Box 2: Money market: Liquidity and credit risk spread

The interest rate differential between the rate on three-month negotiable certificates of deposit (NCDs) and the yield on 91-day Treasury bills is an indicator of perceived liquidity and credit risk in the banking sector. NCDs, which can be likened to term deposits that are fully negotiable before the date of maturity, tend to be held by financial intermediaries such as money-market funds, pension funds and insurance companies. The current low spread indicates that the market is liquid with no undue risk being perceived. A rising spread, as observed during the intensification of the global financial crisis in 2008, is associated with tightening credit markets and reduced liquidity, and signals a possible downturn in financial markets. The risk spread is currently low compared to historical standards, even falling below levels before the financial crisis, as yields on three-month NCDs are fluctuating close to the virtually risk-free yields on Treasury bills.

Liquidity and credit risk spread