

LIQUIDITY REGULATION, MONEY MARKETS AND MONETARY POLICY

Optimal Bank Liquidity Regulation
TCH/Columbia SIPA Research Conference

Head of Division
Money Market and Liquidity
ECB

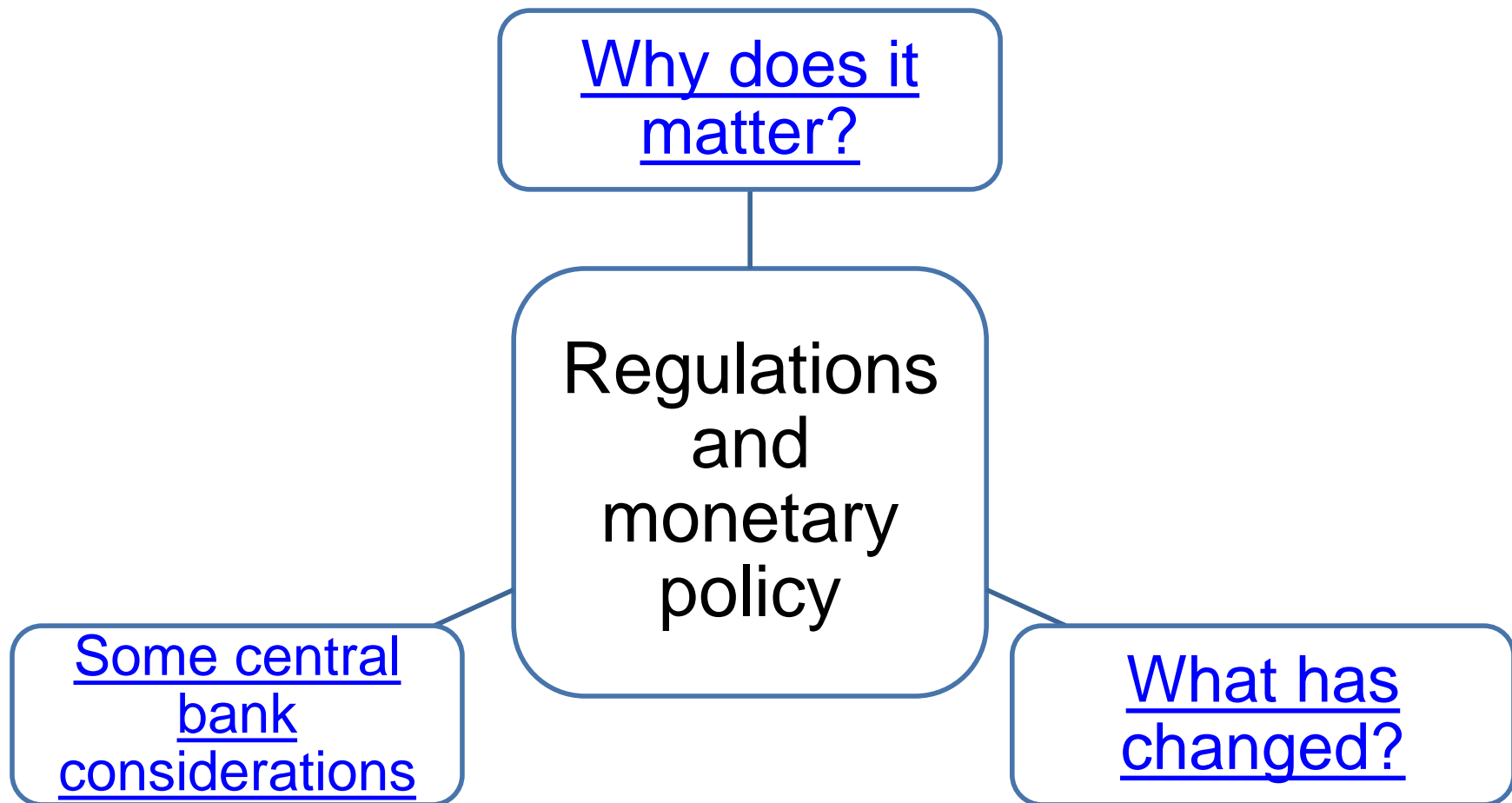
Seconded to FRBNY as Senior Policy Adviser

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DISCLAIMER

The views that I express are my own and do not necessarily represent those of the Federal Reserve Bank of New York or the Federal Reserve System, nor do they necessarily represent those of the European Central Bank.

Outline



Why does it matter?

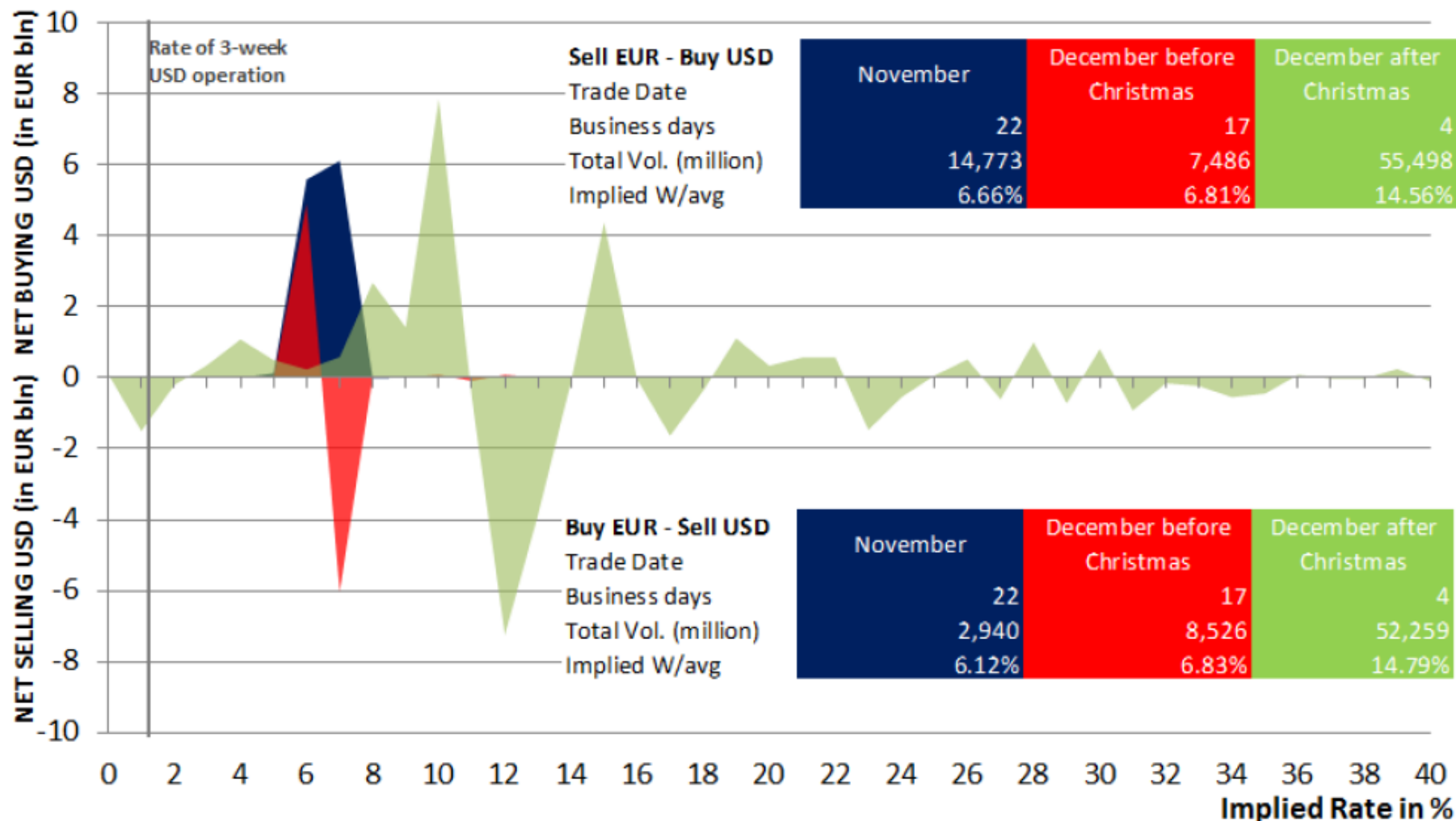
- Illustration of market impact of balance sheet costs and induced behavior at 2016 year-end (back of envelope)

	Germany	Austria
Bank Levy	0.06%	0.11%
Return on Equity (RoE)	7.2%	7.2%
Length of year-end in days	4	4
Year-end USD O/N rate	0.55%	0.55%
Implied cost with Bank Levy	6%	10.5%
Implied cost with Leverage Ratio of 3%	20%	20%

Source: ECB: [Developments in the FX swap market – MMSR perspective \(H. Neuhaus, P. Nicoloso\)](#)

Why does it matter?

FX Swap EUR vs USD Net Activity by period & rate, Settlement Date 30/12/2016, Maturity Date 03/01/2017



Source: ECB: [Developments in the FX swap market – MMSR perspective \(H. Neuhaus, P. Nicoloso\)](#)

Source: MMSR

[overview](#)

What has changed?

- Regulations and supervisory attention

What has changed?

- Regulations and supervisory attention e.g.
 - LCR
 - NSFR
 - Intraday
 - Resolution and recovery
 - Leverage ratio, focus on capital
 - Stress tests
 - Money Market Fund Reform
 - Market infrastructure oversight
 - ...

What has changed?

- Regulations and supervisory attention
- Conscious steering of liquidity beyond regulatory needs
- Mix of global and local perspective
 - Local needs for payments/settlement
 - some rules apply at level of legal entities
 - not necessarily at currency level
 - market conditions play role (liquidity and pricing)
 - as do policies of various central banks
 - => possibly variable demand for liquidity for given currency
- Changed value of certain instruments, counterparties, funding mixes

Some central bank considerations

- What do and what don't we know?
- Change in transmission mechanism?
- How to calculate neutral liquidity?

Some central bank considerations

- What do and what don't we know?
- Change in transmission mechanism?
- How to calculate neutral liquidity?
- Impact on the operational framework?
 - Operational target
 - Corridor vs floor
 - How to provide/absorb liquidity?
 - Range of counterparties?

Some central bank considerations

- What do and what don't we know?
- Change in transmission mechanism?
- How to calculate neutral liquidity?
- Impact on the operational framework?
- Liquidity insurance beyond operational framework?