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

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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
• Possible adjustments to the policy implementation framework
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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
Outline

• Policy Implementation with abundant reserves
• Learning about reserves demand
• **Possible adjustments to the policy implementation framework**
  • Even more abundant reserves
  • A standing RP facility
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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