# Discussion of

# Money Market Disconnect

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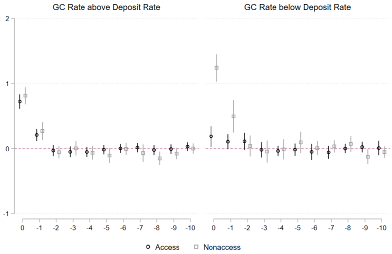
[1] The views of this paper/presentation are solely the responsibility of the author and should not be interpreted as reflecting the views of the Board of Governors of the Federal Reserve System or of any other person associated with the Federal Reserve System

# Motivation and Perspective

- Repos can be cash- or collateral-driven. Either to:
  - invest cash safely at prevailing market rates
  - source sought after collateral
- Different economic motives to trade result different repo rates
- Central bank policy choices—reserve balance remuneration and asset purchases—can affect repo lenders' incentives to participate the market and rates depend on:
  - Lender identity (access to deposit facility)
  - Collateral availability (effect of asset purchases)
- Recognizing spreads between repo rates can have an effect of monetary policy transmission (MPT)

# Empirical Framework and Results

- Studies *daily* changes in lender and collateral specific repo rates to *daily* changes in unsecured rates
- When repo rates are below the rate on deposit facility bank-lender and QE eligable collateral repo rates are less responsive to changes in unsecured rates




*Source:* Ballensiefen, Ranaldo & Winterberg (2022)

- **Interpretation**: a large fraction of repo trades are *collateral driven*, thus MPT—which operates, in part, through changes in funding rates—may be affected by collateral driven repos

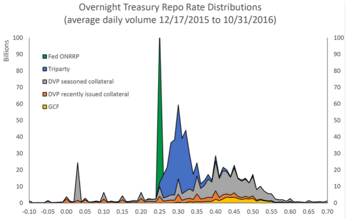
# Overview of comments

0. Don't listen to me!
1. Lower rates for collateral driven repos is well documented
2. What is the "collateral-driven" reason to lend at lower repo rates?
3. Role of regulation?

# Comment 1): Lower rates for collateral driven repos

- Just to clarify, lower rates for collateral dirven repos is well documented
- Duffie (1996), and others, have documented that Treasury repo rates can trade *special*—below prevailing market rates
- Secured Overnight Funding Rate (SOFR) construction recognizes wedge between repo rates when they're collateral driven:

  "DVP repo transactions with rates below the 25th volume-weighted percentile rate are removed from the distribution of DVP repo data each day"




*Source:* Bowman et. al (2017), "The Cleared Bilateral Repo Market and Proposed Repo Benchmark Rates"

- **Punchline:** Effect on MPT is more novel, but what should be done about it? Need to know what is the "collateral-driven" motive!

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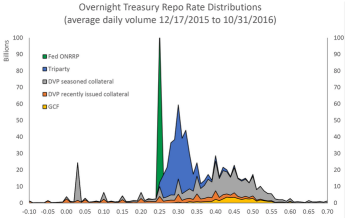


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# Comment 2): What is the "collateral-driven" motive?

- The paper refers to "collateral-driven" repos, but never takes a stance on *why* lenders want to source collateral. Relevant for policy implications....
- Possible answers, for example:
  - Source securities for short positions
  - Profits from relatively low borrowing rates
  - Source and distribute safe assets
- Demand for safe assets?
  - Ballensiefen & Ranaldo (2022) carefully explain the heterogeneity in repo rates $\longrightarrow$ safe asset carry trade
  - Infante (2020) shows repo volumes *decreases* with demand for safe assets
  - Infante & Saravay (2022) shows Treasury reuse (mainly through repos) *increases* with demand for safe assets
- **Punchline:** Is the demand for safe assets driving this behavior? If so, what should be done?

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# Comment 2): What is the “collateral-driven” motive? (con’t)

- Tease out motive to source collateral by inspecting repo contracts separately
- Paper currently pools Overnight, Tomorrow-Next, and Spot-Next repo contracts, but the delivery date of collateral differs across contracts
- Again, Ballensiefen & Ranaldo (2022) carefully study *when* repo lenders receive collateral
- If driven by QE induced asset scarcity for *specific* securities, securities lending programs limit distortions
- **Punchline:** If really collateral motivated, would we observe a differential effects for different delivery times? And, what are the implications for the securities lending program?

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# Comment 3): Role of capital regulation

- While many EU capital regulations measured on quarter-end, banks reponse to regulation is nuanced
- Duffie & Krishnamurthy (2016) suggest that regulation is an important driver of pass-through efficiency
- BrokerTec, Eurex, and MTS repo markets are centrally cleared
- Un-responsive lending rates driven by banks' incentives to net gross repo positions
- Recent research has shown theoretically (Duffie 2020; He, Nagel & Song 2022) and empirically (Favara, Infante, & Rezende 2022) that SLR affects banks participation in Treasury markets
  $\longrightarrow$ increased netting may be a solution!
- **Punchline:** Consider net lending positions—banks with larger net repo borrowing are more incentivized to accept lower rates—or condition on different CCPs!

# Conclusion

- Interesting paper on the effects of widening repo spreads on MPT
- Main suggestion: explore incentives behind collateral-driven repos to understand how to address these effects
  - Relate to safe asset literature
  - Timing of collateral delivery and the effects of securities lending program
  - Discard regulatory incentives