

Discussion of "Reciprocal Lending Relationships in Shadow Banking" by Yi Li and "Nonbank and Lending Standards in Mortgage Markets. The Spillovers from Liquidity Regulation." by Pedro Gete and Michael Reher

Prepared for The Clearing House/Columbia University Conference "Optimal Bank Liquidity Regulation" February 9, 2018

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Overview

- Two papers that discuss regulation and the effect on market intermediation
 - Li looks at money market mutual fund (MMF) interaction with banks.
 - Gete and Reher look at the general equilibrium effect of the liquidity coverage ratio on the market share of nonbanks in mortgage origination.

Reciprocal Lending Relationships in Shadow Banking (Li)

- The paper lays out the following:
 - MMFs are pushed to invest at shorter maturities.
 - Banks are pushed to borrow at longer maturities.
 - How do these agents resolve this tension?
- Reciprocal relationships—each side gives a little

Reciprocal Lending Relationships in Shadow Banking (Li)

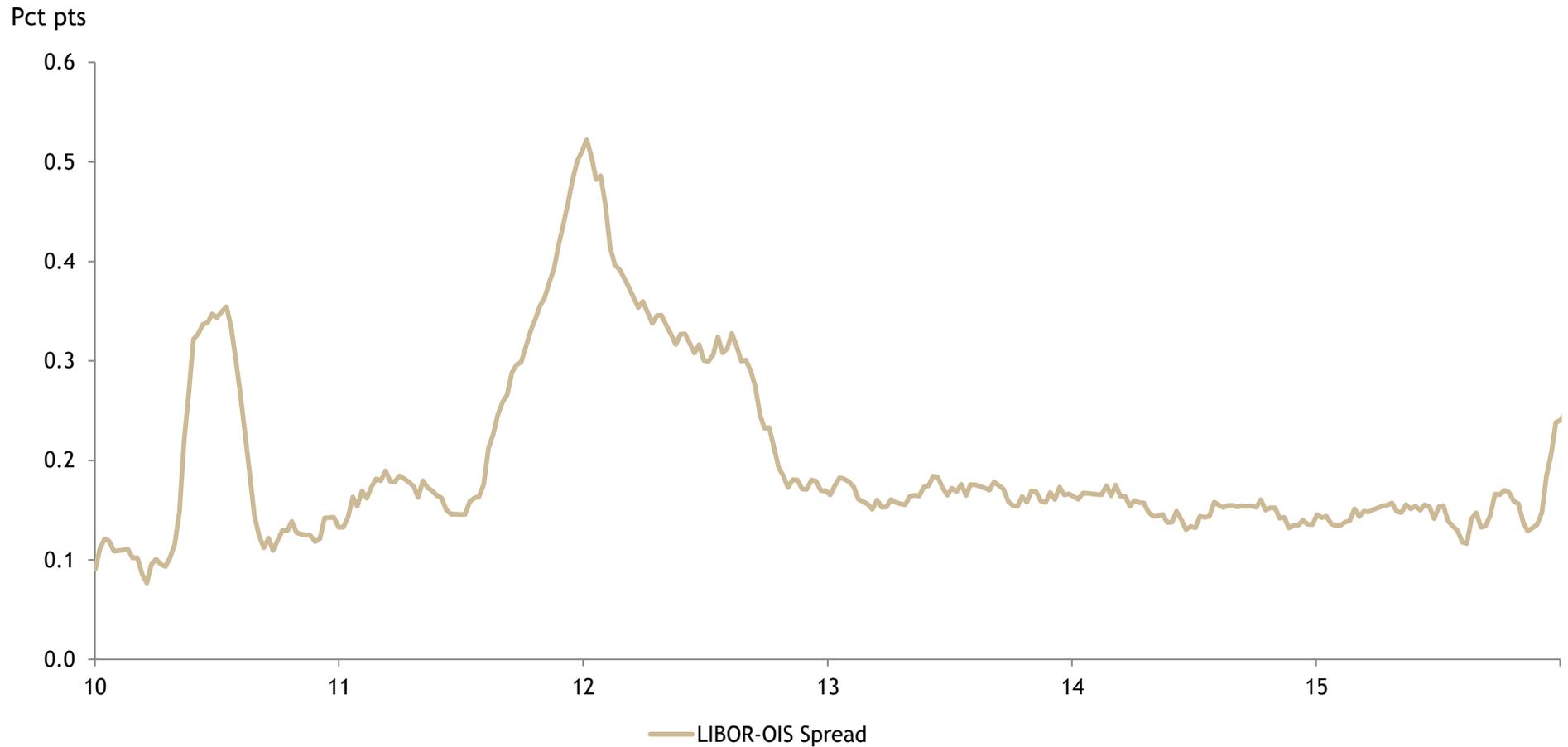
- Why should it matter? Author pushes in two directions.
 - Presumably, if there is a more stable relationship, there is more financial stability, whether intended or not.
 - These relationships can lead to less diversification of risk, perhaps leading to fragility.

Reciprocal Lending Relationships in Shadow Banking (Li)

- What would I have liked to see more of?
 - Mapping the regression coefficients into market rates
 - For example, is Libor-OIS narrower as their micro-level results would suggest?
 - Is there in market data any reflection of differentials based on attachment of banks to MMFs?

Three-month Libor-OIS Spread

Libor-OIS spread



Source: UBS, Bloomberg

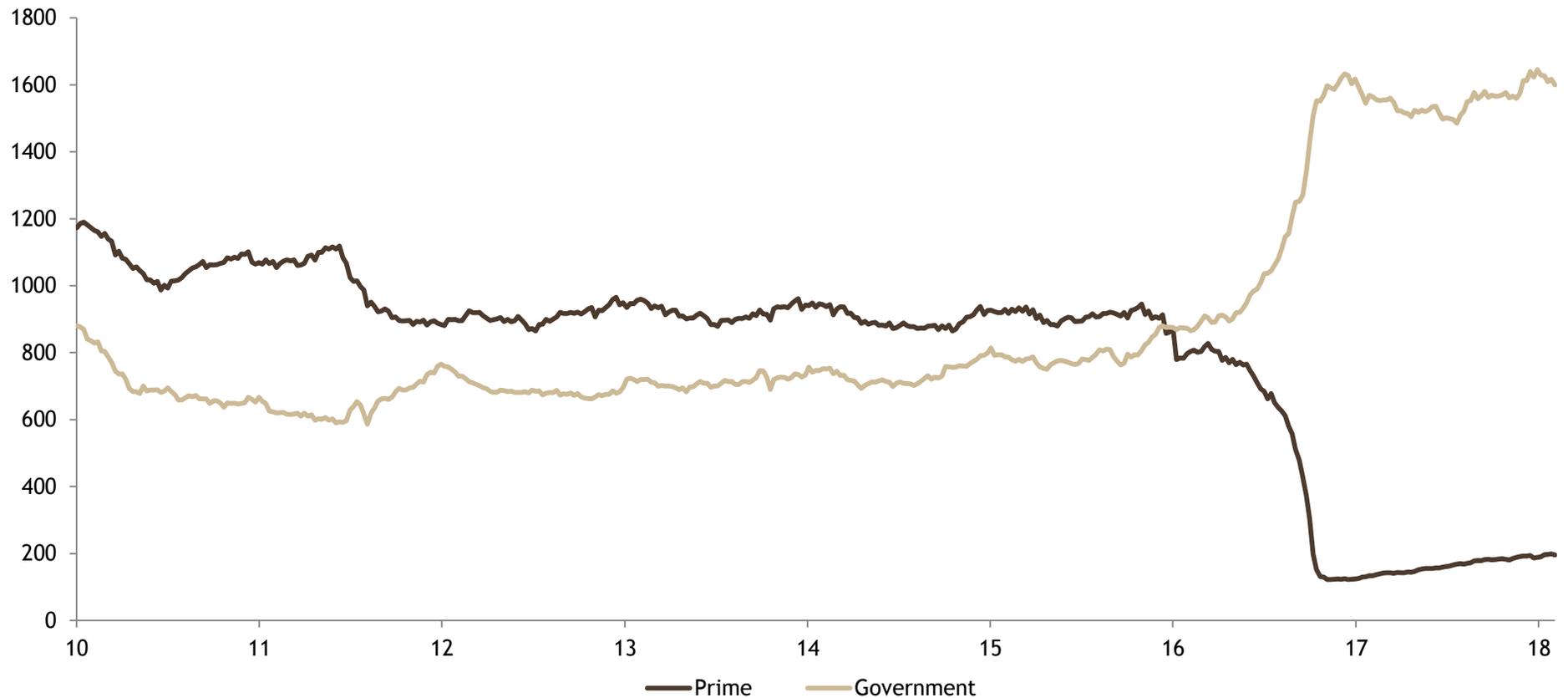
Reciprocal Lending Relationships in Shadow Banking (Li)

- NAV reform led to a sharp drop in Prime funds AUM.
- In 2016, Libor-OIS, 1s/3s, and 3s/6s widened notably. What does this paper tell us about that phenomenon?

MMMF Reform led to a sharp decline in AUM for Prime Funds

Assets Under Management

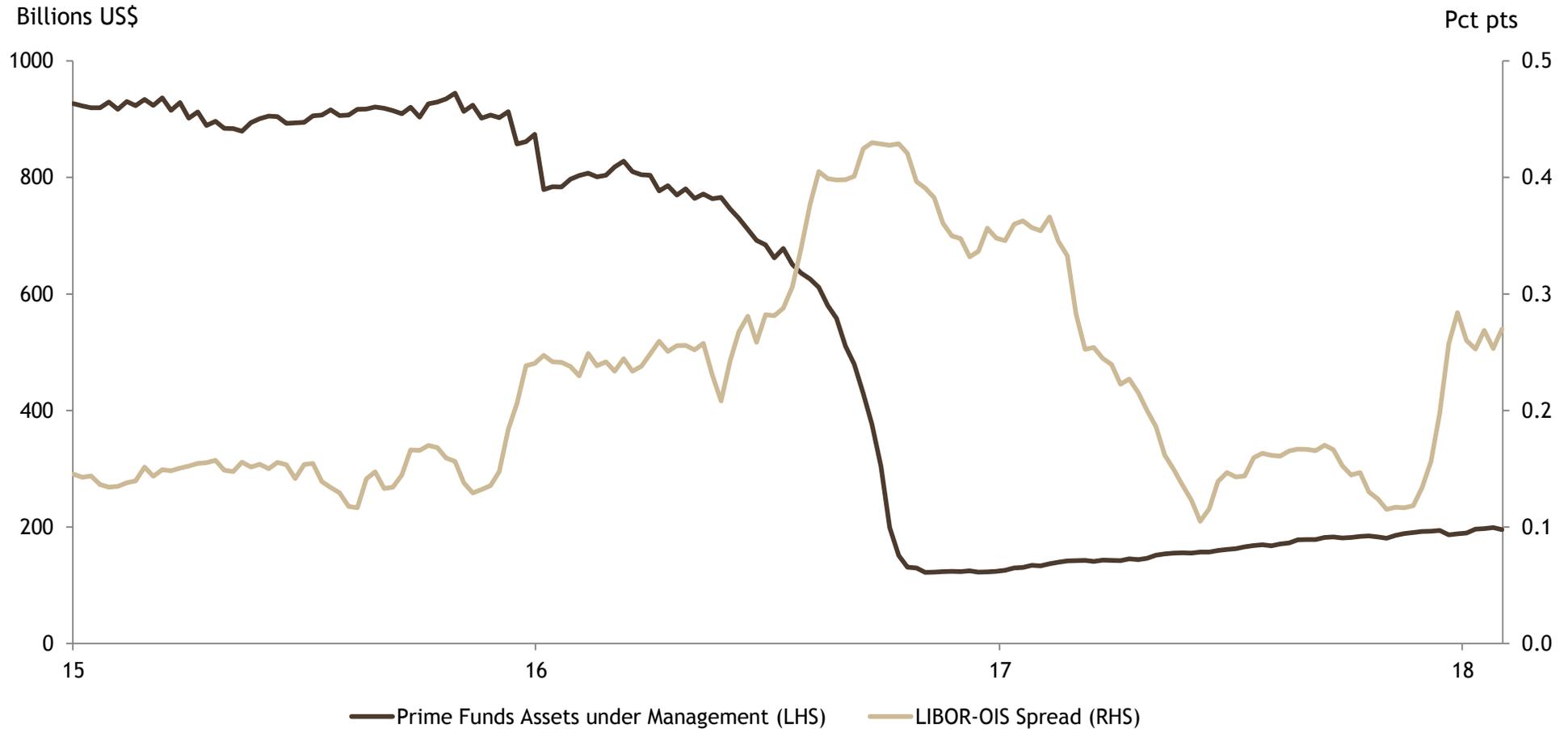
Billions US\$



Source: UBS, ICI

MMF Reform led to a fall in AUM and a spike in Libor-OIS

Prime Funds Assets Under Management and LIBOR-OIS



Source: UBS, ICI, Bloomberg

Nonbanks and Lending Standards in Mortgage Markets. The Spillovers from Liquidity Regulation. (Gete and Reher)

- The authors make the following points:
 - The LCR puts greater value on Ginnie Mae MBS over Fannie and Freddie MBS.
 - This higher value pushes up Ginnie relative prices and creates more liquidity.
 - These effects push nonbanks to produce relatively more Ginnie mortgages and takeover a bigger market share.

Nonbanks and Lending Standards in Mortgage Markets. The Spillovers from Liquidity Regulation. (Gete and Reher)

- This question is a critical issue.
 - Mortgages were an important part of the financial crisis and understanding how the world has changed is useful.
 - The authors cite potential fiscal implications of FHA loans.
 - The housing market is important to the US economy.

Nonbanks and Lending Standards in Mortgage Markets. The Spillovers from Liquidity Regulation. (Gete and Reher)

- Identification

- Probably not as clean as the authors suggest.
 - Other regulation that was being implemented over time could be partially responsible.
 - The "credit box" is tighter for many reasons, perhaps driving some of the results.
- Ultimately not that big a deal—the main point is very important.

Nonbanks and Lending Standards in Mortgage Markets. The Spillovers from Liquidity Regulation. (Gete and Reher)

- Where to look in the future?
 - The Fed balance sheet is unwinding. \$8 billion per month of MBS going to the market.
 - The pace of the unwind will accelerate to up to \$20 billion per month.
 - Authors note that nonbanks finance their inventories, and that cost could be affected by the Treasury-MBS basis.

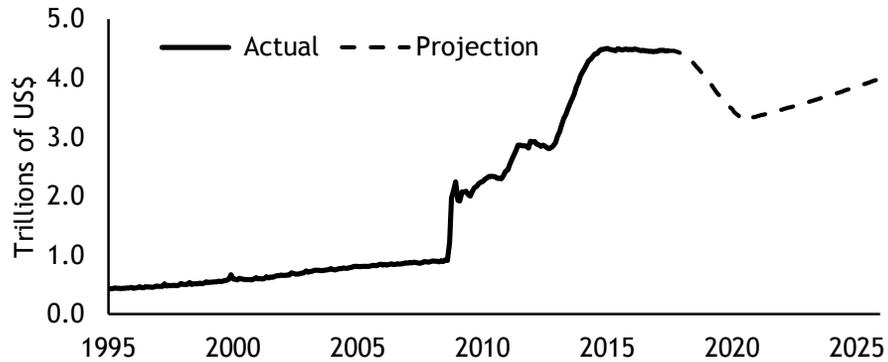
Nonbanks and Lending Standards in Mortgage Markets. The Spillovers from Liquidity Regulation. (Gete and Reher)

- In our projections in 2020, the Fed will buy Treasuries and sell MBS simultaneously.

Our baseline Fed balance sheet projections

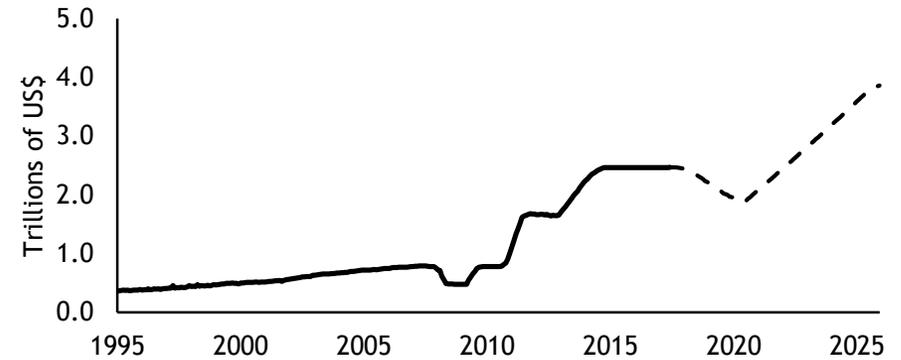
The Fed will be buying Treasuries again in under 3 years

Total Assets



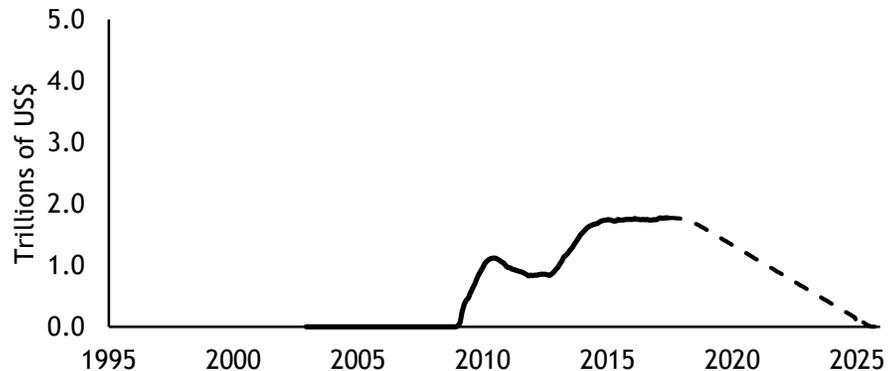
Source: UBS, FRB

Treasury Securities



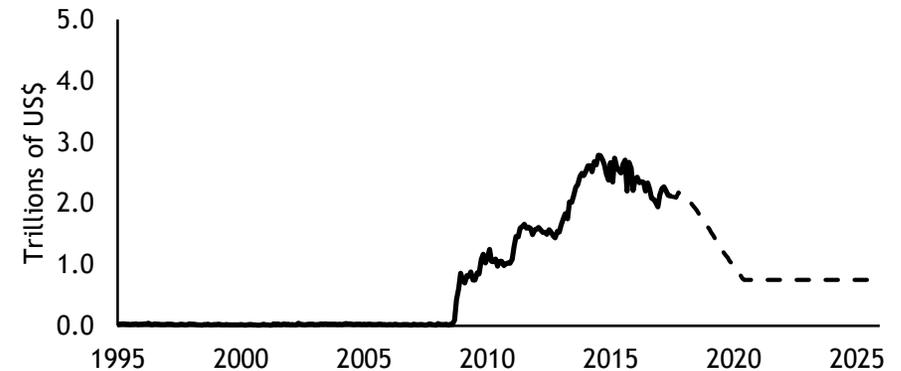
Source: UBS, FRB

MBS



Source: UBS, FRB

Reserves



Source: UBS, FRB

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