Liquidity Regulations, Money Markets and Monetary Policy

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A 3-year experiment in regulatory revealed preference...

As long as foreign banks are willing to act as the swing players in the market for reserves, domestic banks can control the amount of reserves they absorb. And for the past three years, the answer to that particular optimization problem has held steady at $1.5 trillion.
View from the New York Fed’s Open Market Desk:
Keep the supply of reserves in the flat part of the demand curve

Figure 1
Current Framework for Monetary Policy Implementation

https://www.newyorkfed.org/newsevents/speeches/2017/log170518
Demise of the TT&L system

In the absence of a functional Treasury tax and loan system, the Treasury’s account at the Fed will be far more volatile than in the past.
It’s not just the supply side – demand matters too...

Demand for Fed balances may be much more volatile as international banks adopt a multi-currency strategy for managing their liquidity positions.
The outlook for CCP balances at the Fed is a major unknown for the balance sheet.

Financial market utilities could – and should – make greater use of central bank liquidity services going forward.
Regulatory constraints have resulted in some striking money market distortions since the crisis. These are most apparent on statement dates, but there would be potential for more endemic market inefficiencies if the cost of meeting LCR HQLA requirements were unduly expensive.
While still dwarfed by excess reserves, required reserve balances have surged.

Required reserves now exceed $130 billion. They cannot be counted as HQLA for LCR purposes in the U.S., but may serve to meet the many other liquidity objectives that banks have.