Comments on Morten L. Bech, Antoine Martin & James McAndrews'

"Settlement Liquidity and Monetary Policy Implementation Lessons from the Financial Crisis"

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The paper’s contribution

Two (very reasonable) empirical links:

- From emergency measures to more (overnight) reserves

- From higher reserves to a) more payments settled early
  b) less intraday borrowing from the Fed

A great addition to a very nice body of work on delays.

The Fed likes a) because early means more “settlement liquidity”
& b) because it reduces risk exposure of the Fed

Suggesting that paying interest on reserves has some “nonstandard” benefits.

Have we (accidentally) hit on a great permanent solution to payment delays?

Part of the question is whether paying interest on reserves is enough (reserves might be high because of lack of good assets)

"Paying interest on reserves" is a clear policy in models with a single short term rate (where OMO are equivalent to loans to banks).

But what rate should be paid when there are many short term rates?

More than the federal funds rate? (surprisingly possible)

Isn't more than 3-month treasury yield a "subsidy" (i.e. a cost to the Fed)

If "correct number" is .01%, paying .25% on $1.5T is a cost of $3.6 billion.

Liquidity – a nice word we too would like a piece of

"Settlement liquidity" = "ease with which market participants can discharge their … obligations"

At some level, you can discharge if you borrow – a cost of borrowing?

My take: the "market" for **intraday immediacy** may not work well.

Unfortunately, it seems difficult to know the costs of the measured delays.

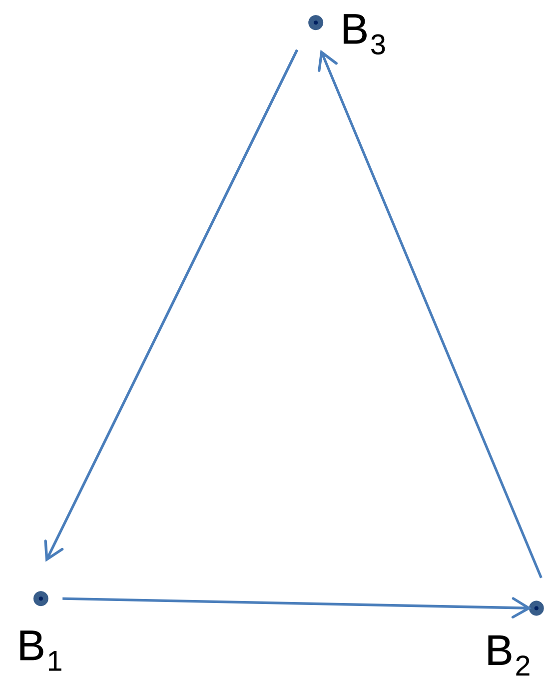
“Purely administrative” delays might not be costly

Suppose payoffs depend only on whether payment is made by the end of the day.

And that there is a one minute administrative delay between the moment that an institution has cash on hand and the moment it posts a payment (a “verification delay”)

Then system in which everyone starts with ample cash is faster than system where banks have to wait to receive cash before they can pay.

So what?



Data that might bear on the cost of delays

Survey to see if some payments are delayed overnight (“defaults”).

Use overnight rates at different times of day to compute intraday rates. (Furfine 2000, Baglioni and Monticini 2008)

(would “shadow” intraday rates soak up the power of reserves in the regression?)

Fed revenue from intraday lending (a rough measure of willingness to pay)

Liquidity – a nice word we too would like a piece of

“Settlement liquidity” = “ease with which market participants can discharge their … obligations”

Which?

a) Banks – and their obligations to each other

b) Bank customers – and their “covered” obligations

Is bank discretion good for settlement?

Right now, banks have discretion about when to submit customer requests to a LVPS.

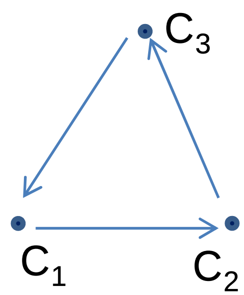
Why not have all customers post their requests/desires to a central system that removes cycles?

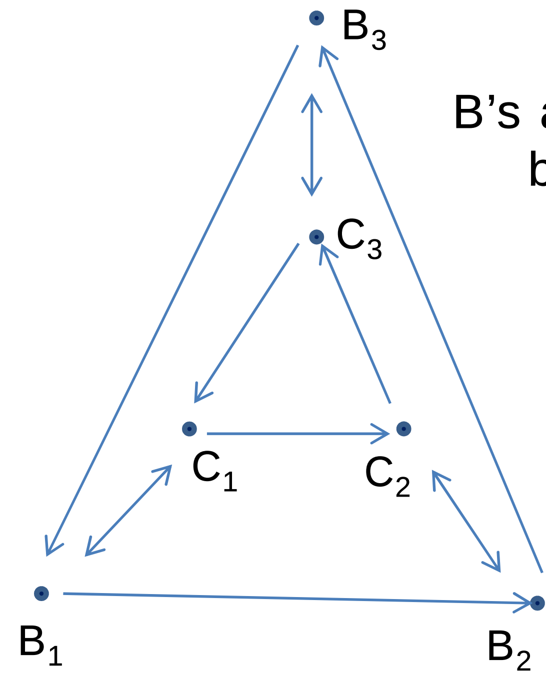
Suppose C_1 wants to pay \$1 to C_2
C_2 wants to pay \$1 to C_3
C_3 wants to pay \$1 to C_1.

Right now one bank may have to give intraday credit to one of these, then decide to post payment to the next, whose bank must post the payment to the next...

Decentralization of "cycles" to banks:

C's = customers with
Required payments





B's are
banks

Possible to have complete freeze without intraday credit.

An aside: should intraday credit be welcome (as adding to "settlement liquidity") or curtailed?

In repo market, the Fed seems to want less of it…

Conclusions

Very useful addition to an important body of work.

Raises questions about cost and benefit of

- Delays
- High reserves
- "Interest on reserves"
- Intraday credit
- Banks as engines of settlement