Comments for “The repo market disruption: What happened, why, and should something be done about it?”

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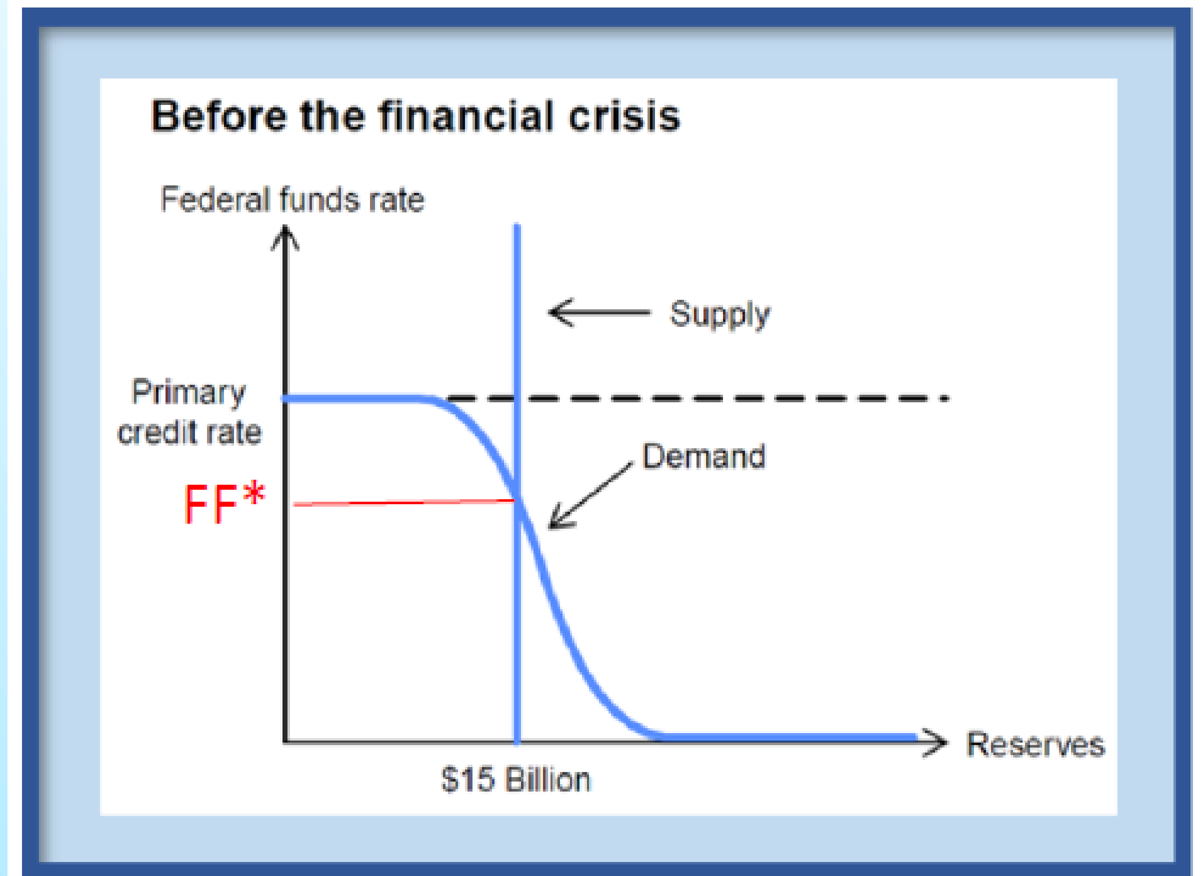
December 5, 2019

Outline

- Policy implementation frameworks
- Learning about reserves demand
- Possible adjustments to the policy implementation framework
  - Even more abundant reserves
  - A standing RP facility

Policy Implementation Frameworks

- Prior to the crisis, the Fed had a small balance sheet with a low level of reserves. It used small open market operations to adjust the supply of reserves to hit demand at the desired target for the federal funds rate.



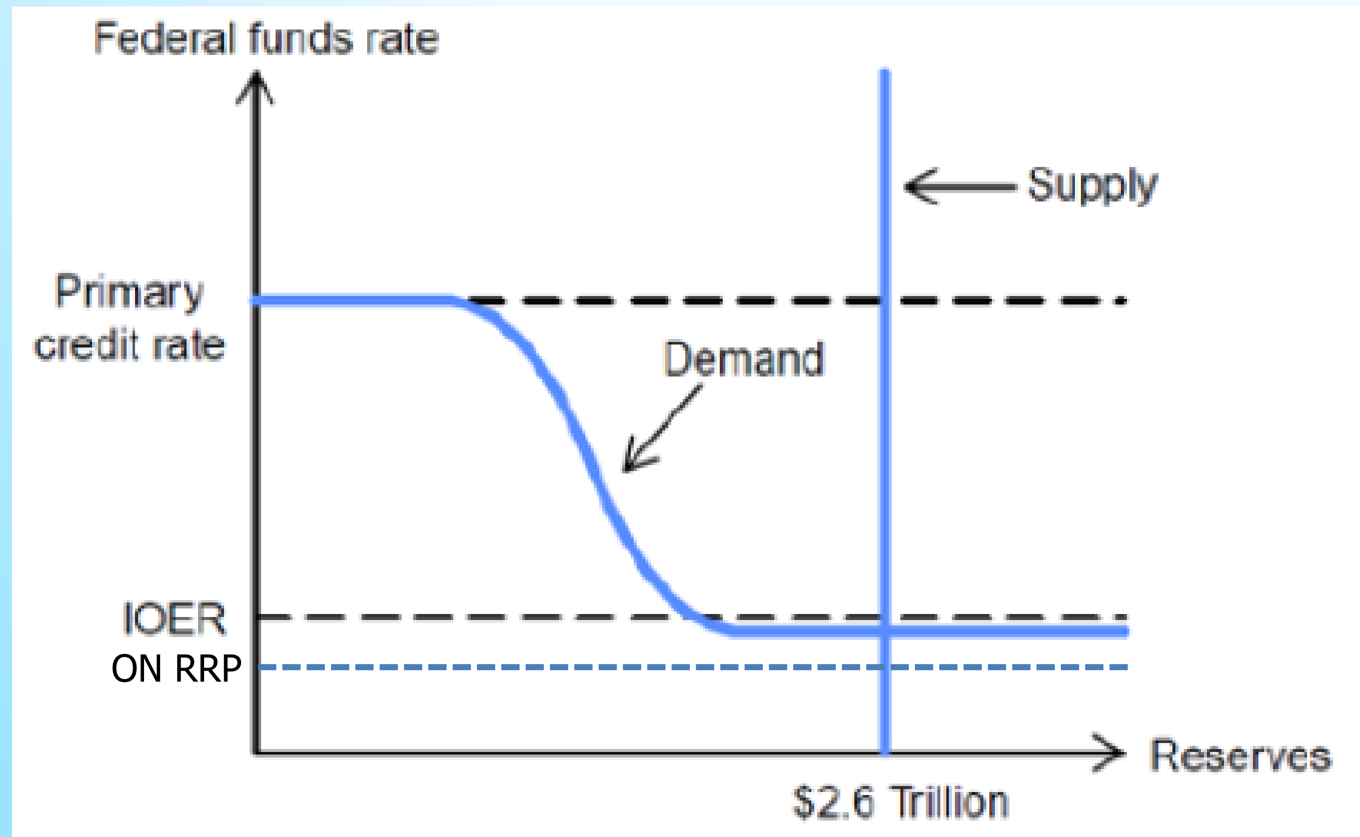
Source: Ihrig, Meade, and Weinbach (2015)

Policy Implementation Frameworks

- But after the crisis – and after QE – the level of reserves was far too large to allow the framework to be used effectively
- When it came time to liftoff, the Fed developed new tools to control money market rates despite the very large level of reserves
  - IOER
  - ON RRP

Policy Implementation Frameworks

- This system proved effective



Source: Ihrig, Meade, and Weinbach (2015)

Policy Implementation Frameworks

- Balance sheet normalization began in 2017, without a decision about the long-run implementation framework
- Last winter the Committee decided to stick with the "abundant reserves" framework for policy implementation
- So operate with a much higher level of reserves than prior to the crisis
  - How much larger?
  - They were not sure

Outline

- Policy Implementation with abundant reserves
- **Learning about reserves demand**
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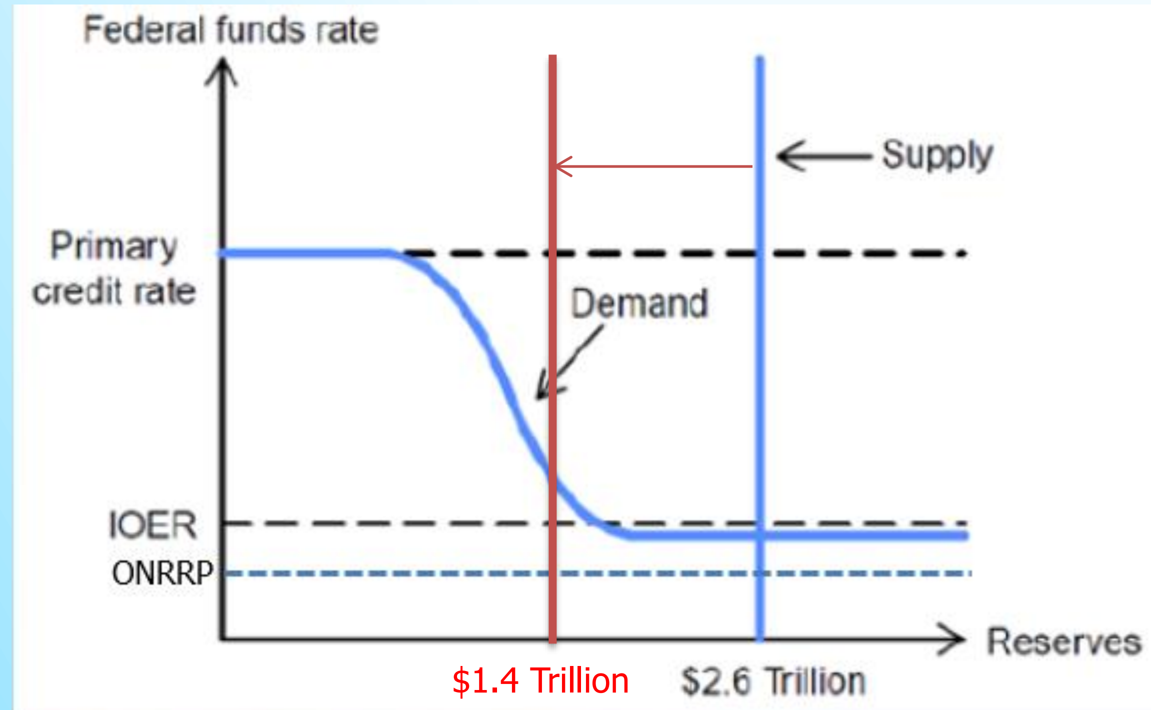
Learning About Reserves Demand

So, what happened in September?

- The Fed learned that the demand for reserves was higher and less elastic than they thought
- So money market rates rose unexpectedly



Learning About Reserves Demand

- In addition, repo demand was strong at the time, and banks did not step in to lend in the repo market
  - So repo rates spiked

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- **Possible adjustments to the policy implementation framework**
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Possible Adjustment – Even more abundant reserves

- The Fed realized that it had allowed reserves to fall too low
- Short-run: temporary reserve adding operations
- Longer-run: Permanent reserve adding operations
  - Purchases of Treasury bills
  - Important to note that the purchases are not intended to reduce long-term rates, as was the case with the LSAPs
  - Just adjusting the supply of reserves to implement the desired policy stance (like pre-crisis, but much larger)
- And that has worked

Possible Adjustment – Even more abundant reserves

- Could go even further – add reserves until you see significant usage of the ON RRP program by money funds
- That would provide a cushion of funds that could shift into repo market if rates began to spike
- But would require a bigger role for the ON RRP program and money funds in policy implementation than the Fed might be comfortable with

Possible Adjustment – Standing RP facility

- Always on; fixed rate
- Should lead to automatic increases in reserves in response to upward pressure on money market rates
- Could be an effective ceiling on money market rates
  - Which the discount rate doesn’t provide anymore because of stigma
- But raises a number of questions for the Fed

Possible Adjustment – Standing RP facility

Two framing questions:

- Footprint? How big a role does the Fed want in the repo market?
- Effectiveness? Would market participants want to use it, or would it be stigmatized, like the discount window

Possible Adjustment – Standing RP facility

Three structural questions:

- Who can participate?
  - Presumably primary dealers – helps cap repo rates
  - Probably banks – helps cap the funds rate
    - Could also encourage banks to reduce their holdings of reserves, so lead to a smaller Fed balance sheet
  - Others?
- What collateral?
  - Probably just Treasuries, at least in normal times

Possible Adjustment

- At what rate?
  - Higher rate would encourage more market intermediation, avoid moral hazard
  - Lower rate would encourage participation, limit stigma
- So, hard decisions to be made

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