

FREQUENTLY ASKED QUESTIONS

SHIFT TO VARIABLE-RATE AUCTION IN THE BSP'S OVERNIGHT REVERSE REPURCHASE (RRP) FACILITY

(Version as of 12 October 2023)

A. Key Changes Implemented with the Shift to Variable-Rate Auction for Overnight RRP Facility

1. What is the BSP's objective in shifting to a variable-rate auction format for its overnight RRP facility?

The shift to a variable-rate auction format for the RRP facility aims to enhance the transmission of monetary policy by strengthening the link between monetary policy strategy and implementation. The transformation of the RRP facility into a more active monetary instrument will allow the BSP to steer the interest rate for overnight funds, and this in turn could affect price developments in the economy via the various channels of monetary policy transmission.

2. What specific enhancements were carried out in the transition to a variable-rate RRP auction format?

The BSP adopted a phased implementation of the reforms to the RRP facility to ensure smooth and orderly transition to the eventual shift to a variable-rate RRP auction format beginning on 8 September 2023.

Starting on 29 May 2023, the daily RRP operation was moved to a morning schedule to provide the market with guidance on overnight rates in the morning and set the tone for overnight transactions for the rest of the day. This was also intended to encourage more active liquidity management among banks.

For an interim period, a fixed-rate full-allotment RRP auction format was adopted on 14 July – 7 September 2023. This shift allowed the BSP to better gauge actual market demand for RRP and refine our day-to-day forecasts of excess liquidity in preparation for the eventual shift to variable-rate RRP auction format.

3. What are the other benefits of shifting to a variable-rate auction format for the RRP facility?

Aside from strengthening the monetary policy transmission, the shift to the variable-rate auction format will also support the price discovery process by providing market participants and monetary authorities alike a market-determined overnight interest rate that would represent the prevailing cost of and demand for overnight funds in the financial system.

4. What are the key changes in operationalizing a variable-rate RRP auction format?

With the shift to a variable-rate RRP auction on 8 September 2023, two key changes were implemented:

- 1) The BSP's monetary policy rate is now called the "Target RRP Rate"; and
- 2) The BSP introduced a formal operational target, which is called the "Overnight (ON) RRP Rate".

5. How would the renaming of the BSP's policy rate impact BSP's monetary policy communication?

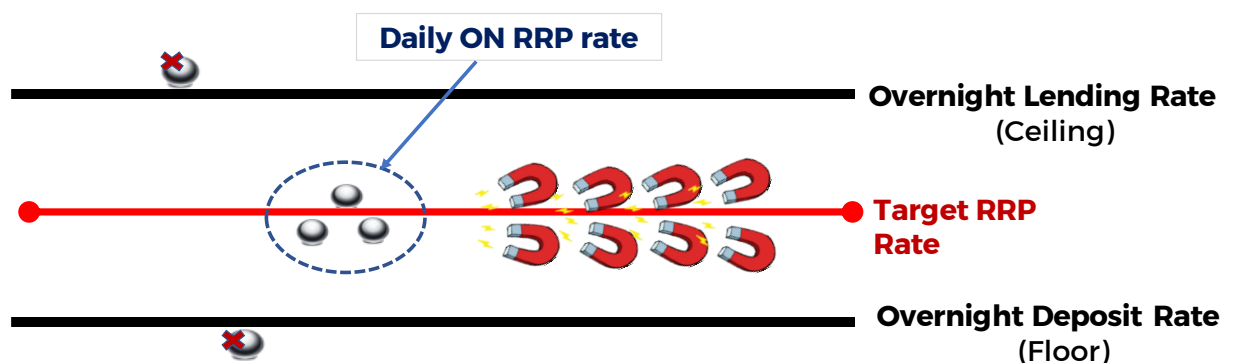
The renaming of the BSP's policy rate to "Target RRP Rate" means that the BSP will communicate its monetary policy stance through changes in the Target RRP Rate.

6. How is the ON RRP Rate different from the Target RRP Rate?

The Target RRP Rate is the overnight interest rate set by the Monetary Board to signal the stance of monetary policy. Its value will only change to reflect adjustments in the policy stance following each monetary policy meeting. To operationalize the announced Target RRP Rate, the BSP conducts daily operations in the RRP facility to yield an actual ON RRP Rate that is close to the target RRP Rate.

The ON RRP Rate is the resulting weighted average interest rate of accepted bids from the daily auctions in the RRP facility. The objective of the BSP's RRP operations under a variable-rate auction format is to guide the daily ON RRP Rate close towards the Target RRP Rate (*Figure 1*).

Figure 1. Overnight RRP Facility Under Variable-Rate Auction Format



7. What is an operational target?

An operational target represents the market interest rate that should be consistent with the BSP's policy rate. It is a key indicator that the BSP and the market can use to assess the effective stance of monetary policy.

8. Why is it important to formally adopt an operational target?

The operational target will provide market guidance and help strengthen the monetary policy transmission mechanism as market participants can translate the overnight interest rate into longer term yields. Moreover, the ON RRP Rate, as the operational target, will help the BSP in assessing if the monetary policy stance is effectively transmitted to short-term market interest rates.

9. What makes the ON RRP rate a suitable candidate for an operational target?

The regularity of the BSP's RRP operations and its widespread use by banks make the ON RRP Rate feasible as an operational target, given the relatively minimal transactions in the Philippine interbank market. Meanwhile, the BSP is working with the industry to spur interbank market activity.

10. Does this reform in the RRP facility represent a change in the BSP's monetary policy stance?

These changes in the RRP facility are largely operational in nature and do not constitute any change in the BSP's prevailing monetary policy stance at the time of implementation.

B. Operational Details of the Variable-Rate RRP Auction

11. Prior to the shift to variable-rate auction format, how were the daily overnight RRP operations conducted?

Before 8 September 2023, the interest rate for the overnight RRP facility was fixed at the policy interest rate of the BSP. During the daily RRP operations, participating institutions submitted only the amounts that they wanted to place in the facility within the specified auction time window. Setting the interest rate for the overnight RRP facility fixed at the policy rate along with the conduct of term liquidity management operations of the BSP help ensure that the overnight interbank market rate is aligned with the policy rate and closer to the middle of the BSP's interest rate corridor.

For the period 3 June 2016 to 13 July 2023, the overnight RRP facility was operated using fixed-rate and fixed-volume auction format. The interest rate was fixed at the policy rate of the BSP while the volume offering was at ₱305 billion. Banks submitted bid amounts and the BSP awarded on a pro-rated basis the offered volume to all participants whenever the auction was oversubscribed.

The practice of offering fixed volume in the daily RRP operations prior to 14 July 2023 was due to the historically limited amount of BSP's holdings of government securities (GS) that could be used as collateral for RRP operations. The opening of the GS purchase window as part of the extraordinary measures to ease liquidity conditions during the COVID-19 pandemic allowed the BSP to build up its GS collateral base and offer larger volumes in the RRP facility.

For 14 July - 7 September 2023, the overnight RRP facility was offered using a fixed-rate and full-allotment method, wherein all bids received from BSP counterparties were accepted or awarded.

12. How is this reform going to change the features and the procedures of the BSP's overnight RRP operations?

With the shift to a variable-rate auction, most of the existing features of the overnight RRP facility prior to the change were retained. **Table 1** lists the key features of the overnight RRP facility under a variable-rate auction format.

Table 1. Key Features of the Overnight RRP Facility

| Feature | Details |
|---------------------------------|---|
| Frequency of operations | Daily (on business days) |
| Maturity | Overnight |
| Auction format and pricing | Variable-rate tender, multiple price auction |
| Auction size | Determined based on the BSP's forecast of excess system liquidity |
| Announcement of auction size | Daily announcement on the BSP's <i>Monetary Operations System</i> prior to each operation |
| Minimum bid amount | P10 million |
| Maximum no. of bids | One (1) |
| Auction time | 11:30 AM - 12:00 PM; submission of bids commences at 11:30 AM |
| Availability of auction results | 12:10 PM onwards |
| Eligible counterparties | Banks and Non-Banks with Quasi-banking Functions |

The daily RRP operations will continue to be conducted via the BSP's Monetary Operations System (MOS). Prior to each operation, the BSP will announce an offer size and RRP participants will submit bids for both the amount of funds and the interest rates at which they are willing to place said funds in the RRP facility. The BSP will review the bids submitted and will determine the successful bids to award.

13. How does the BSP determine the amount to offer in the RRP facility?

The daily offer for the RRP facility may be viewed as the volume that could help align the ON RRP rate to the target RRP rate. It is determined based

largely on the BSP's daily forecasts of system liquidity, vis-à-vis the current level of the ON RRP rate as indicated by actual auction results. The liquidity forecast takes into consideration various factors such as the projected demand from banks for reserves and currency, maturing BSP monetary operations and expected changes in the national government's deposits with the BSP.

14. How will the BSP communicate the results of the daily RRP operations?

After the completion of each RRP operation, the BSP will publish a summary of auction results that indicates the total amount offered, total amount tendered, total amount awarded, the range of accepted yields, and the ON RRP Rate.

15. How is the ON RRP Rate calculated from the results of the RRP operations?

The ON RRP Rate is calculated as the weighted mean of all the bid rates accepted, where each successfully awarded bid rate is assigned a weight equivalent to the amount awarded at the accepted interest rate.

16. How is the BSP going to guide the ON RRP Rate towards the Target RRP Rate?

Accounting for previous auction results and using the daily liquidity forecast in adjusting the daily volume offering is one way to bring the ON RRP Rate in line with the Target RRP Rate.

The BSP also employs an interquartile range (IQR) method for identifying and excluding outlier bid rates that could cause large volatility in the overnight rate. This is done by looking at the distribution of bid rates received for the day and determining the range of values where the bid rates are clustered.

The IQR method starts by determining the first quartile (Q1) and third quartile (Q3) from the array of bid rates received. The IQR is then calculated as the spread of Q3 over Q1. From the said values, the acceptance range is defined by $(Q1 - 1.5 \times IQR)$ as the lower limit and $(Q3 + 1.5 \times IQR)$ as the upper limit. Bid rates falling below the lower limit or above the upper limit are deemed to be extreme or outlier bids and therefore may be excluded from the award.

It is important to note that the daily range of bids accepted could narrow or widen depending on the bids submitted by RRP participants. A narrow IQR indicates that the bids are not spread out and can be interpreted as the market participants having a general consensus on the price. Moreover, a narrow IQR will have lower tolerance for deviations of bid rates from consensus.

17. Are the RRP participants required to submit bid rates within a particular band?

There is no predefined band for the bid rates that will be accepted in the RRP facility. The bid rates submitted by RRP participants are considered to contain relevant information on prevailing liquidity conditions, which will then guide the succeeding monetary operations of the BSP. Nevertheless, the BSP would prefer that submitted bid rates fall within the BSP's interest rate corridor and close to the Target RRP Rate.

18. What happens to the translated overnight rate from the 28-day BSP Bill rate?

The translated overnight rate derived from the 28-day BSP Bill rate was communicated as an interim measure while the BSP was preparing for the reforms to the RRP facility to be completed. With the shift to variable-rate RRP auction format, the ON RRP Rate has taken its place as the overnight reference rate. As announced on the BSP website, the calculation of the overnight rate equivalent of the secondary market rate for the 28-day BSP bill rate has officially ceased effective on 8 September 2023.

