

# Safe Asset Scarcity and Monetary Policy Transmission

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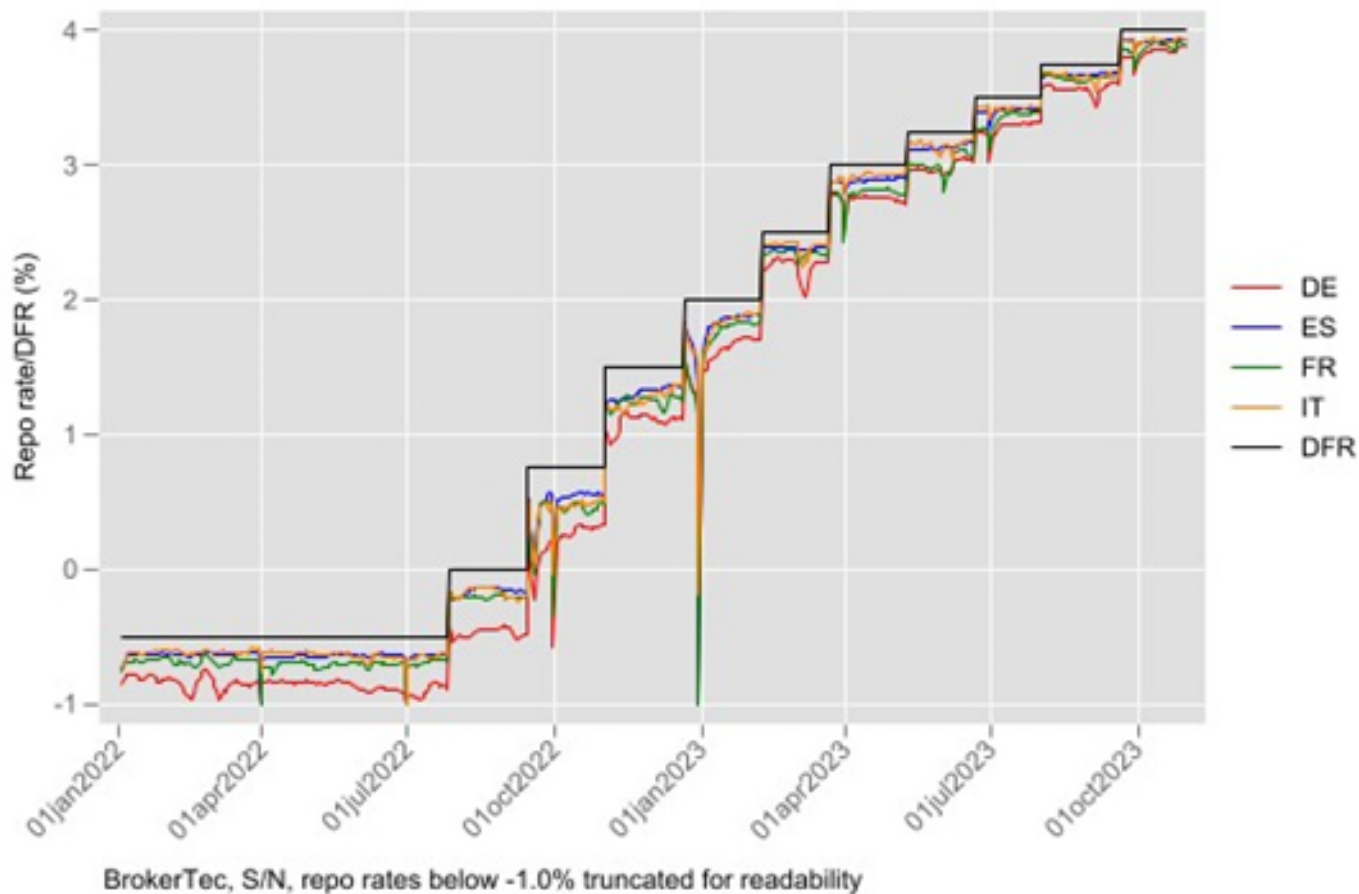
Discussion by Stephan Jank (Deutsche Bundesbank)

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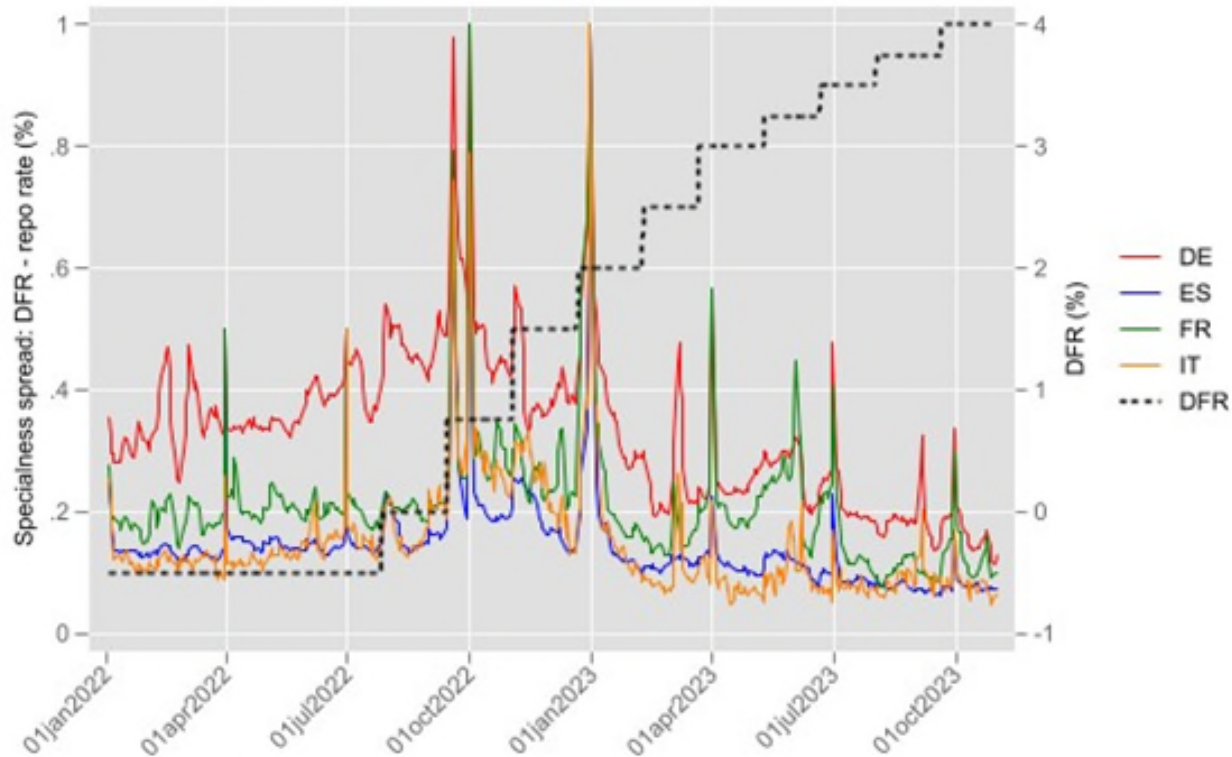
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This presentation represents the author's personal opinions and does not necessarily reflect the views of the Deutsche Bundesbank or the Eurosystem.

# Big picture: Rate hikes and repo rates in the Euro area



# Specialness: a structural feature of the Euro area money market



Data source: BrokerTec, S/N, specialness spreads truncated at 1 ppt for readability.

- High specialness in 2022: ~40 bps for DE!
- Decline in specialness during 2022/23 (many factors: APP reduction of reinvestments? changing investor base? securities lending facilities, Deutsche Finanzagentur? ... )

# This paper: How does monetary policy pass-through work in this environment?

– First-order question!

– Main findings:

- Scarcity of government bonds reduces (delays) the transmission of rate hikes.
- For July 2022 hike (50 bps): bond with a specialness premium of 60 bps → increase in rates only by 28 bps.
- Measurement: Transmission is measured in a window of 5 day around DFR change.
- Similar effects for other rate hikes in 2022, but also notable differences in magnitude.
- Lower pass-through is also reflected in the cash market (yields).
- Evidence that pass-through improves with repo market participation (special – general collateral arbitrage).

# Presentation outline

1. Big picture and summary of results
2. Replication exercise
3. Zooming in: The rate hikes in event time.  
Does scarcity **impair** or **delay** the transmission of monetary policy?
4. Discussion on possible mechanisms

## Replication of main result

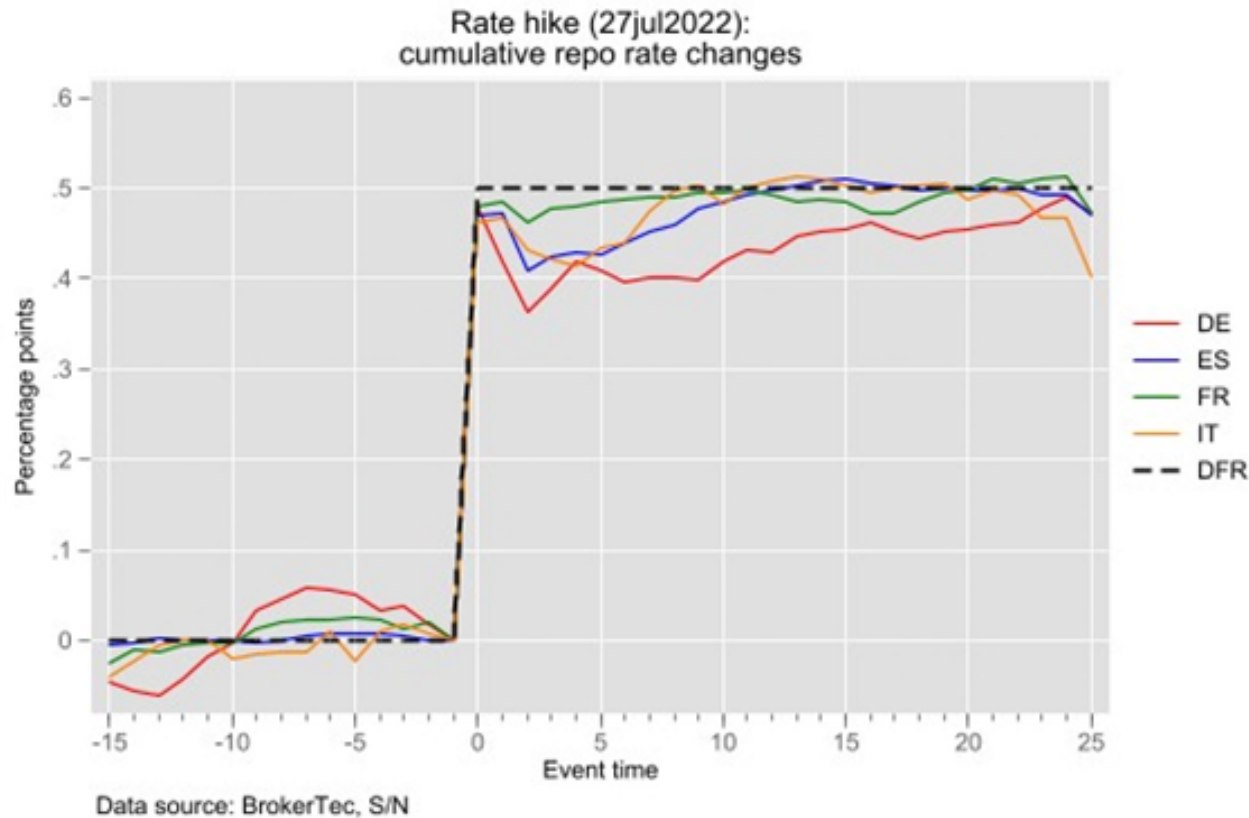
### Replication exercise for the July 22 rate hike:

- BrokerTec (SC) data (countries: DE, ES, FR, IT), market segment: S/N
- Timing convention: settlement date, event window: +/-5 business days
- Caveats: No coverage of bilateral transactions, poor coverage of Italian sovereigns.

	(1)	(2)
	Dep. Variable: Pass-through	
Specialness	-0.46*** (-5.39)	-0.38*** (-3.61)
Constant	0.96*** (66.67)	0.94*** (51.91)
R2	.2111	.2695
N	253	253
Country fixed effects	No	Yes

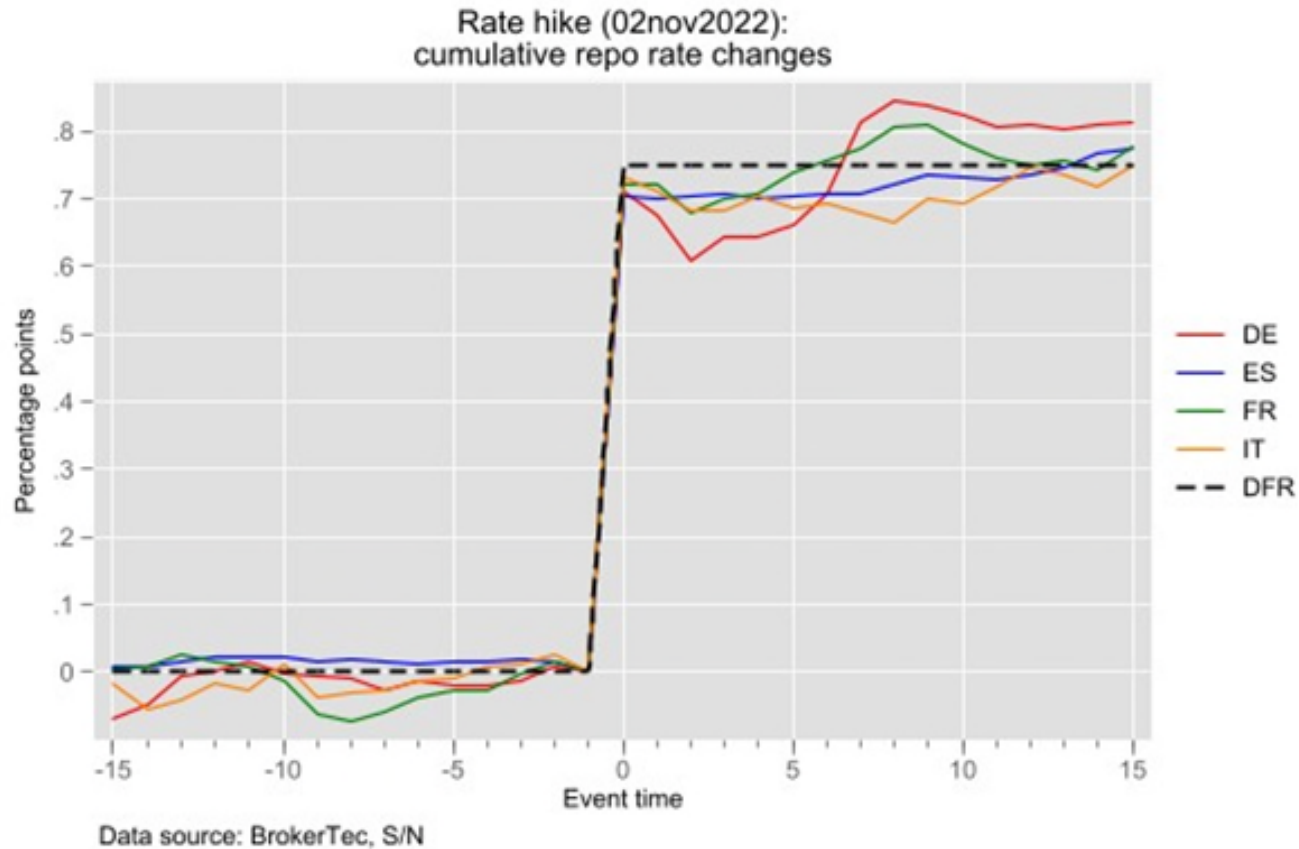
Questions to answer with MMSR: Are there notable differences between ...  
... CCP and bilateral transactions? ... repo tenors? .... counterparty sectors?

## Rate hikes in event time



- Surprising reversal at event time  $t = 2$  (-10 bps for DE!)
- After how many days do repo rates convergence to DFR change? (speed of adjustment)

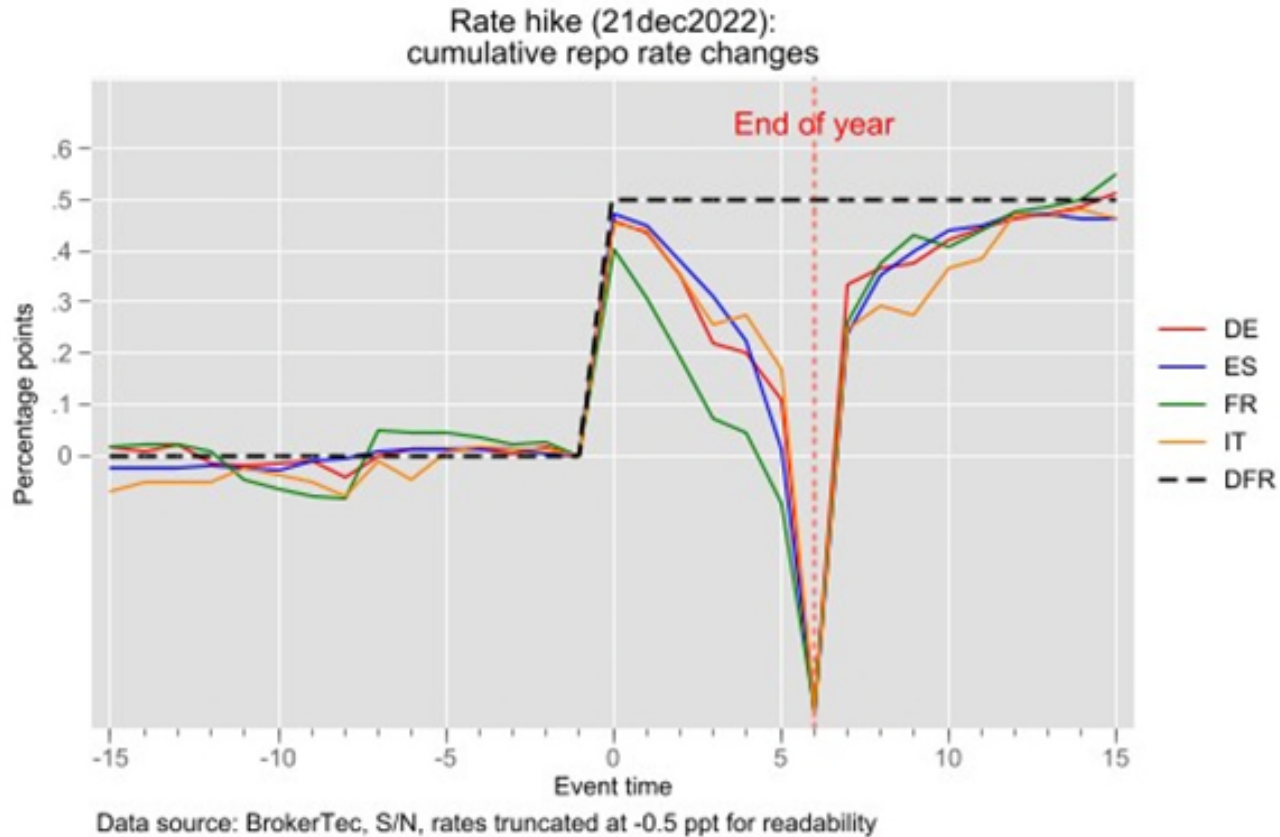
## Rate hikes in event time (cont'd)



– Similar pattern: first “reversal”, then (faster) convergence to DFR change.



## Rate hikes in event time (cont'd)



- 5 day event window overlaps with end-of-year effect.
- Note: Also here convergence to DFR change after approx. 15 trading days.

## Rate hikes in event time: Summary

- Speed of adjustment surprisingly slow (in particular for July 2022).
  - Speed of adjustment seems to differ across rate hikes.
  - For all rate hikes: Interesting reversal pattern at  $t = 2$
  - This may look different in the MMSR sample (especially for bilateral transactions).
  - Speed of adjustment as an additional measure?
  - How does the effect for yields evolve over time?
- 
- For longer horizons one needs to properly control for other demand/supply factors in the repo market (e.g. CTD, on-the-run status, re-issuance phase, end-of-quarter effects ...)
- 
- The horizon at which monetary policy transmission is delayed is key for any policy conclusions and the economic magnitude of funding costs.
  - For the effect of specialness on funding costs see also Tischer (2021).

## Mechanism: What can we learn from different rate hikes?

- Despite similar levels of scarcity in 2022, there are notable differences across rate hikes.
- The effect seems most pronounced in July.
- How does pass-through with respect to specialness behave during 2023? (lower, but still sizable levels of specialness)

	(1) $\Delta Spec_i$
July x $Specialness_i^{Bef}$	0.147*** (3.85)
Sept x $Specialness_i^{Bef}$	0.130** (2.27)
Oct x $Specialness_i^{Bef}$	-0.00444 (-0.07)
Dec x $Specialness_i^{Bef}$	0.0832* (1.95)
ISIN FE	
Time FE	Yes
Adj. R2	0.10
Obs	1295

## **Mechanism: Hedging demand**

- Following monetary policy shocks, the demand for hedging against further rate hikes may also increase.
- So far, this mechanism is not tested in the paper.
- Possibly you could exploit the variation in rates hikes over time, using monetary policy shocks of Altavilla et al (2019).
- Does repo imbalance (e.g. used in Corradin & Maddaloni, 2020) - as a proxy for the demand in repo markets from short sellers – increase following a positive monetary policy shock.
- And, does this influence transmission?

## **Mechanism: Exploit heterogeneity at dealer-customer level**

- Already in the paper: Analysis of pass-through at the dealer-customer-*ISIN* level.
- Saturated regression: Even within dealer-customer specialness reduces pass-through.
  
- Additionally, you could also exploit the heterogeneity at the dealer-customer level using interaction terms.
  - Is the pass-through with respect to specialness more/less pronounced ...
    - ... for centrally-cleared or for bilateral transactions?
    - ... when dealing with less-sophisticated counterparties?
  
  - Possibly, this could allow you to disentangle market power explanations from lack of access to the DFR, looking at the following difference:
    - Dealer – customer (bank, access to DFR)
    - Dealer – customer (non-bank, no access to DFR)

## Conclusion

- Very important and interesting paper!
- More details on how the delay of monetary policy transmission evolves in event time would be useful.
- How does specialness affect pass-through over the entire tightening cycle?
- Utilize MMSR's dealer – customer data to test possible mechanisms.
- Good luck with the paper!