

## RBA announces measures to enhance the functioning of financial markets

24 September 2008

This afternoon the RBA announced two important measures to improve liquidity conditions in Australian financial markets.

The first measure is a **US\$10bn swap facility with the US Federal Reserve**. This swap line will allow Australian banks to pledge A\$ securities in return for US\$ funds. The aim of this facility is to increase the amount, and hopefully reduce the cost, of short-term US\$ funds available to local banks (and in the Asian trading session).

As well as introducing this swap facility with the RBA, the Fed today has also announced similar US\$ swap facilities to the Bank of Sweden (US\$10bn), the National Bank of Denmark (US\$5bn) and the Bank of Norway (US\$5bn). Today's arrangement is worth US\$30bn in total and expands on facilities, worth US\$247bn, offered to other major central banks (ECB, BoE, SNB, BoJ, BoC) since the onset of the financial market turmoil last year.

The second measure is the introduction of a **short-term deposit facility**. Under this facility, the RBA will offer a short-term deposit facility, to be known as RBA Term Deposits (RBATD), to authorised deposit-taking institutions. Institutions will bid for these deposits under auctions. The first auction, for 14-day deposits, will coincide with quarter-end and will be held on Monday 29 September for settlement on Tuesday 30 September. Subsequent auctions will be conducted periodically as required for liquidity management purposes.

The aim of the RBATD is two-pronged. **First, it is a mechanism for the RBA to ensure the Australian payments system is functioning properly and the level of the overnight cash rate remains at the desired level.** Local banks, like their counterparts offshore, have increased demand for cash in the current uncertain environment. The RBA is providing this cash through increased repo operations. This desire to hold cash has caused banks' daily exchange settlement (ES) balances held at the RBA to balloon from \$1.3bn at the start of the month to now be \$6.7bn.

To keep the overnight cash rate at the desired level, the RBA must balance its net injections of liquidity. **Hence, unless offset by a withdrawal of liquidity by the RBA, this higher level of ES balances puts downward pressure on the overnight cash rate.** When ES balances have been elevated during other periods of heightened uncertainty over the last year, the RBA was able to balance this injection of funds by withdrawing funds through running down its foreign exchange swaps book. But having now run down these cross-currency swap lines, the RBA has a lot less liquidity to tap in order to manage its open market operations. As such, the RBA would now prefer ES balances to be held at a lower level. The new RBATD aims to do this by prompting banks to put excess cash on deposit with the RBA, instead of holding it in ES balances.

**The beauty of this term deposit facility is that it should also increase the amount of funds that the RBA holds, which it can then in turn use to lend to banks via repos under open market operations.** These increased repo arrangements will remain the primary mechanism by which the RBA attempts to address the stresses currently hampering the interbank market, and in turn hopefully put downward pressure on interbank rates (which have increased by around 20bps since the start of last week).

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