precautionary reasons, redistribute liquidity more actively and make greater use of repo and other money markets. Lower demand for reserves can support a smaller central bank balance sheet. However, if the opportunity cost becomes too high, institutions may reduce reserve holdings too much. This could leave short-term funding markets more exposed to repo market imbalances and rate volatility.

The design and pricing of a facility can also influence how many reserves institutions choose to hold. If participants know central bank liquidity is available when needed through routine standing facilities, they may be comfortable holding fewer reserves in normal times. The trade-off is that automatic or assured access to central bank liquidity could weaken incentives for institutions to manage liquidity risk prudently through markets, depending on how a facility is designed.

From decision to transmission: How Canada puts monetary policy to work

The design of an MPI framework depends on the structure of each country's financial system, payment system and money markets. In Canada, the Bank implements monetary policy by targeting a secured overnight rate. That context is especially important because the Bank assesses interest rate control primarily through the [Canadian Overnight Repo Rate Average](#) (CORRA). It measures the cost of overnight funding in Canadian dollars using Government of Canada (GoC) securities as collateral. CORRA is also Canada's main risk-free overnight rate benchmark. Understanding Canada's framework therefore starts with looking at the features of the overnight market that shape how the Bank implements monetary policy.

How repo markets shape Canada's MPI framework

Like most of its peers, the Bank targets a single overnight policy interest rate. What makes Canada different is the type of rate the Bank uses to assess whether monetary policy is being transmitted as intended. Canada's framework focuses on the secured overnight repo rate, as measured by CORRA.⁷ Other jurisdictions assess transmission differently.

- The US Federal Reserve (Fed) and the Reserve Bank of Australia, for example, focus mainly on unsecured interbank lending rates.
- The European Central Bank (ECB) and Bank of England (BoE) focus on an administered rate, such as the rate paid on central bank reserves.

Even where other rates are the primary focus, repo market conditions remain an important consideration. For example, persistent repo market pressures in the United States can, over time, influence both the Fed's unsecured target, the federal funds rate, and decisions about adjusting the level of reserves supplied.

The Bank's focus on CORRA as its main benchmark for assessing interest rate control reflects the structure of Canada's overnight market. The secured repo market in Canada has historically been larger and more important than the unsecured interbank market because it offers greater transparency and lower counterparty risk.⁸ As a result, the Bank's framework needs to pay close attention to imbalances between cash lenders and borrowers in the repo market rather than solely targeting a level of reserves to supply.⁹ The reason is that those imbalances can move CORRA away from the target for the policy interest rate.¹⁰

Repo imbalances can arise when dealer balance sheets are constrained—that is, when dealers have limited capacity or willingness to expand the amount of repo activity they intermediate. This can happen around quarter-ends and other reporting dates for banks, or when GoC issuance, investor demand or large government flows shift where cash and collateral sit in the system. These pressures can persist because the institutions with cash are not always the same ones active in repo markets. As a result,

⁷ For more information on repos, or repurchase agreements, see C. Garriott and K. Gray, "[Canadian Repo Market Ecology](#)," Bank of Canada Staff Discussion Paper No. 2016-8 (March 2016).

⁸ For more information, see C. Reid, "[The Canadian Overnight Market: Recent Evolution and Structure Changes](#)," *Bank of Canada Review*, Spring 2007: 15–29.

⁹ For more information on repo market imbalances and how they are funded, see E. Dudley, J.-S. Fontaine, D. Hadjistavropoulos, N. Maru, S. Tchamova, A. Uthemann and J. Yang, "[Balancing the Canadian Repo Market through QT: The Diminishing Role of Settlement Balances](#)," Bank of Canada Staff Analytical Paper No. 2026-40 (September 2026).

¹⁰ See J.-S. Fontaine, N. Maru and S. Tchamova, "[A buoy on funding tides: How client repo demand and dealer constraints lifted CORRA](#)," Staff Analytical Paper No. 2026-15 (May 2026), for details on the growing imbalance between repo lenders and borrowers in Canada.

liquidity may not flow easily to where it is needed, which can put upward pressure on CORRA.

This market structure highlights an important feature of Canada's framework. Reserves in Canada are held by participants in [Lynx, Canada's high-value payment system](#). Participants use central bank reserves, also called settlement balances, to settle large payments and manage liquidity.¹¹ They may also hold reserves for precautionary, regulatory or other liquidity management purposes. Because not all Lynx participants are active in repo markets—and not all active repo market participants are in Lynx—a larger amount of reserves does not necessarily translate directly into more repo market intermediation. Conversely, repo market pressures that affect CORRA may at times have little to do with the amount of reserves available.

Repo markets include a broader set of participants than Lynx, including securities dealers and buy-side firms such as pension funds and hedge funds. Adding reserves can support payment system functioning, but this action may not directly ease repo market pressure unless that liquidity moves into the repo market. This is why the Bank needs tools for both parts of the system:

- Standing facilities support payment efficiency and counteract system liquidity shocks.
- Repo operations address broader cash and collateral imbalances in repo or money markets.

How the Bank keeps short-term rates sufficiently close to the target policy rate

The Bank uses several tools that work through different parts of the financial system to keep short-term rates sufficiently close to the target policy rate.

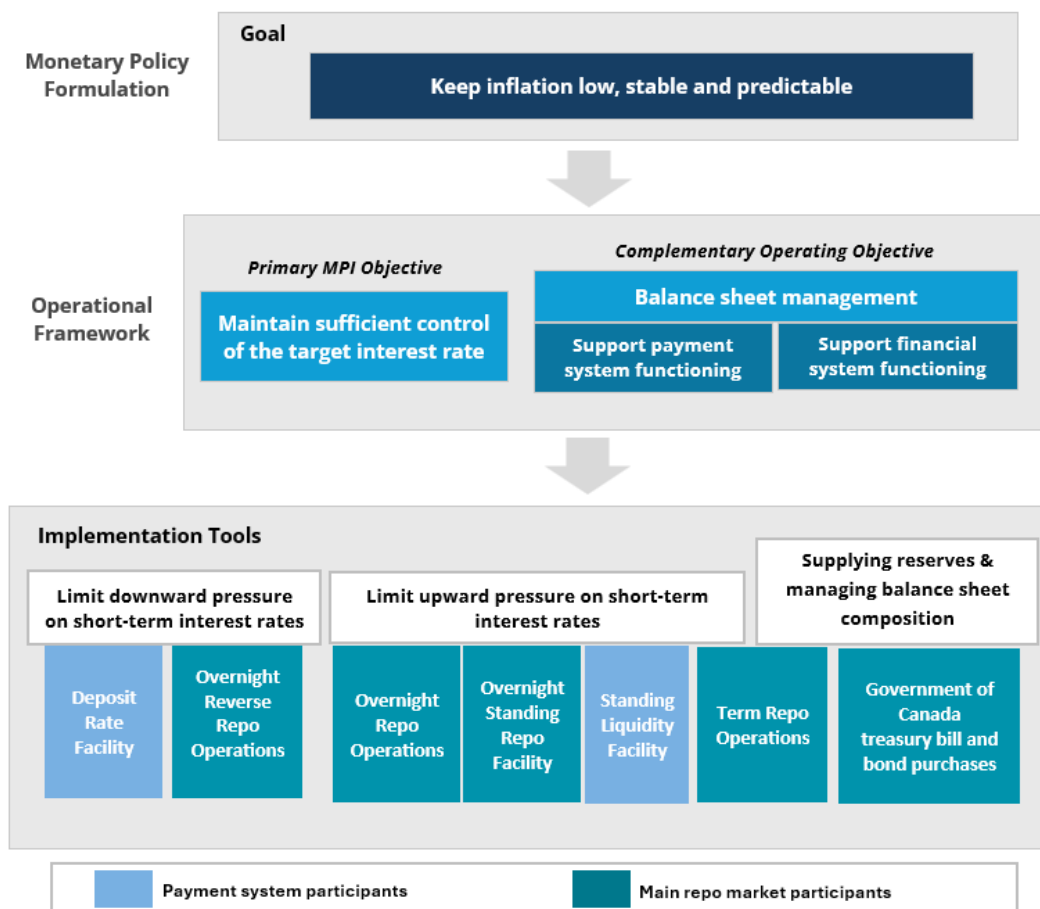
- Repo operations address pressures in the secured overnight market, where CORRA is determined.
- Standing facilities support Lynx participants and reinforce the operating band.

Figure 1 shows how repo operations and standing facilities work together to address market pressures and reinforce the operating band. Balance sheet tools play a related role by supplying reserves and managing the composition of the Bank's assets. Together,

¹¹ In Canada, reserves are commonly called settlement balances because they were supplied in limited amounts and used mainly to settle payments under the corridor system used before the COVID-19 pandemic. Since 2020, their use has broadened beyond payment settlement, including for liquidity management.

these tools form the broader [operational framework](#) that supports the transmission of monetary policy and the functioning of payment and financial systems.

Figure 1: Overview of the Bank of Canada’s monetary policy implementation framework



Note: MPI is monetary policy implementation. *Payment system participants* refers to financial institutions that directly participate in Lynx, Canada’s high-value payment system. *Main repo market participants* refers to participants such as primary dealers for Government of Canada securities.

Using repo operations to manage overnight rate pressure

Repo operations are the Bank’s most direct tool for addressing pressures in the secured overnight market. The Bank uses [overnight repo operations](#) as needed to provide cash when temporary upward repo pressures emerge and [overnight reverse repos](#) to absorb excess cash when downward pressures emerge. Changes in the size of the two-week term repo operation, which is conducted weekly, also address pressures that are more persistent or predictable. These tools allow the Bank to respond directly in repo markets without relying solely on the aggregate level of reserves.

The federal government’s daily morning Receiver General auction, or AM RG, can also affect repo market conditions. Although the Bank as the government’s fiscal agent conducts the auction, the AM RG sits outside the Bank’s monetary policy framework and

is not used to directly address pressures in the secured overnight rate market. Nonetheless, the AM RG influences cash conditions in the repo market by placing excess government cash with market participants through repo transactions. **Box 1** explains this channel in more detail.

Overnight repos: Providing cash when secured rates face upward pressure

Overnight repos (ORs) are the Bank's main day-to-day tool to address temporary upward pressure on secured overnight rates, proxied by CORRA. ORs provide overnight cash to eligible counterparties against GoC securities, helping ease repo funding pressure when upward pressure threatens to move CORRA away from the target policy interest rate.

ORs are discretionary operations, not a standing facility. As well, they are not automatically triggered whenever CORRA moves away from the policy interest rate. Instead, the Bank accepts some deviation to preserve market price signals and incentives for participants to trade with each other. Deciding about when the Bank should intervene and how much liquidity it should provide is based on several factors. These factors include:

- repo market activity and positioning
- recent CORRA settings
- broader funding conditions

When the Bank does intervene, it offers cash through a uniform price, competitive auction, with the minimum bid rate set at the policy target.¹² The Bank determines the size of each operation based on market conditions and observed demand. Limits are also applied to individual participants. This means ORs are not an unlimited source of cash and do not create a hard ceiling on repo rates. As a result, the price determined by the auction can rise above the policy interest rate, and CORRA can still sit above target when pressures are strong or persistent.

This design is deliberate and reflects the trade-offs discussed earlier. By not providing unlimited cash at a fixed price or mechanically intervening each time CORRA deviates from the target policy rate, the Bank preserves market price signals and incentives for financial institutions to manage liquidity through private markets.

¹² For operational details, see [Overnight Repo Operations: Terms and conditions](#) on the Bank's website.

Box 1

Morning Receiver General auction: Linking government cash management and repo markets

The Government of Canada (GoC) holds its cash balances in the Receiver General (RG) account at the Bank of Canada. These balances can change significantly from day to day as government payments, tax receipts, debt issuance and bond maturities flow through the account. All else equal, when RG balances rise, more cash is held at the Bank and fewer reserves are available to financial institutions. The opposite is the case when RG balances decline.

The [morning Receiver General auction](#), or AM RG auction, is generally conducted daily and helps return excess government cash to the market through repo transactions with eligible participants. This adds cash to the repo market—typically for terms of up to five business days—and supports market functioning, liquidity distribution and the government’s ability to earn a competitive return on excess cash. In balance sheet terms, the operation converts one Bank liability into another by effectively transforming government deposits into reserves ultimately held by Lynx participants. This supports system liquidity without increasing the overall size of the Bank’s balance sheet.

The Bank conducts the AM RG auction on behalf of the federal government. While the auction is not a monetary policy operation, it can still affect the repo market conditions that influence the Canadian Overnight Repo Rate Average (CORRA). Larger AM RG auctions can help ease repo pressures by adding cash to the market, while limited activity—particularly ahead of large government outflows such as GoC bond maturities—can leave less cash available. Expected AM RG activity is therefore one factor the Bank considers when deciding whether to adjust the size of the two-week term repo operation or use overnight repos.

Overnight reverse repos: Absorbing cash when secured rates face downward pressure

The counterpart to ORs is overnight reverse repos (ORRs). They are used when there is downward pressure on secured overnight rates and the Bank wants to absorb, rather than provide, cash in the repo market. Such pressure could reflect excess reserves or imbalances in the repo market, such as increased demand to short and borrow GoC securities leading to stronger cash lending in repo markets. It could also become more relevant in different interest rate or balance sheet environments, such as a downward-sloping yield curve or a larger supply of reserves from asset purchases.

Just like ORs, ORRs are discretionary operations with a predetermined size. They are not automatic nor unlimited facilities. As a result, they do not create a hard floor under repo rates. The price determined by the auction can be below the policy interest rate, and CORRA can still trade below the policy rate when downward pressures are strong or persistent.

In practice, the Bank has used ORRs much less often than ORs, reflecting a long-standing feature of Canada's MPI framework. Upward pressure on CORRA has historically been more common than downward pressure, in both the corridor (scarce reserve) system used before the COVID-19 pandemic and the current floor system. This is consistent with a *just enough* approach to reserves where reserves are calibrated closer to underlying system needs. The result is that repo market pressures are more likely to require additional cash through ORs than cash absorption through ORRs.

Two-week term repo: A flexible complement to overnight repos

The Bank has used one- and three-month [term repo operations](#) since 2015 to acquire short-term assets to help manage its balance sheet.¹³ In October 2025, the Bank responded to lower demand for longer-term operations by introducing a two-week term, allowing it to acquire assets more effectively and better manage reserve volatility from flows on and off its balance sheet.

The two-week term has since evolved from a tool to manage the balance sheet into an important complement to ORs in implementing monetary policy. ORs remain the Bank's main tool to counteract temporary upward pressure in the repo market, while the two-week term gives the Bank a regular way to provide extra liquidity over a slightly longer horizon.

Operationally, the two-week term is offered on a regular weekly schedule, normally on Wednesday. Its timing is similar to weekly repo operations used in demand-driven frameworks, such as the one-week repos offered by both the [BoE](#) and [ECB](#). But unlike the BoE and ECB facilities, the Bank's two-week term is offered at a predetermined size. The Bank sets the maximum size each week based on liquidity conditions in the overnight market and the Bank's needs for short-term assets. Cash is allocated through a competitive auction, with the minimum bid rate based on prevailing two-week overnight index swap rates.

¹³ The Bank expanded its term repo operations through the Extended Term Repo Facility (ETRF) in March 2020 to support market functioning during the COVID-19 pandemic. This included increasing the frequency, size and maximum term of operations, as well as broadening eligible collateral. The ETRF was suspended in May 2021 as market conditions normalized. For more details, see G. Johnson, "[A Review of the Bank of Canada's Market Operations Related to COVID-19](#)," Bank of Canada Staff Discussion Paper No. 2023-6. The Bank stopped acquiring assets when it began a quantitative tightening (QT) program in [April 2022](#). It restarted one- and three-month term repo operations when QT ended in [March 2025](#), and restarted GoC treasury bill purchases in [December 2025](#).

That combination—regular timing and a longer term—makes the two-week term useful both pre-emptively and in response to emerging pressures. The Bank can adjust the size of the two-week term either as market conditions evolve or ahead of known pressure points, such as:

- financial institutions' quarter- and year-ends
- large government flows or bond maturities
- when low Receiver General balances reduce the amount of cash available through the AM RG auction.

Used this way, the two-week term can help lower the risk that secured overnight rates rise uncomfortably above the target policy interest rate. If pressures do emerge, the two-week term provides a nimble way to increase repo funding while potentially reducing the need for or size of ORs.

Compared with ORs, the two-week term is regularly scheduled, provides liquidity for longer and accepts a slightly broader set of collateral. Both ORs and the two-week term are available to the same eligible counterparties. The difference is that while ORs provide overnight cash secured by GoC securities, the two-week term provides cash for two weeks against a somewhat wider range of high-quality collateral, including eligible federal and provincial securities.

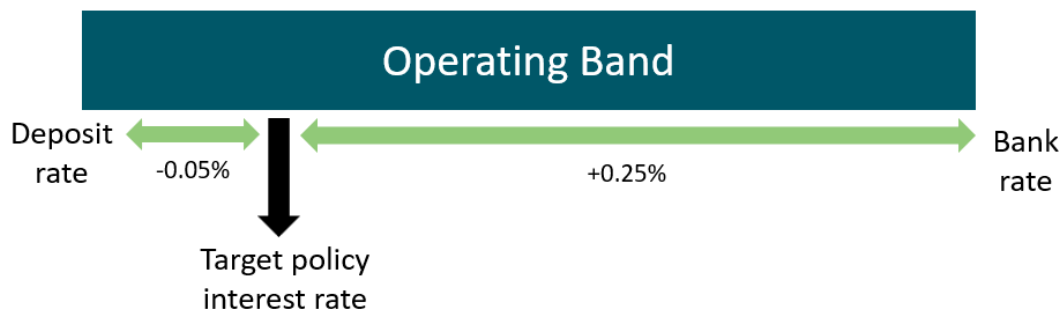
When the Bank is not using the two-week term to actively reinforce interest rate control, the amount offered in the operation helps manage fluctuations in the balance sheet. These operations provide a flexible way for the Bank to acquire short-term floating-rate assets, smooth short-term swings in reserves caused by large government RG flows or other client deposits (i.e., other Bank liabilities) and supply additional reserves when needed.

Using standing facilities to reinforce the operating band

While repo operations address pressures in the broader repo market where CORRA is determined, standing facilities operate through a different channel. They apply to Lynx participants and reinforce the operating band around the policy interest rate.

The operating band sets the guardrails for overnight rates (**Figure 2**). The Bank rate sets the upper limit through the [Standing Liquidity Facility](#) (SLF), which provides secured intraday and overnight credit to Lynx participants at the Bank rate. The deposit rate sets the lower limit by setting the return the Bank pays to Lynx participants on the reserves they deposit at the Bank. Together, these rates shape incentives for institutions to borrow from or hold funds at the Bank or transact in markets.

Figure 2: The Bank of Canada's operating band



Standing Liquidity Facility: Supporting payment system functioning

The SLF is the Bank's standing ceiling facility for Lynx participants and is an embedded feature of the high-value payment system. It provides fully secured intraday and overnight credit against a broad range of high-quality collateral. This helps institutions settle payments during the day and manage end-of-day positions while reinforcing the upper end of the operating band.

Intraday use of the SLF is normal and is integral to the design of Lynx. Participants can borrow against eligible collateral during the day when incoming and outgoing payment flows do not line up perfectly. If a participant ends the day short of cash, that intraday borrowing automatically becomes an overnight advance at the Bank rate.¹⁴ As reiterated in the [September 29, 2026, joint statement](#) between the Bank and the Office of the Superintendent of Financial Institutions, SLF use by Lynx participants is consistent with routine liquidity management activities in Lynx and should not be interpreted as a sign of liquidity stress. This routine access matters in a framework built around supplying just enough reserves. It allows payment system liquidity to be supported through intraday and overnight credit, reducing the need to rely on a higher level of reserves.

The Bank's peers have similar standing lending facilities. For example, the BoE's Operational Standing Facility and the ECB's marginal lending facility provide short-term liquidity at a rate above the policy interest rate, reinforcing the upper bound of overnight rates and supporting monetary policy transmission.

Deposit facility: Reinforcing the floor and supporting more efficient use and redistribution of reserves

The deposit facility reinforces the lower end of the operating band by paying interest on reserves held at the Bank. As a result, institutions that access the facility are incentivized to not lend funds in the repo market at rates below what can be earned at the Bank.

¹⁴ For more information on the SLF, see K. McRae and J. Chen, "Everything You Wanted to Know About the Bank's Standing Liquidity Facility...But were too afraid to ask!" Staff Analytical Paper No. 2026-26 (June 2026).

The deposit rate also affects the opportunity cost of holding reserves. A lower deposit rate increases the opportunity cost of holding reserves by making them less attractive to hold, while a higher rate has the opposite effect by making reserves more attractive to hold.

At the time of writing, the deposit rate is 5 basis points below the policy interest rate, a change that took effect on [January 30, 2025](#). This change increased the opportunity cost of holding reserves for precautionary reasons, encouraging financial institutions to hold fewer reserves and redistribute liquidity into the money market where a higher return can be earned. After the change, CORRA set closer to the policy interest rate after being persistently about 4–5 basis points above target. As well, the need for active OR interventions declined significantly.

But the deposit rate is a broad tool. It applies to all participants that hold settlement accounts at the Bank, not all of which are active—or active to the same degree—in repo markets. As a result, adjustments to the deposit rate affect payment system participants directly and repo market conditions only indirectly, by changing incentives for institutions to hold, conserve or redistribute reserves into money markets.

For that reason, the deposit rate is not used to fine-tune temporary pressures in the repo market. Instead, the rate can be adjusted when pressures appear persistent or structural, and when the Bank does not want to increase the overall level of reserves. Examples of these pressures include:

- a sustained upward shift in repo demand
- a lasting change in how reserves are distributed across institutions
- a broader or lasting change in reserve demand that temporary operations cannot address effectively

In these cases, changing the deposit rate could help adjust the overall incentives to demand and hold reserves and redistribute liquidity. Any such change would typically be announced alongside a decision on the policy interest rate, just like with the change on January 30, 2025.

Table 1 summarizes the tools that support the Bank’s interest rate control objective, including the repo operations used to address pressures in the secured overnight rate market and the facilities that reinforce the operating band.

Table 1: Tools used to keep short-term rates close to the target policy rate

Tool channel	Tool	Main Role	When it is used
Repo Market Operations*	Overnight repos (ORs) / Overnight reverse repos (ORRs)	• 1-day repo operations that inject or absorb cash through uniform price auctions • ORs inject cash; ORRs absorb cash • minimum (and maximum) bid rates set at the target policy rate	These tools are used at the Bank of Canada's discretion based on an assessment of repo market conditions. They are not automatically triggered by every short-term rate deviation, allowing some movement to preserve market signals and trading incentives.
	2-week term repo	• provides two-week cash • size can be adjusted to respond to repo market pressures or ahead of expected pressure points • supports balance sheet management by acquiring short-term assets	A regularly scheduled repo operation that takes place weekly.
Payment system-related facilities	Standing Liquidity Facility	• routine facility embedded in Lynx • provides fully secured intraday and overnight credit • reinforces the upper end of operating band	The facility is available to Lynx participants during the day and overnight as part of routine liquidity management to support efficient payment settlement.
	Deposit facility	• pays interest on reserves • reinforces the lower end of the operating band • influences the opportunity cost of holding and redistributing reserves	Interest on reserves is paid daily while the rate is adjusted infrequently. The facility can be used to address persistent or structural changes in reserve or repo demand or distribution.

* The Bank's [Overnight Standing Repo Facility](#) is also a source of backstop funding at the Bank rate (target policy interest rate plus 25 basis points) for eligible counterparties that may not have access to the Bank's Standing Liquidity Facility.

Calibrating the “right” amount of reserves

The tools described above help the Bank keep short-term rates close to the target policy rate. But their design and use depend on a key trade-off: how many reserves the Bank should supply to support interest rate control and preserve incentives for institutions to trade and redistribute liquidity.

- Supplying more reserves well above the level of estimated demand can support interest rate control, efficient payment settlement and financial stability. But it can also expand the Bank's balance sheet and weaken incentives for institutions to trade and redistribute liquidity through markets.
- Supplying an amount of reserves closer to, or below, the estimated level of demand can preserve market discipline and limit the Bank's footprint. But it can also make interest rate control more dependent on targeted operations when pressures arise.

The Bank's approach is to supply *just enough* reserves. This does not mean supplying the smallest possible amount, or keeping reserves fixed at a single level. It means providing enough liquidity for payment settlement, financial markets and monetary policy implementation to function smoothly, while preserving market incentives and avoiding a balance sheet that is larger than necessary. What counts as *just enough* is a judgment that depends on:

- imbalances between demand and supply in the repo market
- the desired level of payment system efficiency
- changes in precautionary reserve demand
- changes in the size and composition of the Bank's balance sheet

A reference range, not a hard target

Because reserve demand and market conditions change over time, the right amount of reserves is better understood as a reference range than a fixed number. The Bank's steady-state demand for reserves—between \$50 billion and \$70 billion at the time of writing—reflects the reserves needed to support efficient payment settlement and precautionary liquidity demand from financial institutions to cover unexpected liquidity needs or funding shocks.¹⁵ It is a planning guide, not a hard operating target.

In practice, reserves may move above or below this range as institutions' demand for reserves, repo market pressures and other balance sheet flows change.¹⁶ A key reason is that the level of reserves does not, on its own, determine whether short-term rates remain close to the policy target. Repo market pressures can emerge even when total reserves are within the Bank's estimated steady-state range. Because CORRA is the

¹⁵ See T. Gravelle, "[The end of quantitative tightening and what comes next](#)" (remarks delivered at VersaFI, Toronto, January 16, 2025), for more details on estimating the current range of settlement balances. An analysis of the original estimate of \$20–\$60 billion can be found in N. Bulusu, M. McNeely, K. McRae and J. Witmer, "[Estimating the Appropriate Quantity of Settlement Balances in a Floor System](#)," Bank of Canada Staff Discussion Paper No. 2023-26 (October 2023).

¹⁶ Measuring payments- or precaution-driven demand for reserves is difficult. To inform the estimate, the Bank regularly surveys and speaks with cash and liquidity managers at banks and other Lynx participants to better understand how much demand for reserves exists in practice and how it may change over time.

Bank's main benchmark for assessing conditions in the secured overnight market, imbalances in repo markets can affect short-term rates independently of the overall level of reserves. The Bank therefore must focus on whether these imbalances are large, broad-based or persistent enough to move CORRA away from the target policy rate and weaken interest rate control.

This does not mean every movement in CORRA away from the policy interest rate calls for an operational response from the Bank. Some movement provides useful market signals and encourages institutions to trade and redistribute liquidity. But when pressures become large or persistent, targeted tools such as ORs or changes in the size of the two-week term repo operations can provide temporary liquidity where needed and reinforce interest rate control. Because these tools add cash to the system, they temporarily increase the overall level of reserves, all else equal, and can temporarily push reserves above the estimated demand range.

Other factors can also move reserves away from the steady-state estimate. Changes in the Bank's liabilities—such as client deposits and Receiver General balances—also affect the supply of reserves. When these liabilities rise, reserves decline, all else equal. At the same time, the precautionary demand for reserves from Lynx participants can rise and fall as they change how much cash they want to keep on hand for unexpected funding shocks. Temporary movements in reserve supply or demand do not necessarily require a response. However, more persistent shifts may factor into the Bank's broader assessment of how many reserves are needed.

The composition of the Bank's balance sheet also matters for how reserves are supplied. The Bank holds assets to support its liabilities and generally seeks to align the interest rate characteristics of each.¹⁷ While the level of reserves is currently at or near the Bank's estimated steady-state range, the asset side of the balance sheet has not yet returned to its steady-state composition. The Bank still holds a relatively large stock of GoC bonds purchased during the pandemic. During this transition, maturing GoC bonds are expected to be replaced with shorter-term floating-rate assets, such as term repos and GoC treasury bills. This will allow the term repo portfolio to continue to grow, helping support repo market functioning and interest rate control without requiring a higher level of reserves.

Taken together, these factors mean the Bank may at times operate near the top of, or temporarily above, its estimated steady-state demand range when actual or anticipated repo market pressures warrant a response. At other times, it may operate closer to the lower end of, or temporarily below, the range if liquidity needs are lower, market

¹⁷ Generally, floating-rate liabilities such as reserves and client deposits are better matched with floating-rate assets (e.g., term repo and GoC treasury bill purchases). Similarly, longer-term liabilities, namely currency in circulation, are better matched with fixed-rate assets such as GoC bonds. This helps limit the interest rate risk the Bank is exposed to.

conditions are stable or reserves are being used more efficiently. Both outcomes are consistent with the *just enough* approach: the Bank calibrates reserves to demand and market conditions, supplying enough liquidity to support interest rate control and market functioning while keeping its balance sheet no larger than necessary.

Bringing it all together: After the interest rate decision

Setting the target for the policy interest rate is the most visible part of monetary policy, but that is where monetary policy implementation begins, not where it ends. After the Bank's Governing Council announces its decision, the MPI framework helps ensure the decision is reflected in financial markets by keeping short-term interest rates close to the target policy rate. In Canada, the key benchmark for assessing this is CORRA, a secured overnight repo rate. This means the Bank must pay close attention to transactions and conditions in the repo market where CORRA is determined, in addition to the supply of reserves.

A central message of this paper is that implementing Governing Council's monetary policy decisions is not simply about choosing a fixed quantity of reserves to achieve the desired policy rate. Repo market imbalances can move CORRA away from the target policy rate even when the overall level of reserves is within the estimated range of steady-state demand. At the same time, supplying more reserves is not without cost: it can reduce incentives for institutions to trade with one another and actively manage and redistribute liquidity risk through markets. The Bank therefore needs to balance its objective of interest rate control against market discipline and the size of its balance sheet.

The Bank's operational tools help manage this balance. Repo operations, including ORs and adjustments to the size of the two-week term repo, allow the Bank to respond to pressures in the secured overnight market. At the same time, standing facilities support system liquidity for Lynx participants and reinforce the operating band around the target policy rate. In combination, these tools are designed to support interest rate control without eliminating all market movement. Some variation in short-term rates provides useful signals and can encourage institutions to redistribute liquidity through markets.

This is why the Bank's approach to implementation is best understood as supplying *just enough* reserves. The aim is not to supply plentiful reserves nor to minimize them at all costs. It is to provide enough liquidity to support efficient payment settlement, market functioning and monetary policy implementation, while preserving incentives for institutions to manage liquidity actively and keeping the Bank's balance sheet no larger than necessary. In this sense, Canada's MPI framework sits between the supply-driven

and demand-driven ends of the spectrum. The framework allows the Bank to provide a structural level of reserves to support the financial system but also relies on targeted and discretionary operations when market pressures warrant a response.

Recent refinements show how the Bank can adapt its tools as market conditions, reserve demand and its balance sheet evolve. These refinements include the introduction and more active use of the two-week term repo and the January 2025 adjustment to the deposit rate. The objective, however, remains the same: to maintain effective interest rate control by keeping short-term market rates close to the policy interest rate.