The voice of banking & financial services

Understanding BBA LIBOR

- a briefing by the British Bankers' Association

The British Bankers' Association London Interbank Offered Rate (BBA LIBOR) closely reflects the real rates of interest being used by the world's big financial institutions. Central banks (such as the Bank of England, the US Federal Reserve and the European Central Bank) fix official base rates monthly, but BBA LIBOR reflects the rate at which banks borrow money from each other each day. BBA LIBOR figures are issued daily on more than one million screens around the world and are widely reported in the press. Rates are quoted for a range of borrowing periods, ranging from overnight loans to 12 months, and in a range of currencies.

How is it calculated?

The BBA uses Thomson Reuters to fix and publish the data daily by 12 noon UK time. It assembles the interbank borrowing rates from 16 contributor panel banks at 11am, looks at the middle eight of these rates (discarding the top and bottom four) and uses these to calculate an average, which then becomes that day's BBA LIBOR rate. This process is followed 150 times to create rates for all 15 borrowing periods (ranging from overnight to 12 months) and all 10 currencies for which a BBA LIBOR rate is quoted.

The Australian Dollar, Danish Krone, New Zealand Dollar and Swedish Krone panels have eight banks, not 16. The Canadian Dollar and Swiss Franc panels have 12 banks. Each still follows the procedure of discarding the upper and lower quartiles and averaging the centre quartiles to create a rate.

In calculating the rates, Thomson Reuters follows procedures set out by the Foreign Exchange and Money Markets Committee, a group of active market practitioners including representatives from banks, the money markets, corporate treasurers and exchanges. This body oversees all aspects of the rate setting procedures, and scrutinises the rates to ensure they are accurate. Details of this are available on the BBA LIBOR website.

How did it become so important?

BBA LIBOR was first developed in the 1980s as demand grew for an accurate measure of the rate at which banks would lend money to each other. This became increasingly important as London's status grew as an international financial centre. More than 20 per cent of all international bank lending and more than 30 per cent of all foreign exchange transactions now take place in London.

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BBA LIBOR is now used to calculate the interest rates for a range of financial instruments: derivatives based on the BBA LIBOR rates are now traded on exchanges such as LIFFE and the Chicago Mercantile Exchange (CME) as well as over-the-counter. The rates are also used as the basis for many types of lending, from syndicated and commercial lending, to calculating rates on residential mortgages.

How often is this process reviewed?

The BBA LIBOR setting process is kept under continuous review by the Foreign Exchange and Money Markets Committee. Twice a year, this committee determines the membership of each currency panel using a methodology which is published on the BBA LIBOR website (www.bbalibor.com).

Why is it in the news?

BBA LIBOR rates are calculated daily from the rates at which banks will agree to lend each other money, so it is accepted as an accurate barometer of how global markets are reacting to prevailing market conditions.

BBA LIBOR rates were widely reported in the media throughout the credit crunch as a leading market indicator. When Bear Stearns informed investors of their likely losses from two hedge funds in July 2007 (now regarded as one of the first signs of the credit crunch) LIBOR was among the first indicators to illustrate the trends in the markets that led to this event. When Lehman Brothers failed in 2008, LIBOR was the indicator that showed how much pressure the credit markets were under.

Throughout late 2009 and early 2010, LIBOR rates decreased to new lows. They have now begun to rise again, although they are still, relatively and absolutely speaking, very low. Nevertheless, any upward trend inevitably leads to speculation on whether the markets are heading back into stressed times.

Recent market movements

The figures below put the current rises into perspective.

All the figures are quoted as a spread over base rate (the rate set by the Monetary Policy Committee in the UK and the Fed Funds rate in the US).

The rates are for overnight, one month, three-month and six-month LIBOR in pounds sterling and US dollars, and are quoted as annualised percentage rates, as is the convention. Please note, data for overnight borrowing is only available from 2001 onwards.

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Below, we show these averages over four time periods:

1. **Year to date** – the average rates seen in the market this year.
2. **July 2007 to year end 2009** – the average rates prevailing in the credit crunch.
3. **January 2000 to July 2007** – the average rates in what is regarded as an unusually extended benign time in the market, when credit was easily available.
4. **January 1994 to December 1999** – to show a contrast with the very benign conditions seen in the early 2000s.

Sterling

Average Spread Year to Date			
Overnight	1Month	3Month	6Month
0.03	0.04	0.15	0.38

Average Spread July 2007 - end 2009			
Overnight	1Month	3Month	6Month
0.09	0.37	0.69	0.80

Average Spread 2000 - July 2007			
Overnight	1Month	3Month	6Month
0.02	0.07	0.13	0.20

Average Spread 1994 - 2000			
Overnight	1Month	3Month	6Month
N/A	0.05	0.18	0.30

US dollars

Average Spread Year to Date			
Overnight	1Month	3Month	6Month
-0.04	0.00	0.05	0.20

Average Spread July 2007–end 2009			
Overnight	1Month	3Month	6Month
0.12	0.33	0.59	0.79

Average Spread 2000 - July 2007			
Overnight	1Month	3Month	6Month
0.09	0.11	0.18	0.26

Average Spread 1994 - 2000			
Overnight	1Month	3Month	6Month
N/A	0.22	0.33	0.44

NB – As of 16 December 2008, the Federal Open Markets Committee, responsible for setting the US base rate have been maintaining the rate at a spread of 0 – 0.25 per cent. In order to generate a single number for these tables, we have assumed that the rate is at the higher end and used a figure of 0.25 per cent.

British Bankers' Association
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