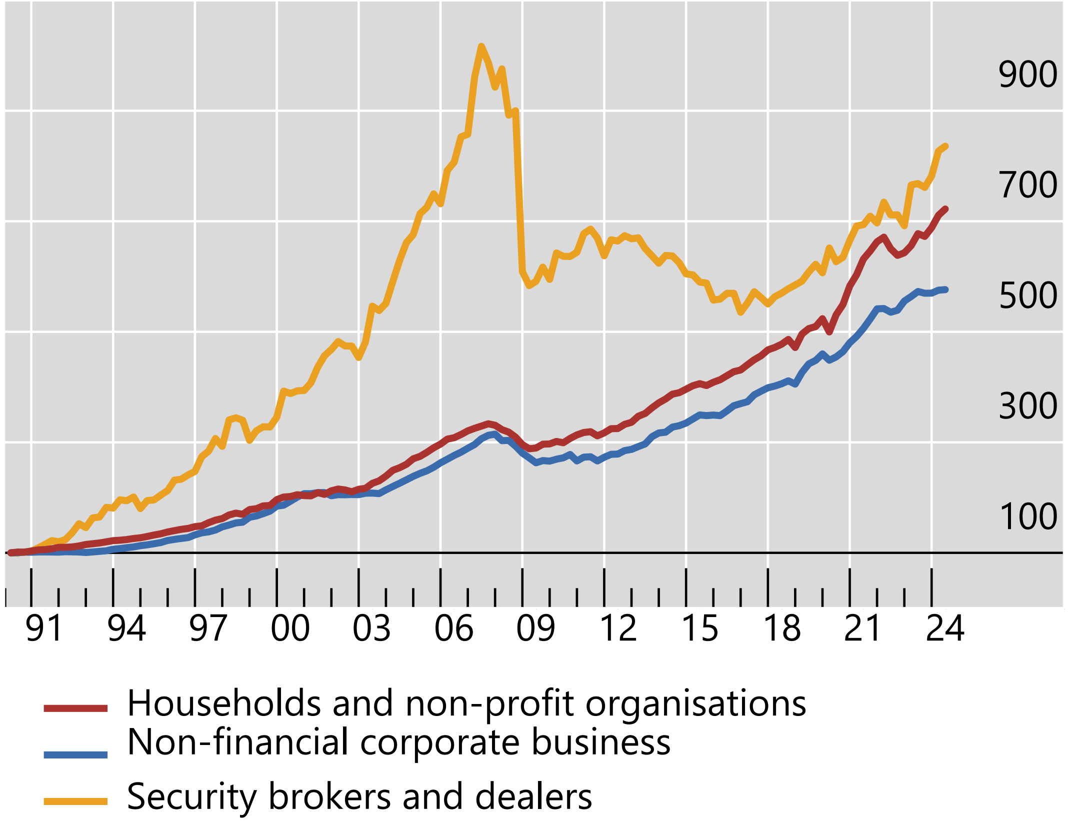
Discussion of "Treasury market dysfunction and the role of the central bank" by Kashyap, Stein, Wallen and Younger

Hyun Song Shin*, Bank for International Settlements
Brookings Conference, 28 March 2025, Washington, DC

* Views are my own, not those of the BIS

Broker-dealer balance sheets have smaller heft in the financial system post-GFC, as market-based intermediation has migrated elsewhere

Total assets (1990Q1 = 100)



Source: Federal Reserve, *Flow of Funds*

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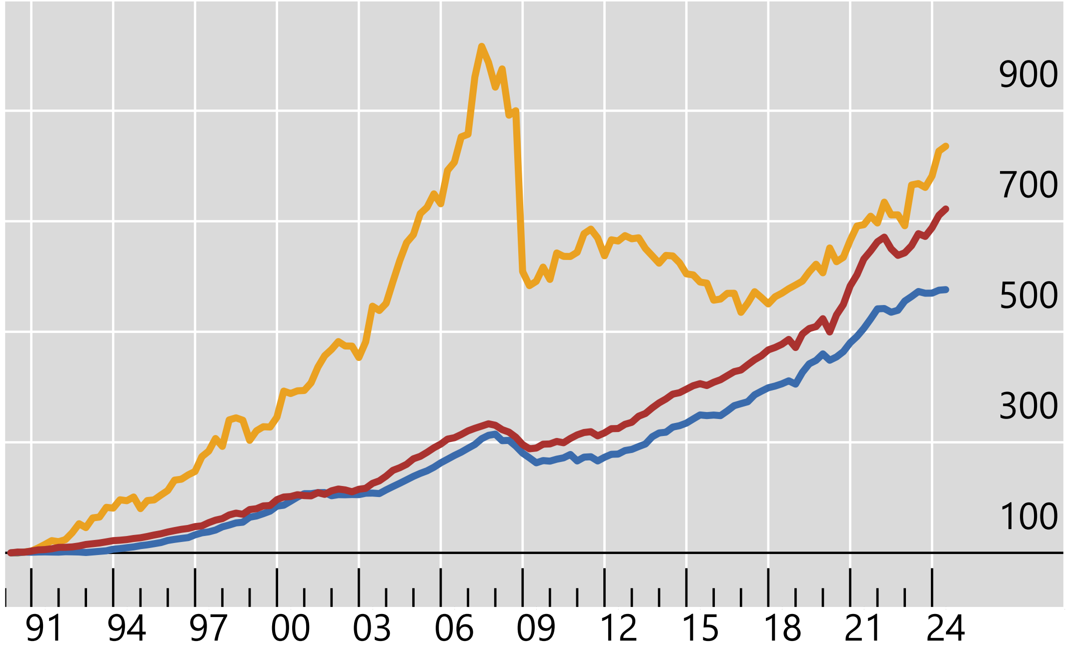
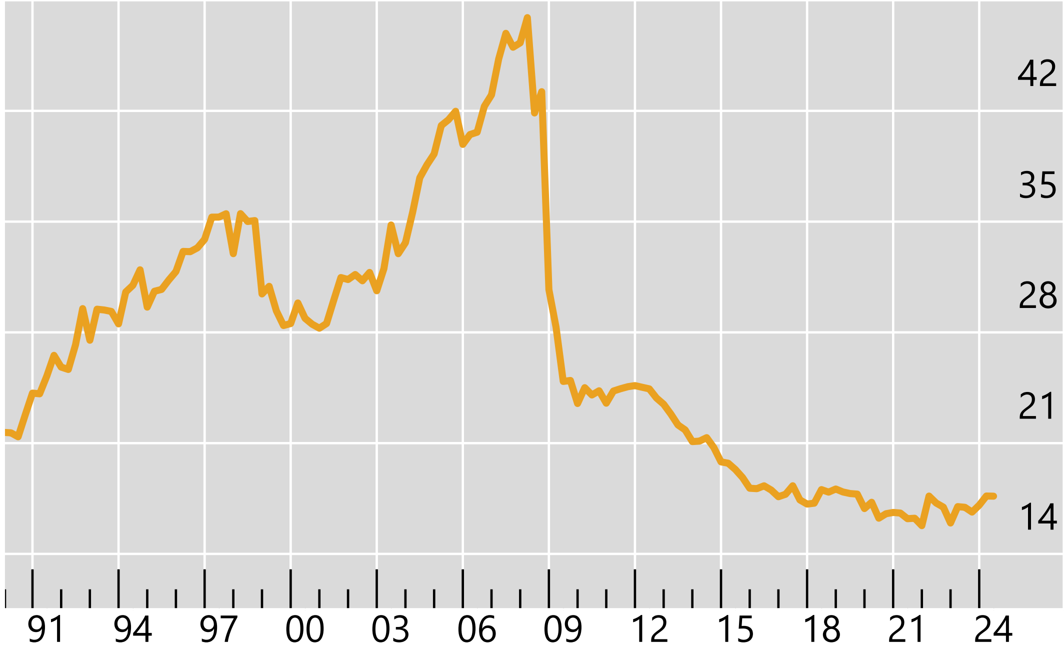


Households and non-profit organisations
Non-financial corporate business
Security brokers and dealers

Leverage (=assets/equity)



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Structural changes in the financial system after the Great Financial Crisis

- Before the GFC:
  - Focus on **private sector claims** (mortgages, corporate bonds)
  - Banks and broker dealers **warehoused claims** (either on-balance sheet or in associated special purpose vehicles)
  - Lesson (*): leverage and asset growth of ***regulated entities*** could track overall exposures and risks; incorporated in financial stability monitoring frameworks (eg, FSB)

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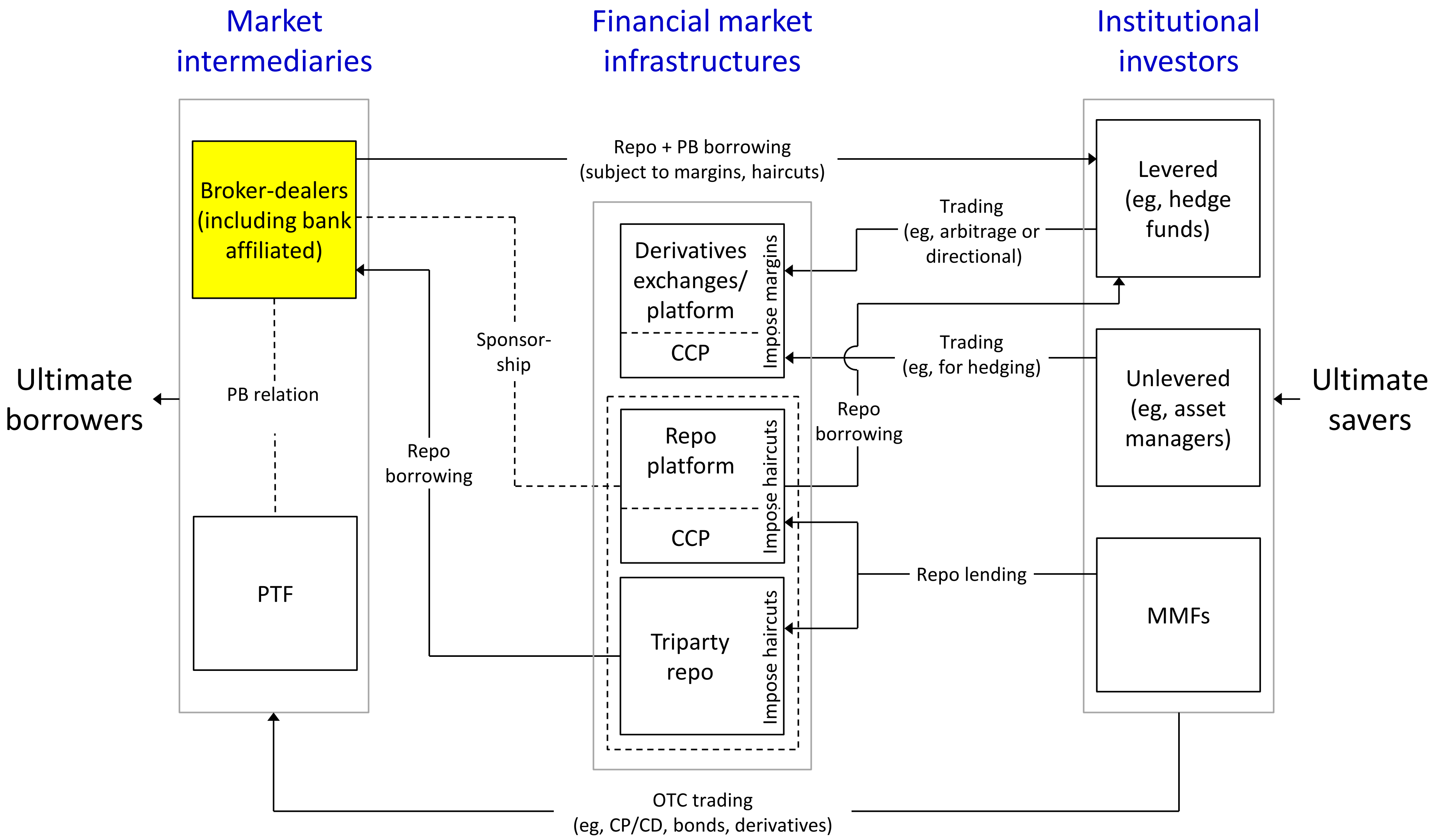
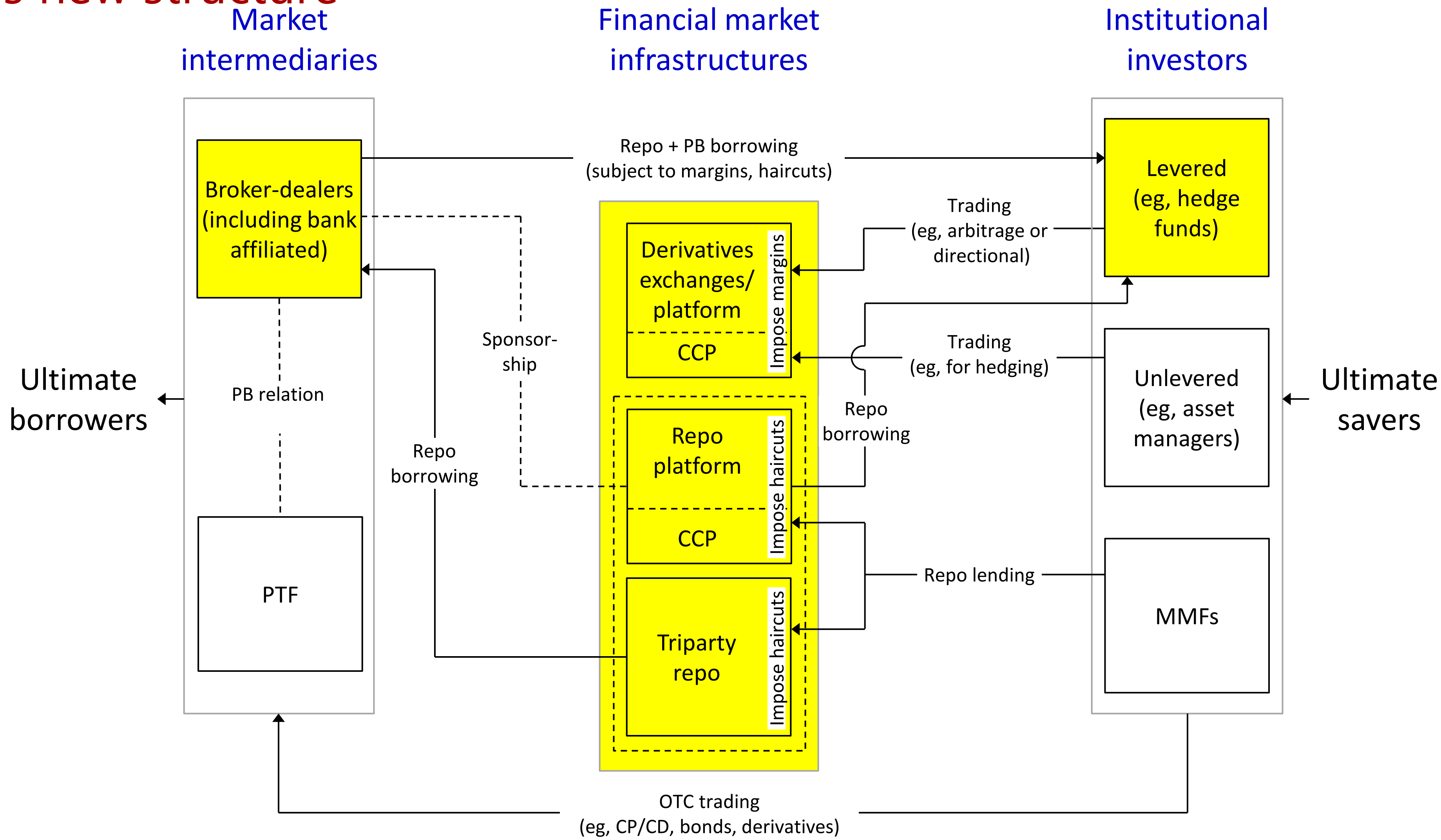
- After the GFC:
  - Focus on **sovereign bonds** rather than mortgages; stress impacts real economy through the yield curve (eg, mortgage rates and spreads)
  - Not sufficient to track balance sheets of regulated entities; need to unlearn lesson (*)
  - **Repo markets and clearing infrastructures** obscure underlying intermediation pattern and extent of leverage and exposures

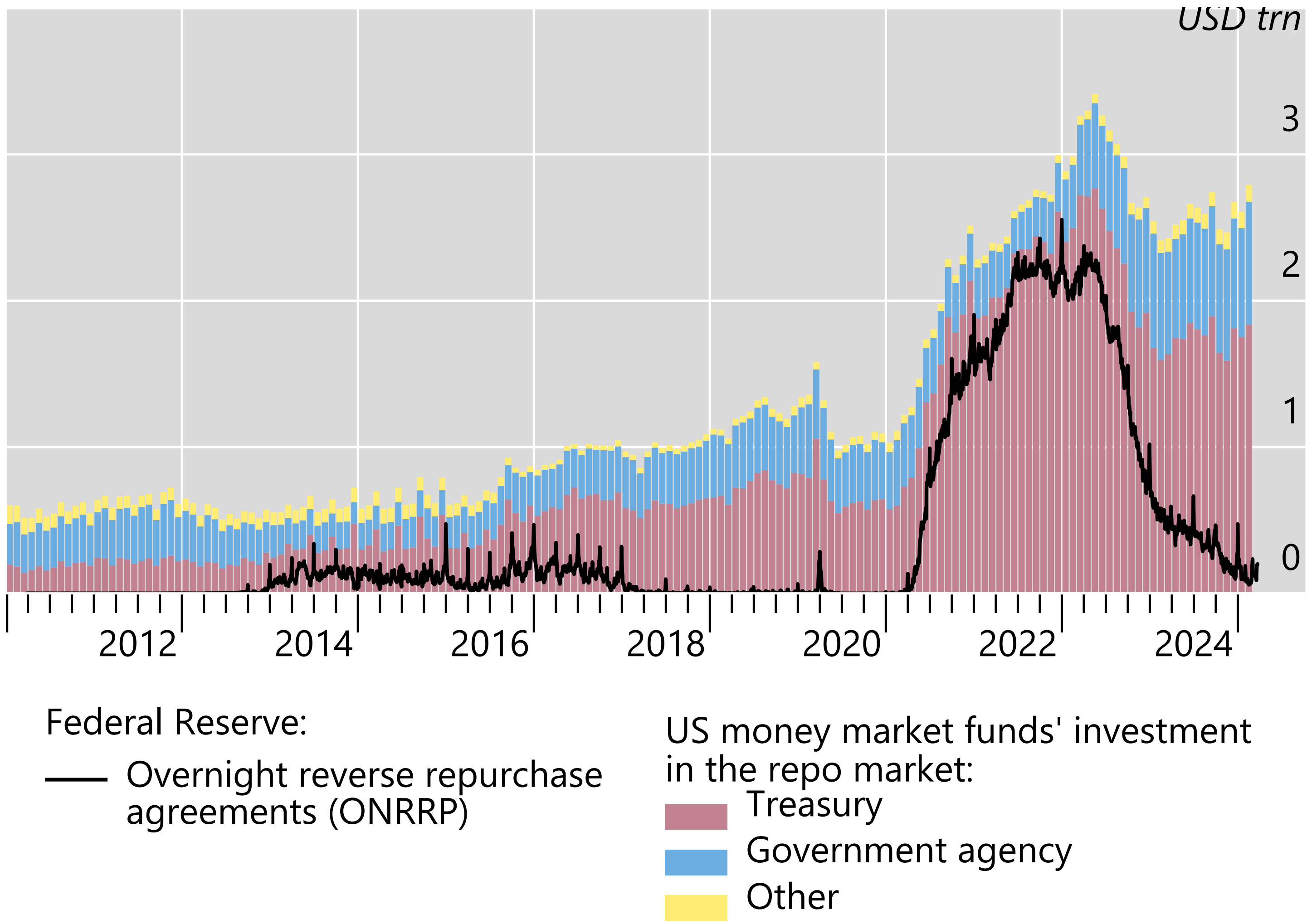
Structural changes in the financial system after the Great Financial Crisis; the role of broker dealers has changed



Instead, hedge funds, repo markets and associated financial market infrastructures have taken a key role; broker dealers, while smaller, underpin this new structure

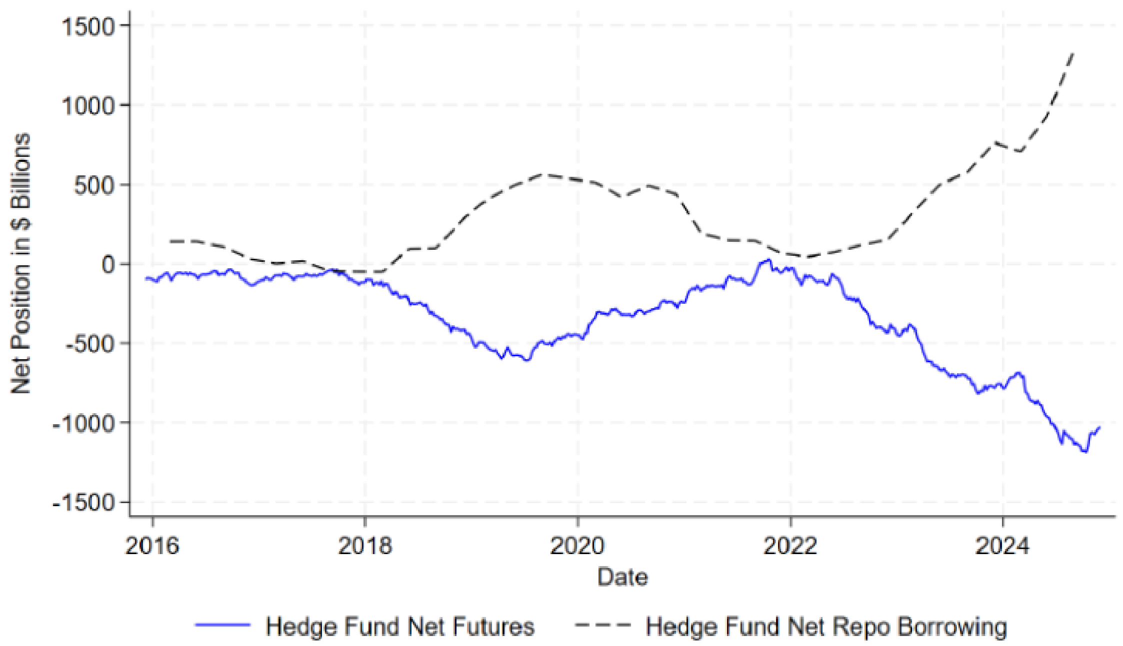


Repo markets reflect this shift in the pattern of financial intermediation



In this context, hedge funds play a crucial role in the treasury market, interacting with other parts of the system

Figure 4: Hedge Fund Treasury Futures Position and Repo Borrowing



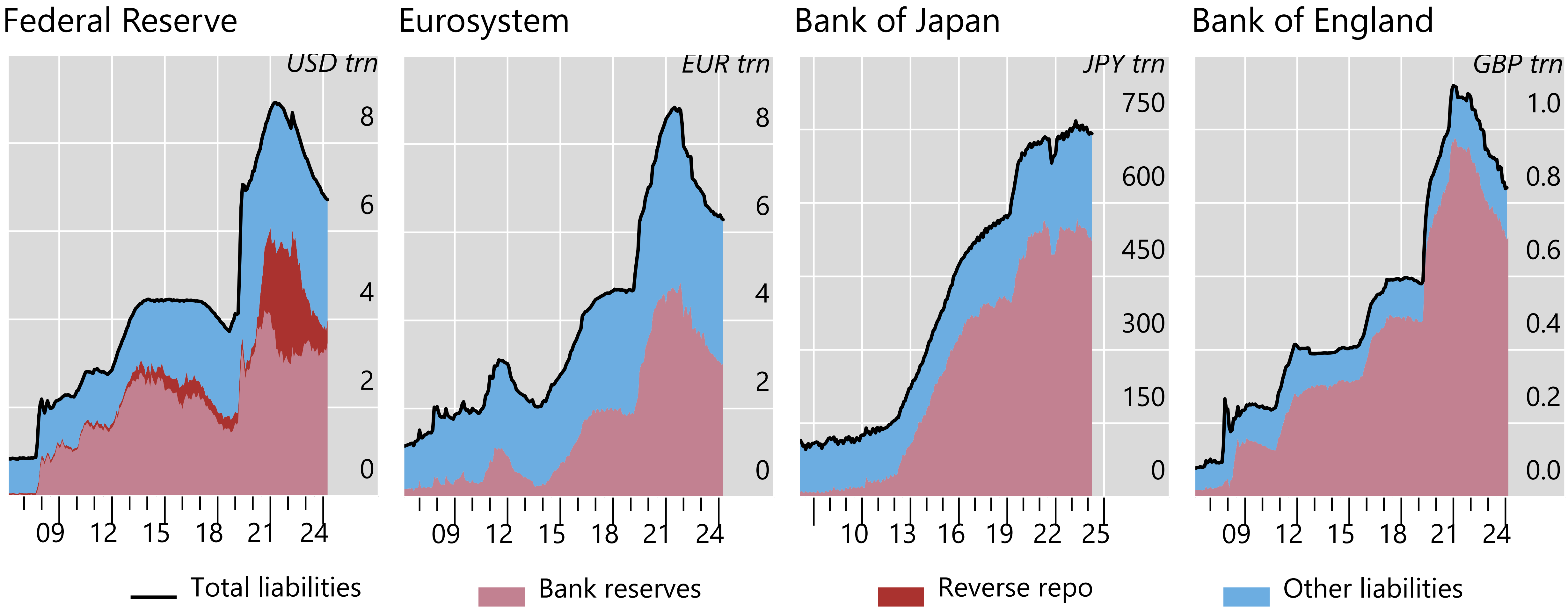
This figure shows hedge fund net repo borrowing and net Treasury futures positions. The hedge fund net repo borrowing is aggregated from the SEC Form PF data by the Office of Financial Research and is quarterly from January 2016 to September 2024. The net Treasury futures position data is weekly and is taken from the CFTC, where we take the reported data for "leveraged money positions" to be hedge funds. The data are from January 2016 to December 2024.

Assessing policy proposal of KSWY

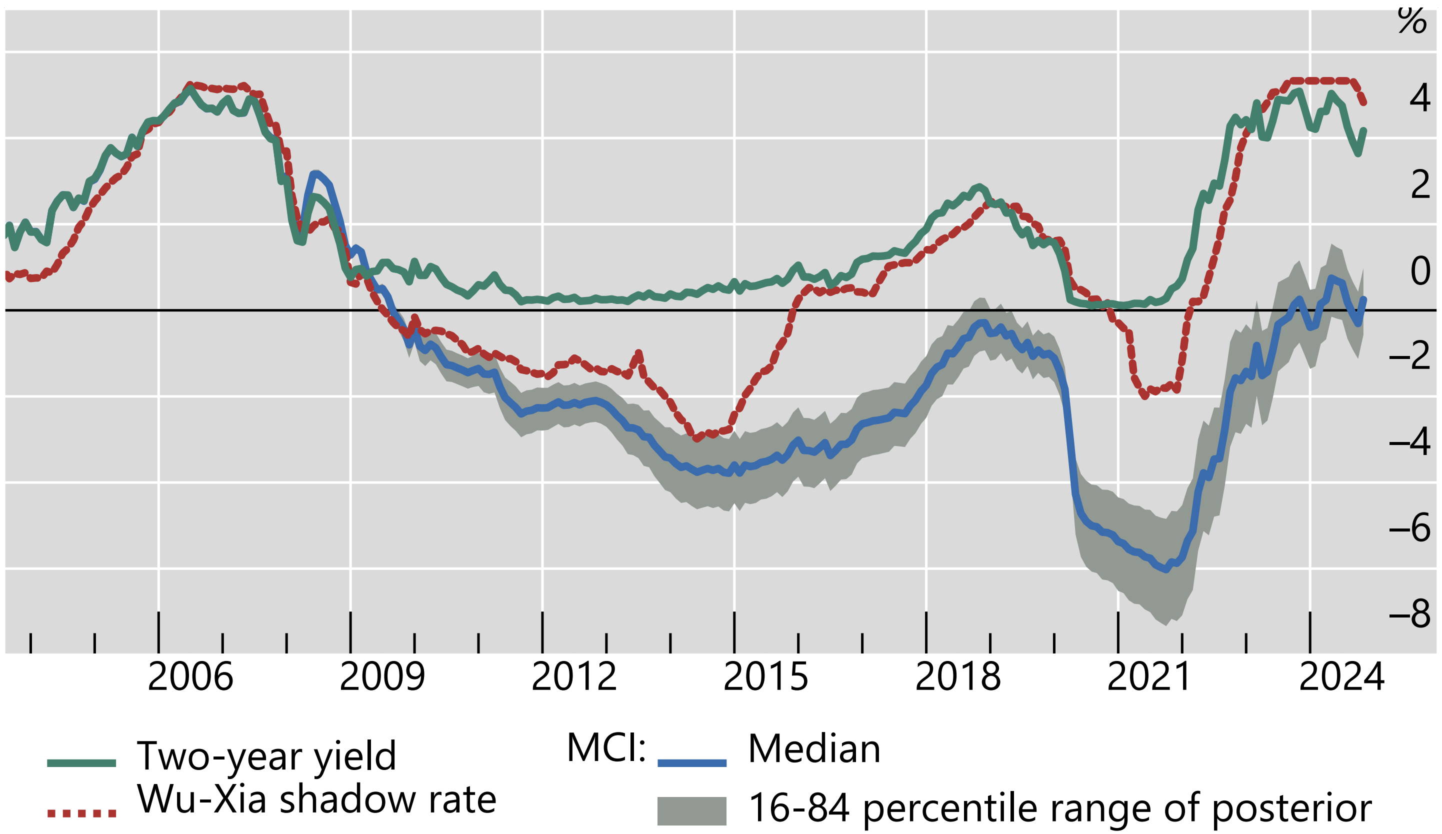
- Ex post, no doubt effective for stress mitigation

- Ex ante, need to factor in:
  - Endogenous position size given smaller tail risk; bigger sell-offs have bigger impact on rates that matter for the real economy (eg, mortgage rates and spreads)
  - Evolution of bank business models in repos and FX swaps
  - Monetary policy implications of large CB balance sheets

Central bank balance sheets remain large

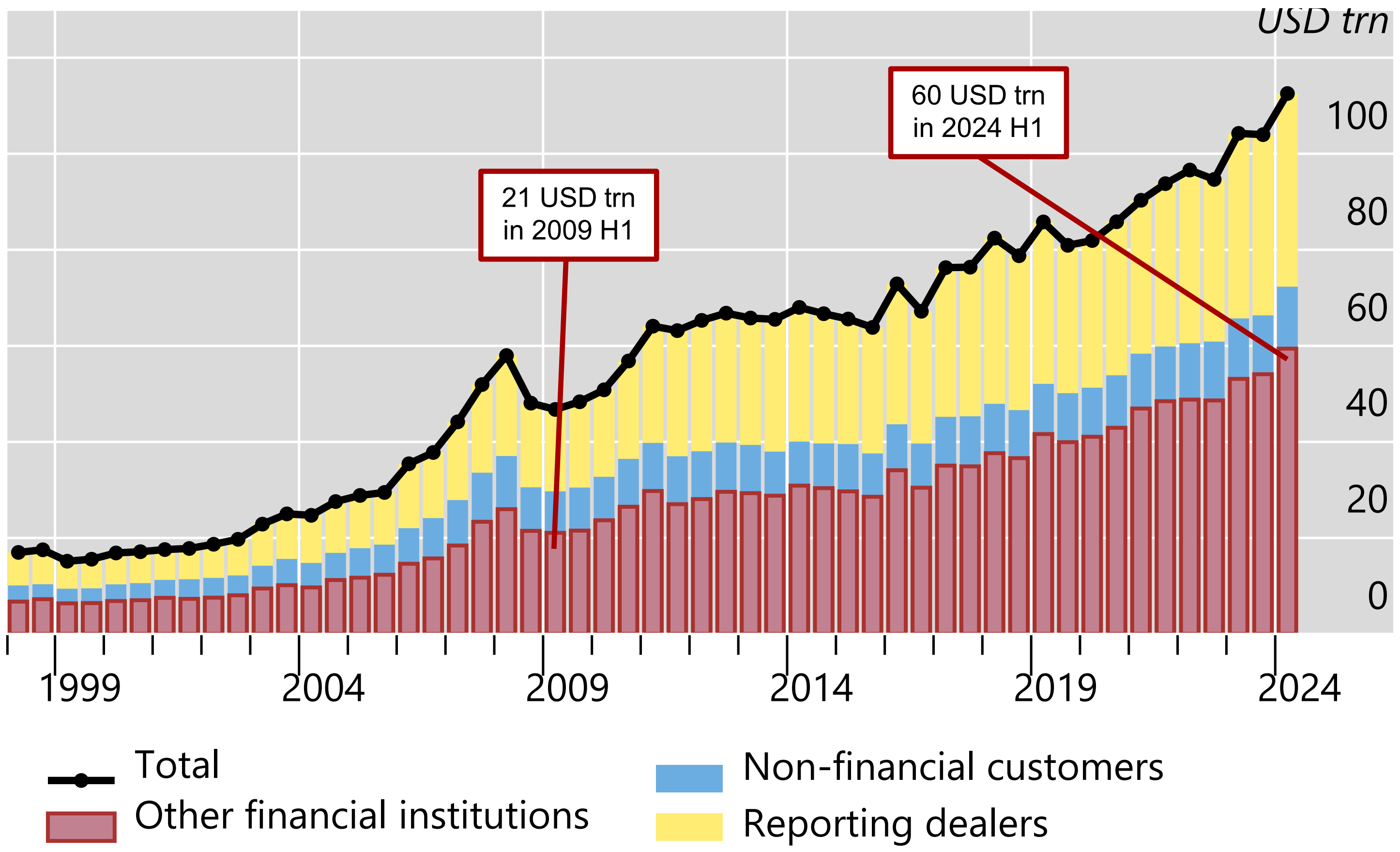


Monetary conditions measured as weighted average of policy rate and CB balance sheet size



Source: Mojon, Rungcharoenkitkul and Xia (2025); MCI is a weighted average of short-term rate and central bank's balance sheet size; weight is derived from BVAR of the index, financial conditions, inflation, and output gap; prior for the weight based on substitutability between balance sheet and policy rate in the literature. Plot gives the median posterior estimate, with the grey shaded area giving 16 to 84 percentile range of posterior.

Outstanding FX swaps stand at 113 trillion dollars, with the largest and fastest growing component being the "other financial institutions" segment; this portion has tripled since 2009



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- Congruent regulation (Metrick and Tarullo (2021)) together with sustainable fiscal trajectories would be the orthodox prescriptions