Handout for:

Passthrough Efficiency in the Fed's New Monetary Policy Setting[1]

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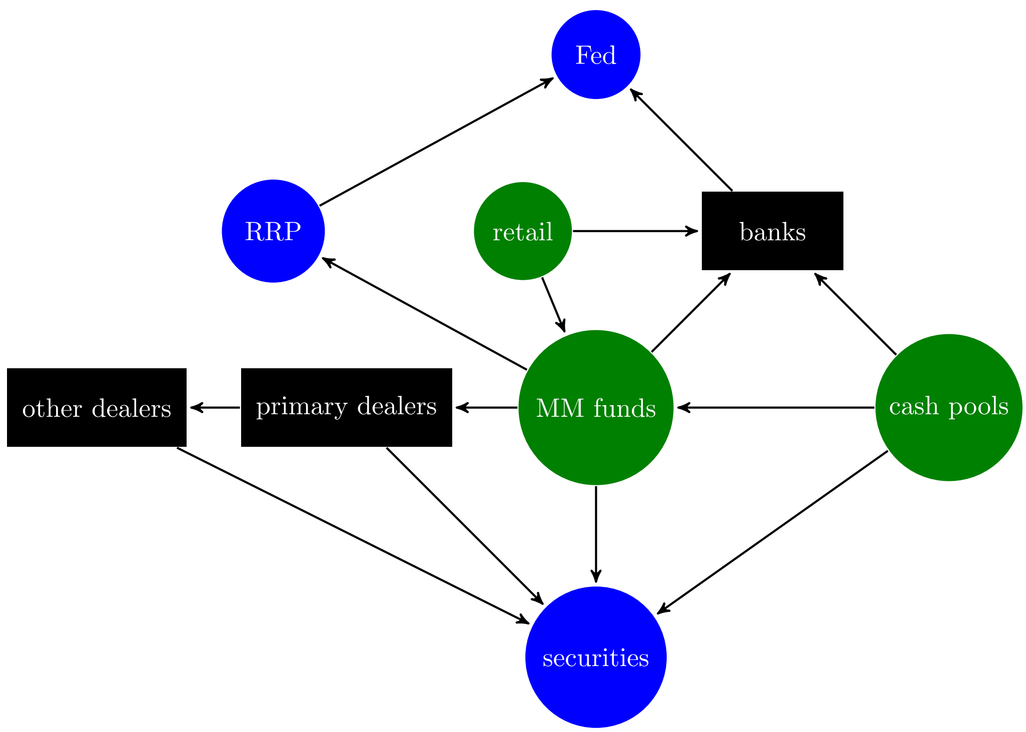


Figure 1: Segmentation in U.S. money markets. Typical active choices of selected money-market cash investors. Arrows indicate the direction of cash investment.

[1]From a paper for presentation at the 2016 Jackson Hole Symposium of the Federal Reserve Bank of Kansas City.

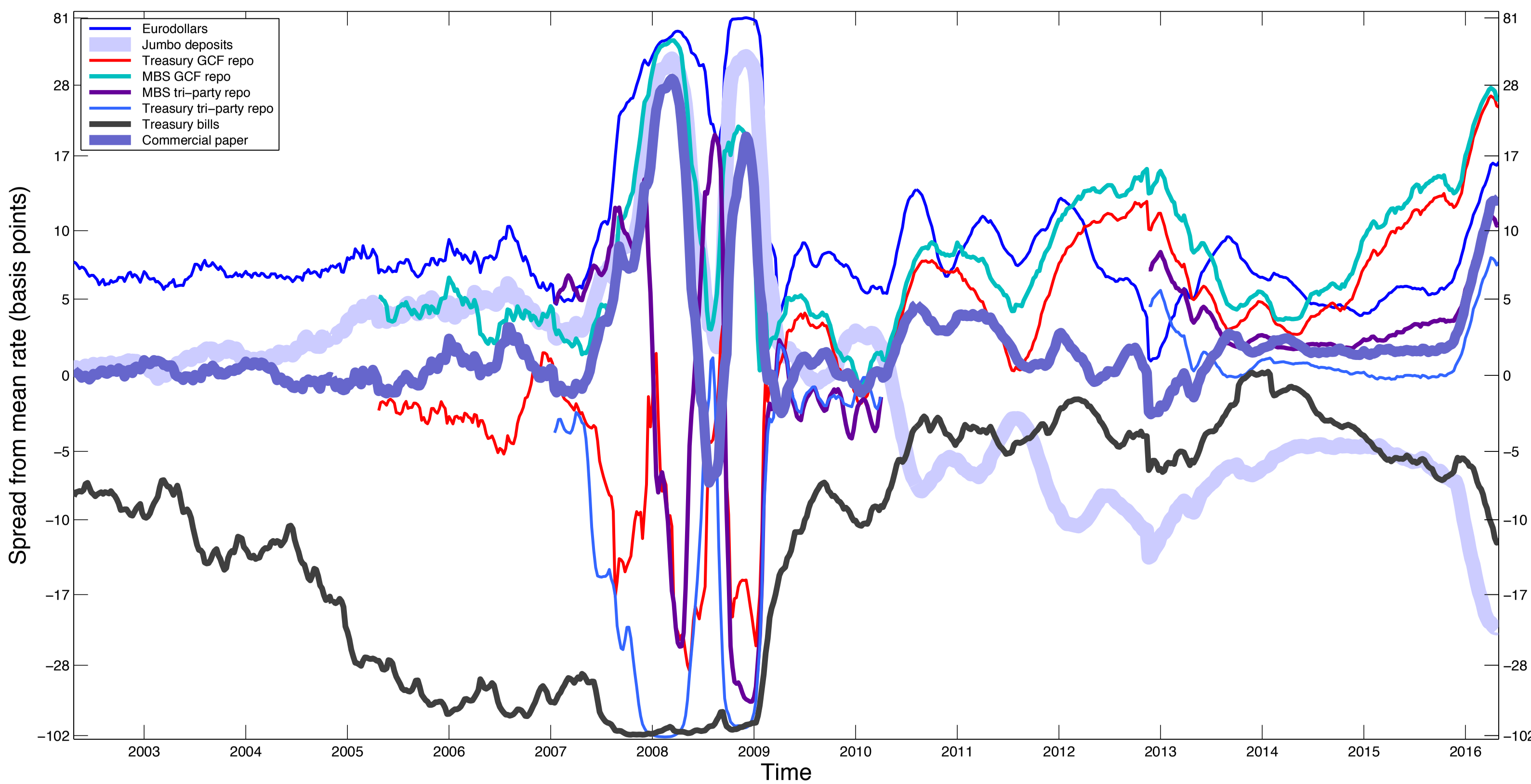


Figure 2: The cross-sectional distribution of a selection of overnight-equivalent money-market rates, shown as rolling 120-day lagging averages, in excess of the weighted average mean, after adjusting for term and credit risk premia. The line weight of a given rate is proportional to the average outstanding quantity of the instrument over the period in which it is present in the sample. Data sources are given in the paper.

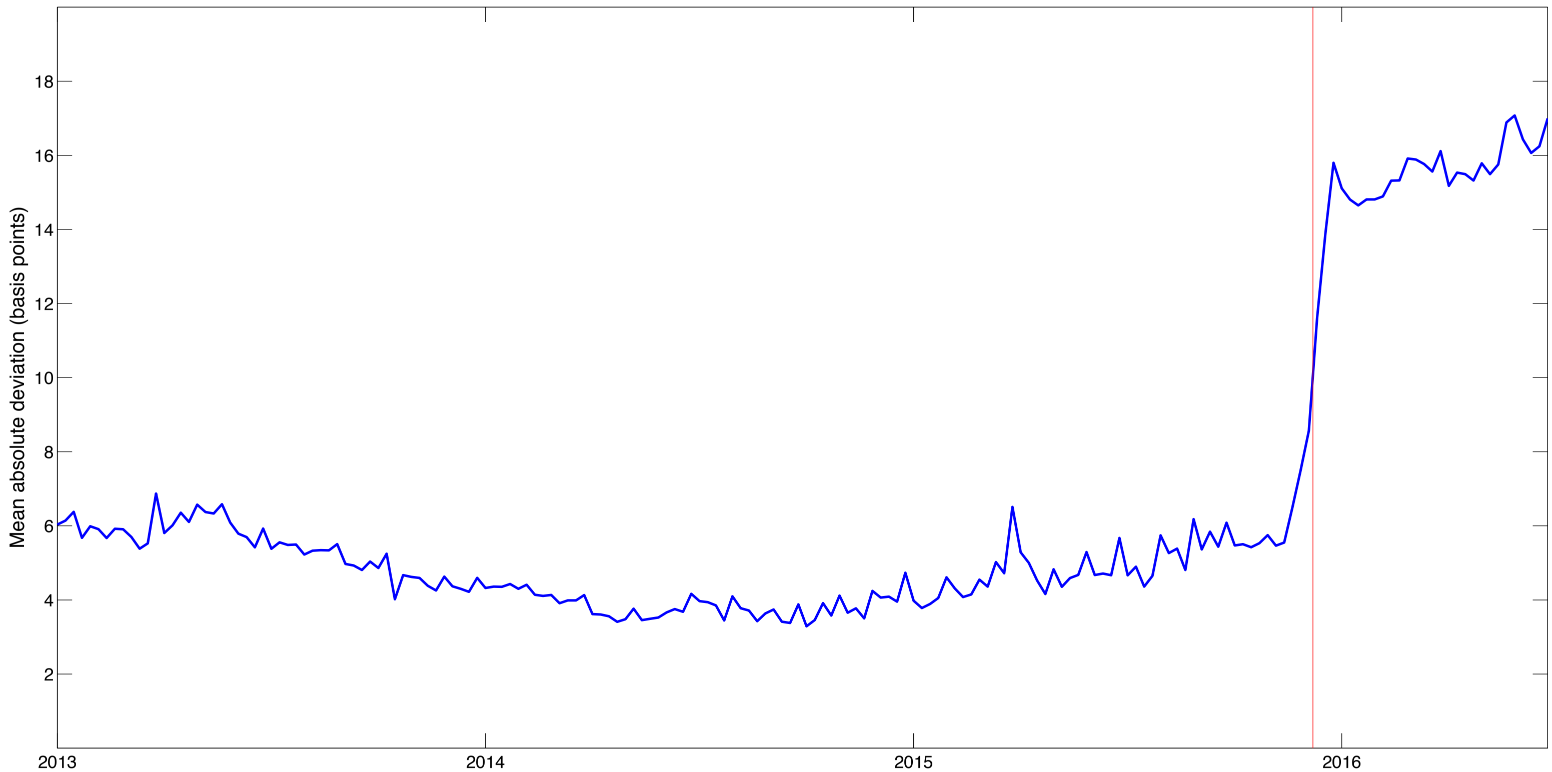


Figure 3: The adjusted dispersion index D_t, the weighted mean absolution deviation of the cross-sectional distribution of overnight-equivalent money-market rates. Dispersion rises by about 10 basis points at the "passthrough event" of December 17, 2015, marked with a vertical bar, when IOER was raised from 25 basis points to 50 basis points (effective December 18), and the Fed's RRP rate was increased from 5 basis points to 25 basis points.

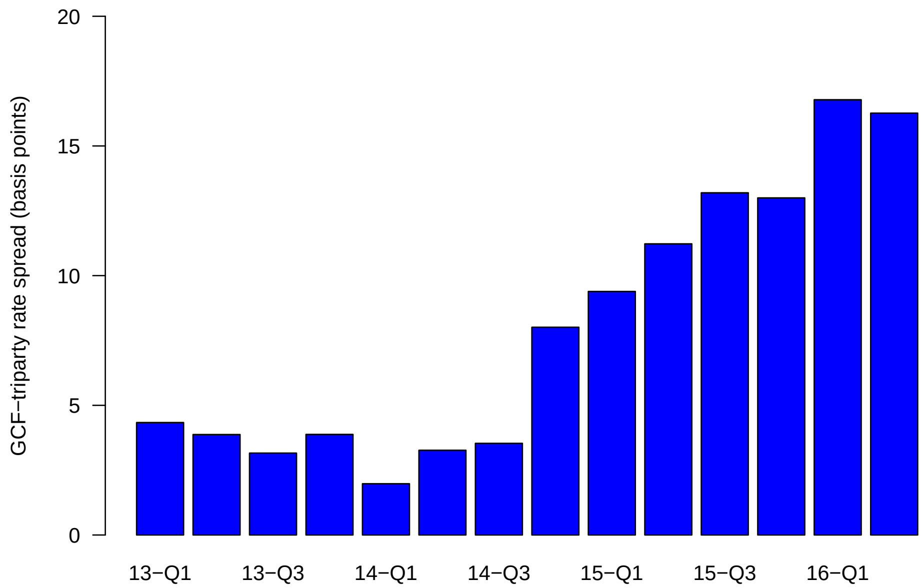
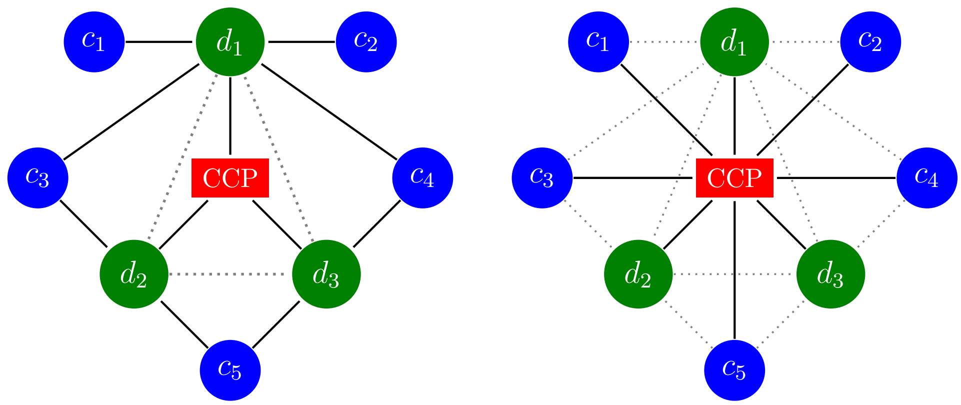


Figure 4: Within-quarter averages of the spread in basis points between the overnight GCF repo rate and the overnight tri-party repo rate. Data sources: Bloomberg and Bank of New York Mellon.



(a) A narrow inter-dealer CCP. Dealers d_1, d_2, and d_3 centrally clear their trades with each other. Positions of dealers with counterparties that are not clearing members, c_1, c_2, c_3, c_4, and c_5, remain on the balance sheets of dealers.

(b) With a broad-market CCP, the repo positions of non-dealer counterparties can also be novated to the CCP, further reducing the balance sheet space of dealers that is required to intermediate the repo market.

Figure 5: Original repo trades that were subsequently novated to the CCP are shown in dotted lines. Through this novation, known as "central clearing," the CCP becomes the buyer to each original seller, and the seller to each original buyer. With a broad-market repo CCP, as shown in Panel (b), more positions can be novated to the CCP, thus reducing the amount of space on dealers' balance sheets needed to intermediate the repo market.

Main Policy-Related Conclusions

1. The reverse repurchase (RRP) facility aids passthrough, although this is achieved most directly by disintermediation. As usage of the RRP facility rises, the associated costs include lower passthrough of rates to less sophisticated depositors, and footprint effects that harm credit monitoring and price discovery. Financial instability associated with potential flight to RRP during a crisis is controlled by lending of last resort.

2. The Supplementary Leverage Ratio rule (SLR) harms passthrough, and has already significantly degraded repo market intermediation, a core market function supporting passthrough.

3. The Liquidity Coverage Ratio rule (LCR) may reduce passthrough when rates rise, but this can be mitigated by Fed or Treasury actions to increase the supply of short-term high-quality liquid assets (HQLA), including additional supplies of T-bills .

4. The ongoing regulatory reform of money market mutual funds increases rate dispersion and reduces passthrough by increasing the demand for government paper relative to private paper. These effects can be partly offset by an increase in the supply of T-bills.

5. Improvements in repo market infrastructure, such as a broad repo central counterparty and broadly accessible trading platforms, could significantly improve passthrough to repo markets by reducing demand for "high-rent" space on the balance sheets of dealers subject to SLR. A further option is to modify the SLR for U.S. government securities repo intermediation.

6. As the Fed raises its policy rates, these passthrough effects are likely to strengthen, and take-up at the Fed's RRP facility will probably rise significantly, absent a large increase in the supply of T-bills.