Discussion of
“How Abundant are Reserves? Evidence From the Wholesale Payment System” (Afonso, Duffie, Rigon, and Shin)
&
“Market Power in Wholesale Funding: A Structural Perspective from the Triparty Repo Market” (Huber)

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Disclaimer: The views expressed herein do not necessarily reflect those of the Federal Reserve Board or its staff.
Paper title: **How abundant are reserves? Evidence from the wholesale payment system**

Key finding: Even in the era of large reserve balances (i.e., post-GCF), banks’ outgoing payments remain highly sensitive to incoming payments.

- A 1-percent increment received in incoming payments by a bank in a 15-min window predicts an additional 0.4 percent of outgoing payments in the subsequent 1-min window.
- The coupling of payments is strengthened when aggregate bank reserves are low.

This paper challenges the conventional wisdom that banks’ large reserve balances eliminated the reliance on incoming payments to make outgoing payments.
It supports the emerging view that banks are still subject to balance sheet constraints even with “ample” reserves.

- Reserves are deployed to repo lending and other short-term funding operations. [Afonso, et al. (2021), Correa et al. (2020)]

- Post-GFC regulatory and supervisory liquidity requirements affect intraday reserves management. [Ihrig (2019), Copeland et al. (2022), d’Avernas and Vandeweyer (2021)]

Findings are timely amid the ongoing shrinking of central bank balance sheets around the world.
How much control do banks have for their payment flows?

- The Fedwire is a real-time interbank payment system, and the majority of payment transactions are requested by bank customers (rather than scheduled by banks themselves).
- Banks are subject to unexpected payment outflows and inflows.

Is it possible to decompose the sensitivity of outflows to inflows?

- What proportion of such sensitivity is contributed by banks’ active payment management?
- What proportion is driven by banks’ passive reaction to customers’ requests?
- Consider utilizing the information on transaction types provided by the Fedwire data.
Zoom into specific events of funding stress

- In mid-September 2019 (repo squeeze) and mid-March 2020 (COVID crisis), overnight repo rates paid by large banks surged.
- Relative to normal times, banks’ incentive to sync their payment outflows with inflows should increase dramatically in times of stress.
- High-frequency transaction-level data should allow for a detailed investigation of these events.
Huber (2022): Summary

- Paper title: Market Power in Wholesale Funding: A Structural Perspective from the Triparty Repo Market
- Using structural estimation, this paper studies imperfect competition in the tri-party repo market.
  - Key feature: Cash lenders allocate their portfolios among differentiated dealers who set repo rates.
  - Key conclusion: Cash lenders’ aversion to portfolio concentration and preference for stable lending grant dealers substantial market power.
  - Key number: Dealers borrow at rates that were 21 bps lower than their marginal value of intermediating borrowed funds.
The paper offers a novel explanation for funding spreads in securities typically financed by repo. The observed repo rate understates the financing rate available to market participants who rely on repo funding (due to dealers’ market power).

It suggests that frictions in wholesale funding markets can be (partially) corrected by policy. The Federal Reserve’s Overnight Reverse Repo Facility (ONRRP) effectively reduces dealers’ markdowns by offering repo lenders a competitive outside option.
Further endogenize the equilibrium model

The model takes the following empirical findings as given:

1. Dealers’ identities drive repo rate variation.
2. Different lenders accept the same rates when lending to the same dealer.
3. Lenders do not shop for the highest rates, but prefer to spread out lending to different dealers.

These empirical facts themselves are outcomes of market equilibrium.

- Dealers’ market power is already built-in in the model setup.
- Consider loosening the assumptions based on the first two empirical facts (i.e., dealers have all the power to set rates)
Huber (2022): Comment 2

- **Use more granular data**

- The current data source is MMF holding report, only capturing month-end snapshots.
  1. With this low-frequency data, only static model estimation is feasible.
  2. For example, all estimates of dealer and MMF parameters are fixed over the 2011-2017 sample period.
  3. This limits the model’s potential to study market dynamics in different time periods (say, during the Eurozone debt crisis).

- Transaction-level tri-party repo data is available.
  1. This data allows for dynamic estimation of the model. All model parameters can be updated every quarter (or even every month).
Conclusions

- Papers are very interesting and provide deep insights!

- Financial institutions’ liquidity condition is subject to various frictions.
  - Despite holding large reserve balances, intraday liquidity management is still a key concern for banks.
  - Wholesale short-term funding markets (like tri-party repo) are far from efficient.

- More research is warranted in these areas!

- Thank you!