

# US Banks and Global Liquidity by Correa, Du, Liao

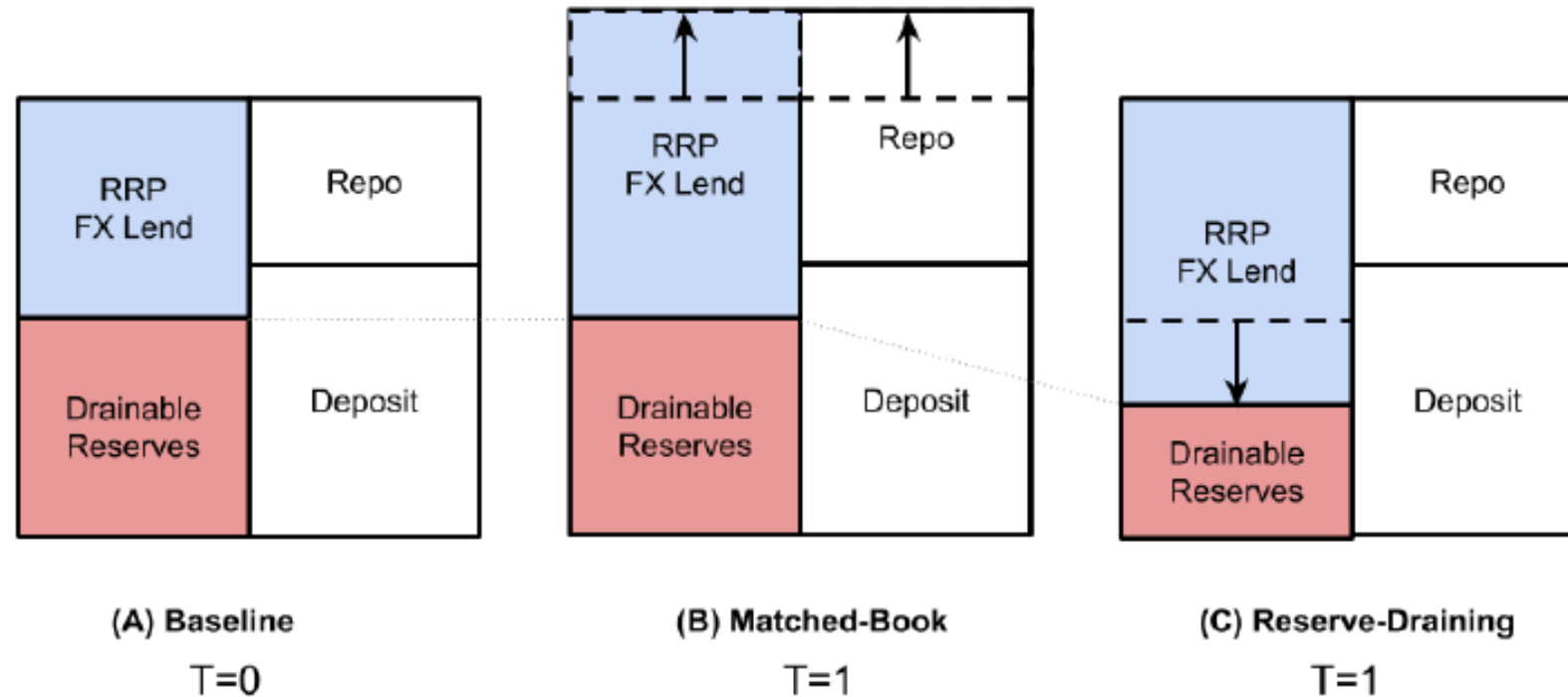
Discussion by  
Valentina Bruno

# Synopsis

- US GSIBs' balance sheet responses to three types of dollar funding shortages:
  - On quarter –ends
  - On days with increases in Treasury General Account
  - On days with reductions in the Fed Open Market Account portfolio
- Reserve draining intermediation has become the dominant strategy for US banks in response to dollar funding shortages.

# Channel

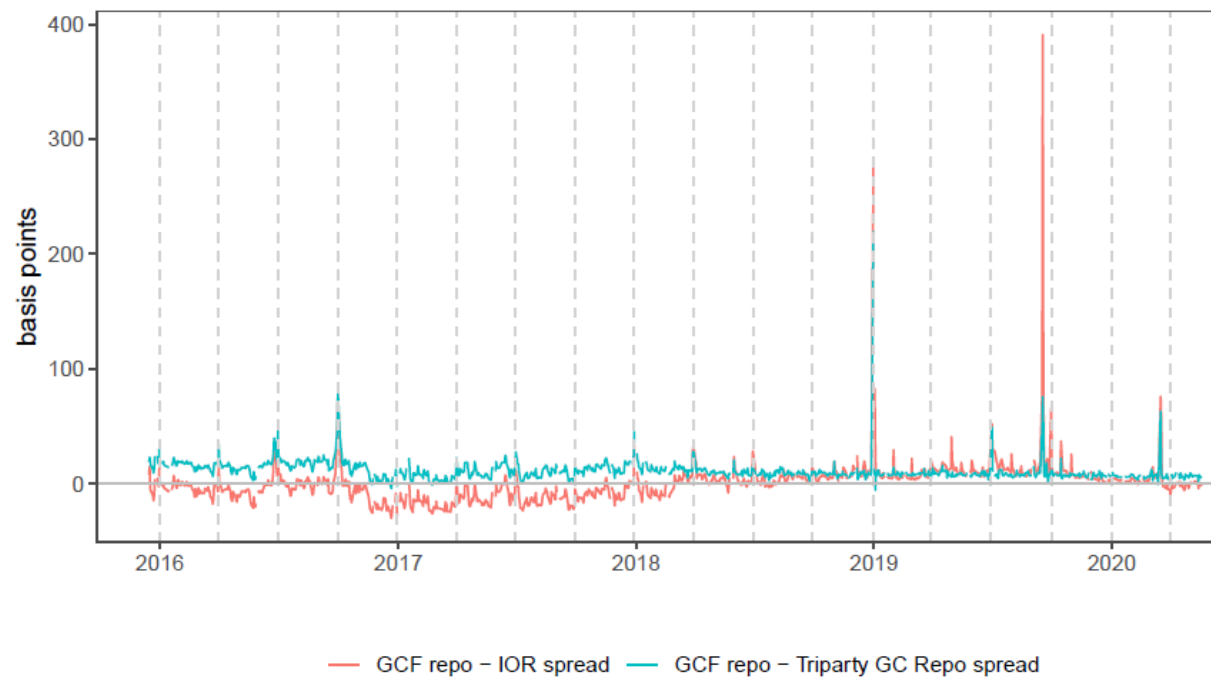
Figure 5: An illustration of different types of dollar intermediation



Reserved based is preferred to matched-book intermediation due to Basel III LR requirement that increases the cost of balance sheet expansions

Figure 7: Short-term intermediation spreads for dollar funding

(A) Repo intermediation spreads



(B) FX swap intermediation spreads

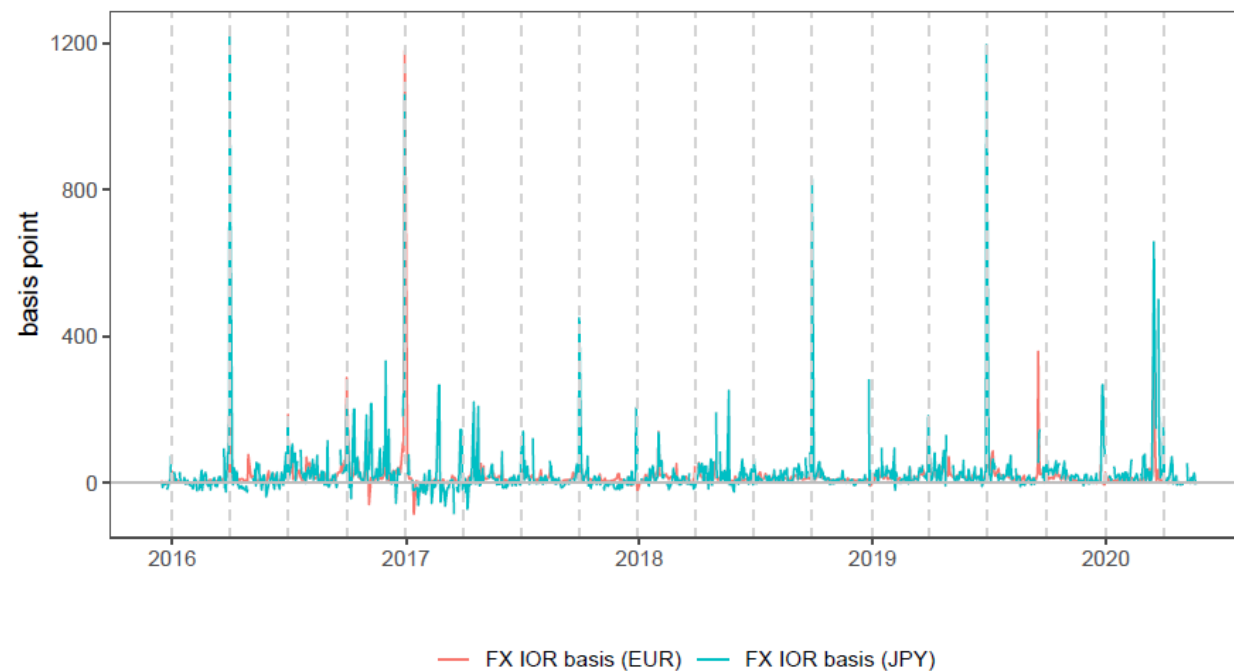
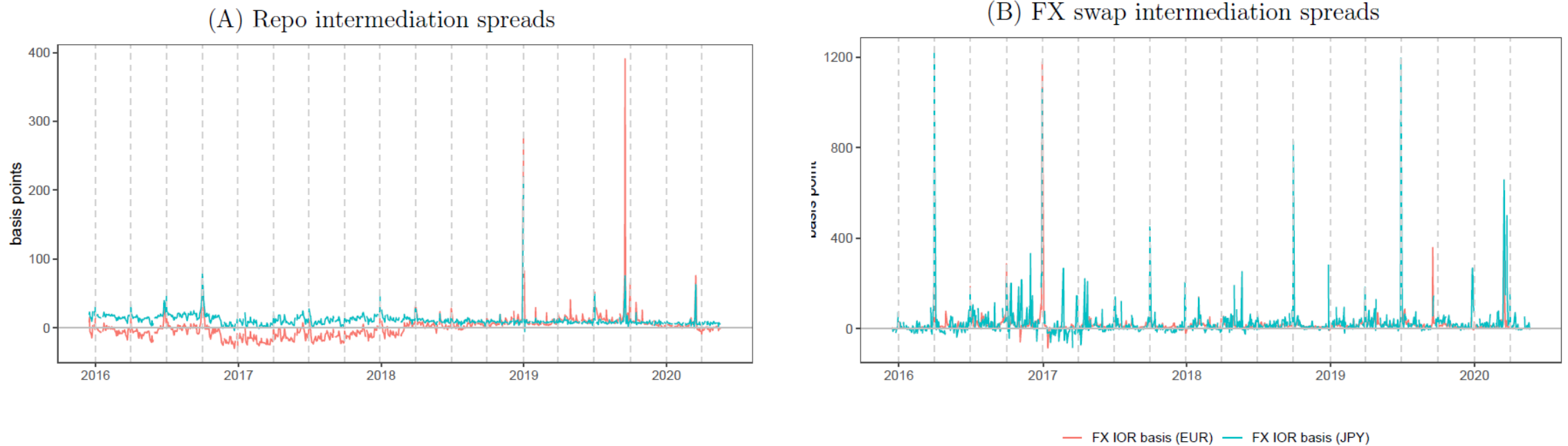
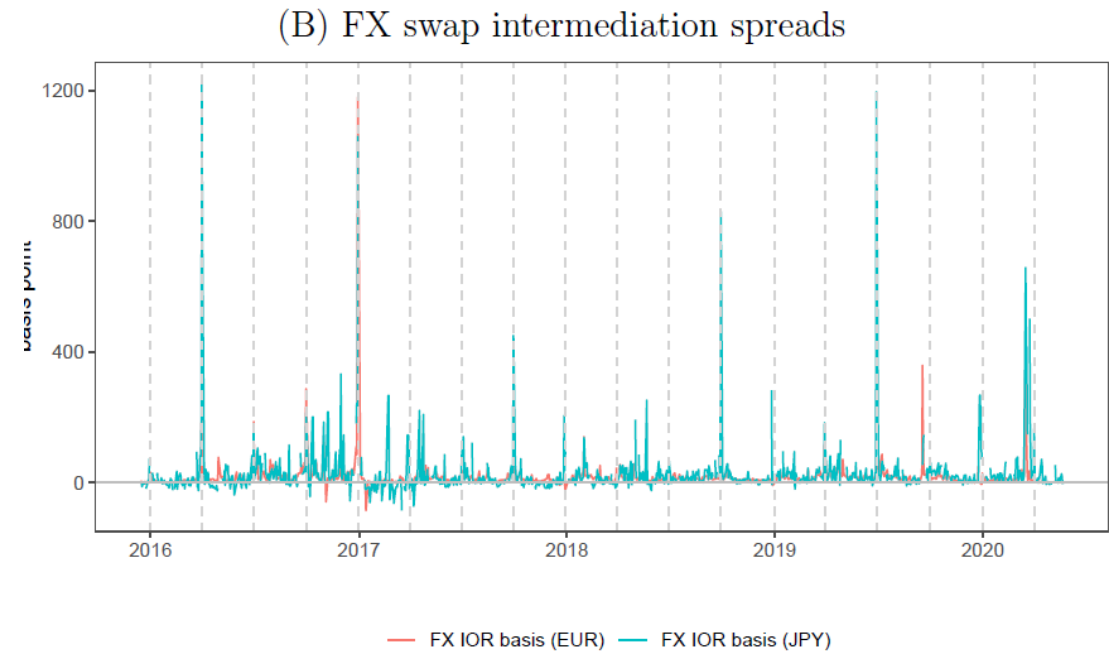
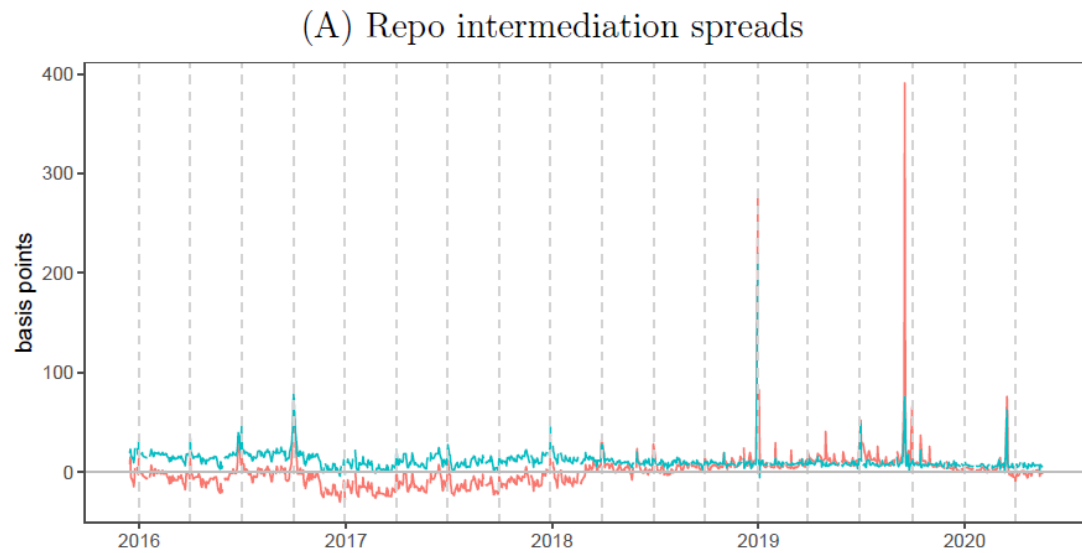


Figure 7: Short-term intermediation spreads for dollar funding



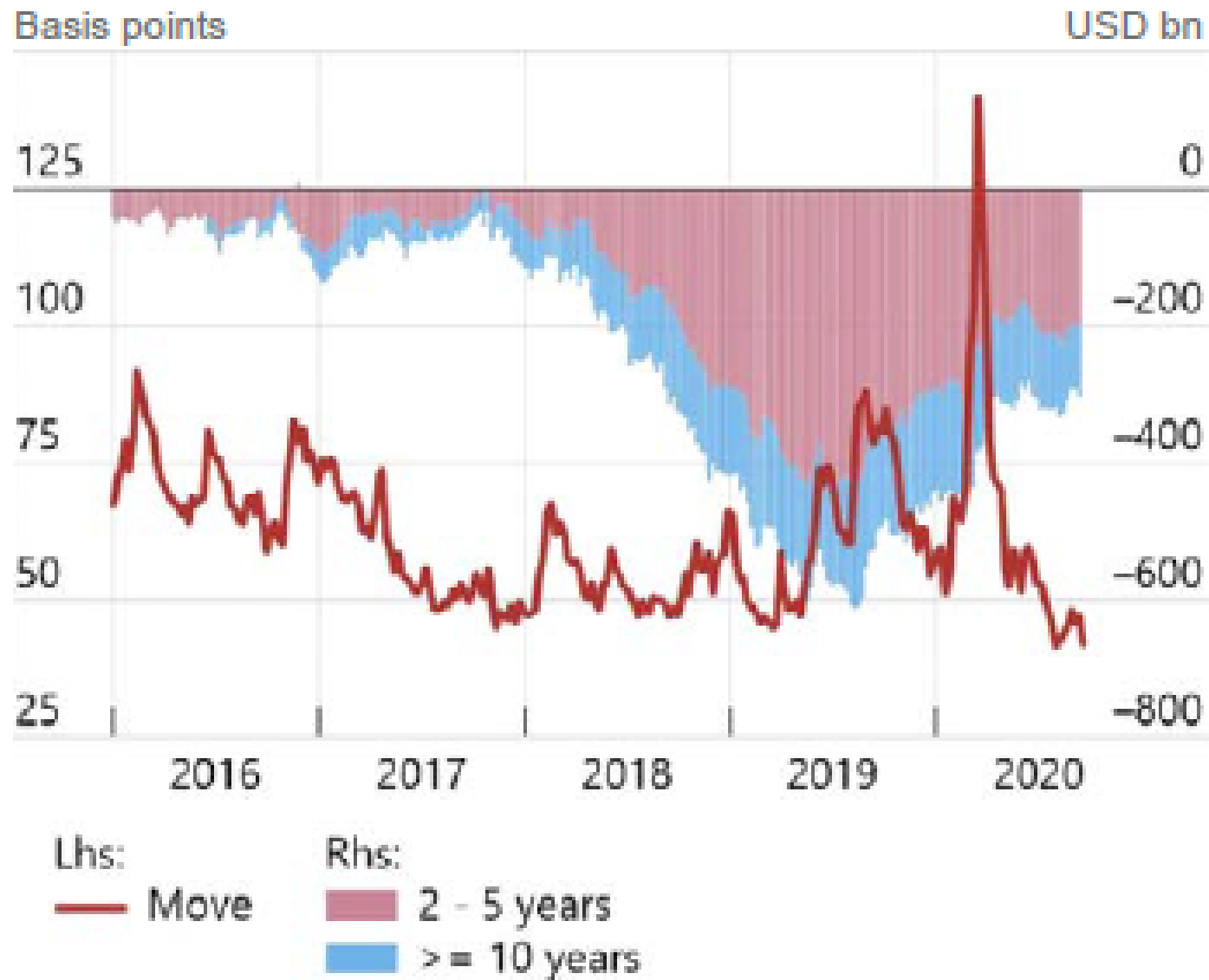
Strong evidence of quarter-end “window-dressing” when we track the spikes in domestic spreads and in FX spreads (CIP deviations)

Figure 7: Short-term intermediation spreads for dollar funding



The domestic spikes and FX spikes are not identical in size, nor they happen at quarter ends only.

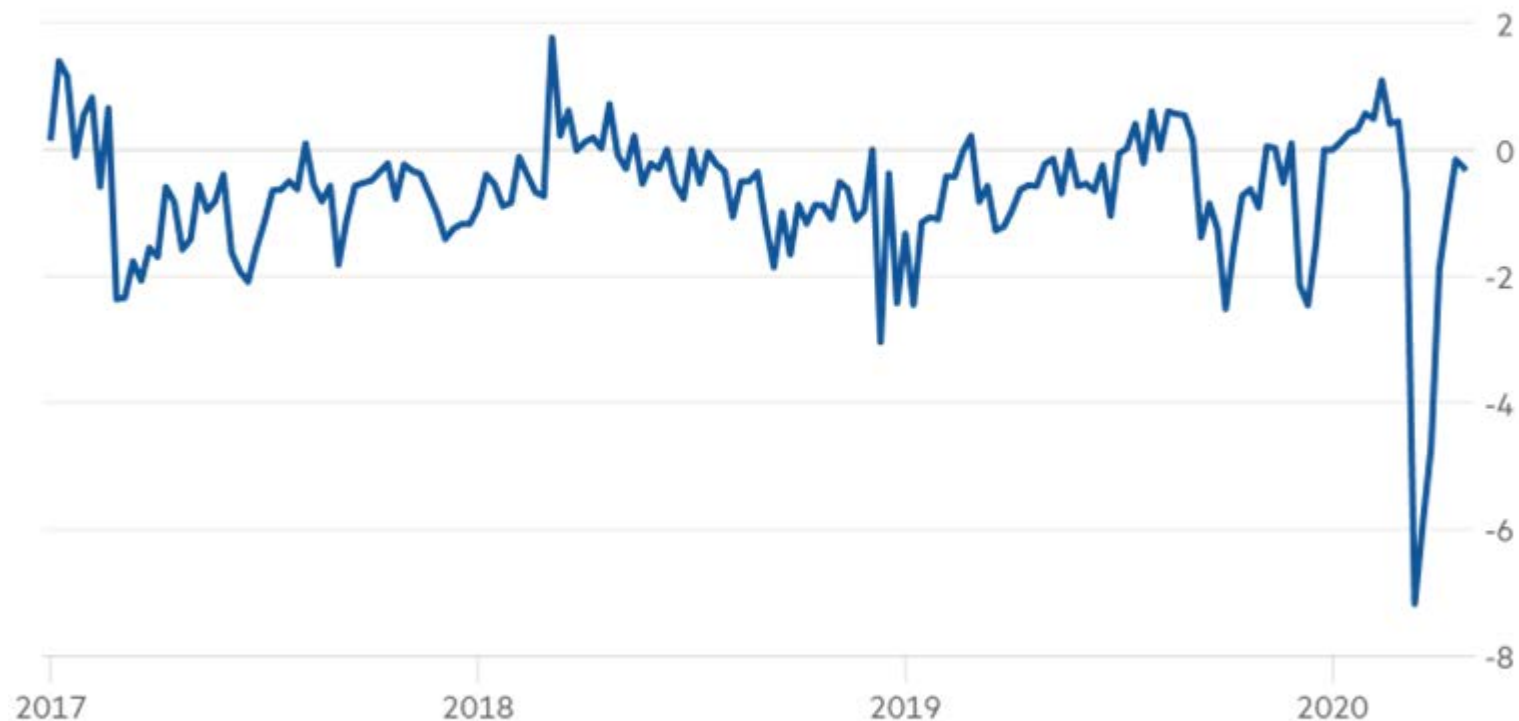
# Net speculative positions in Treasury futures markets and MOVE Index of US Treasury yield volatility



Source: FSB, November 2020, Holistic Review of the March Market Turmoil

## Unwind of leveraged Treasury trade added to market turmoil

Prices between US government bonds and the corresponding futures contract\*



Source: FT, 17  
November 2020

\*Units are in 1/32 of a basis point

Source: JPMorgan

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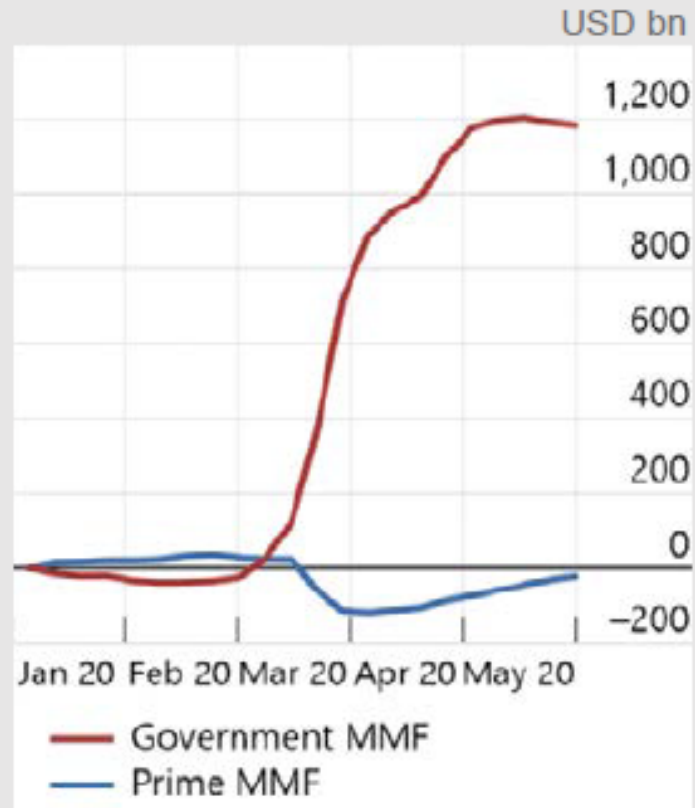
*“The repo market ructions of September 2019 appear to have been a canary in the coal mine for March 2020 turmoil”  
(BIS Bulletin #2)*



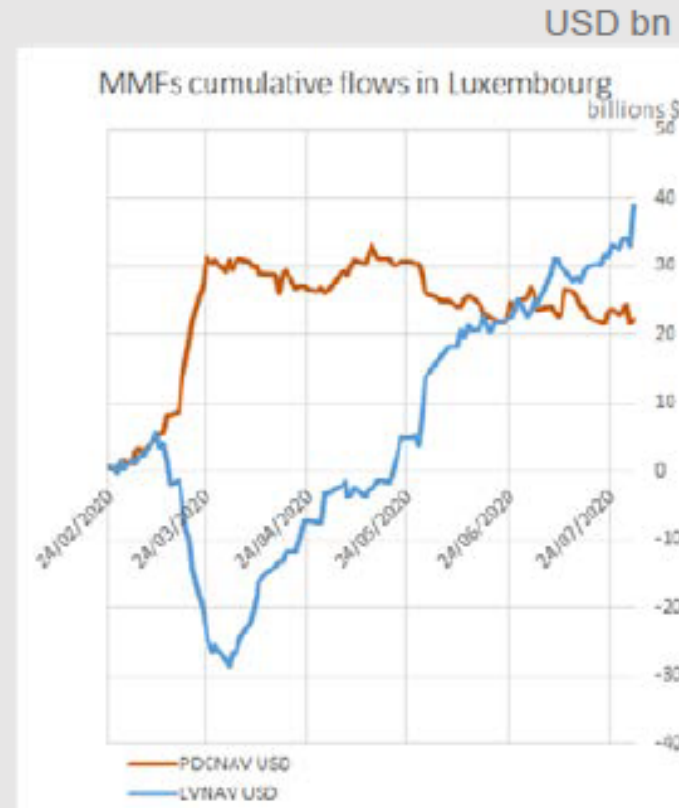
# MMFs flows in different jurisdictions

Graph Box 4.1

Cumulative MMFs flows in the US



Cumulative flows of USD-denominated MMFs in Luxembourg

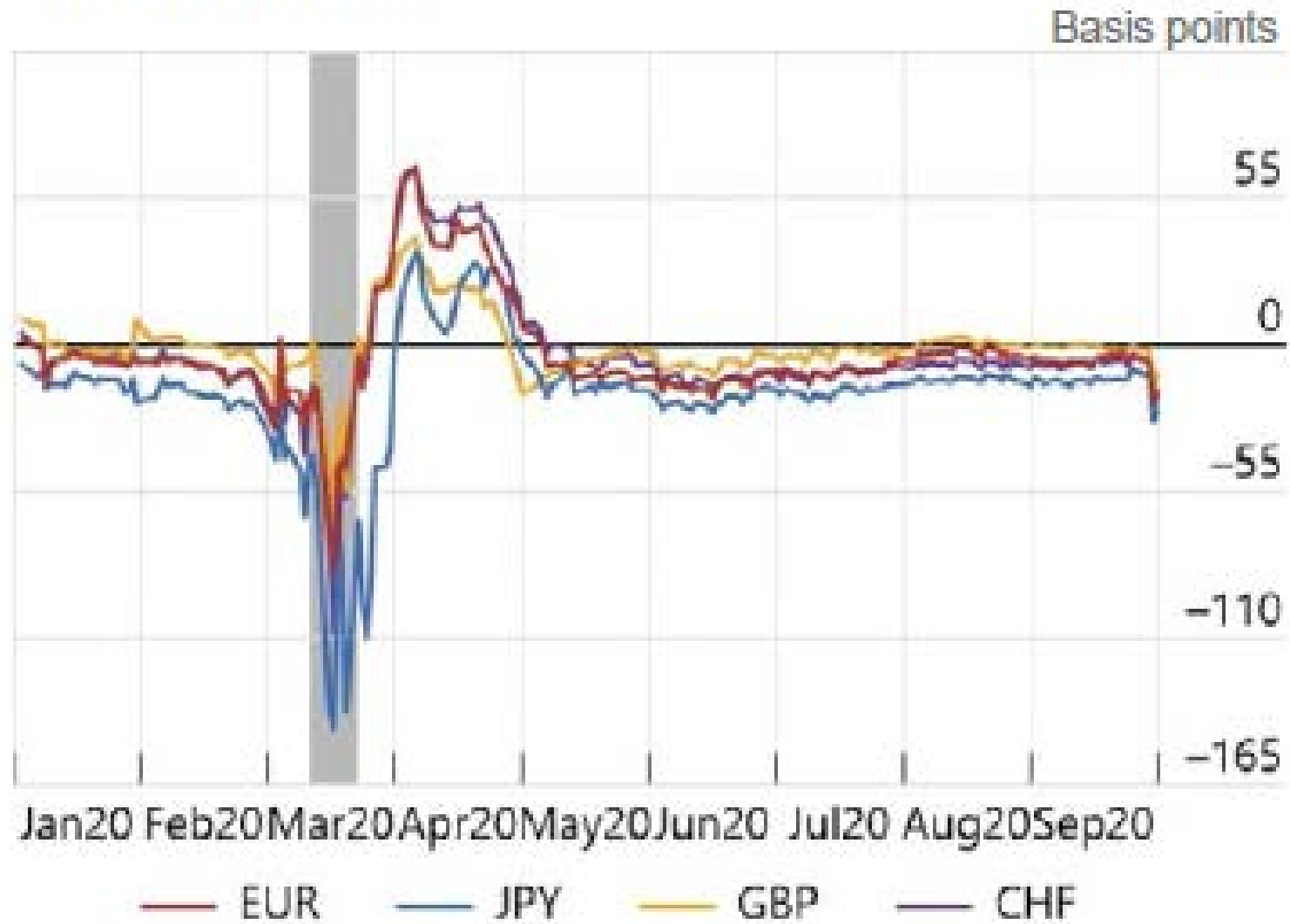


Cumulative flows of EUR-denominated MMFs in France



Source: Source: FSB, November 2020, Holistic Review of the March Market Turmoil

# USD currency basis<sup>1</sup>



Source: Source: FSB, Graph 2.3, November 2020, Holistic Review of the March Market Turmoil

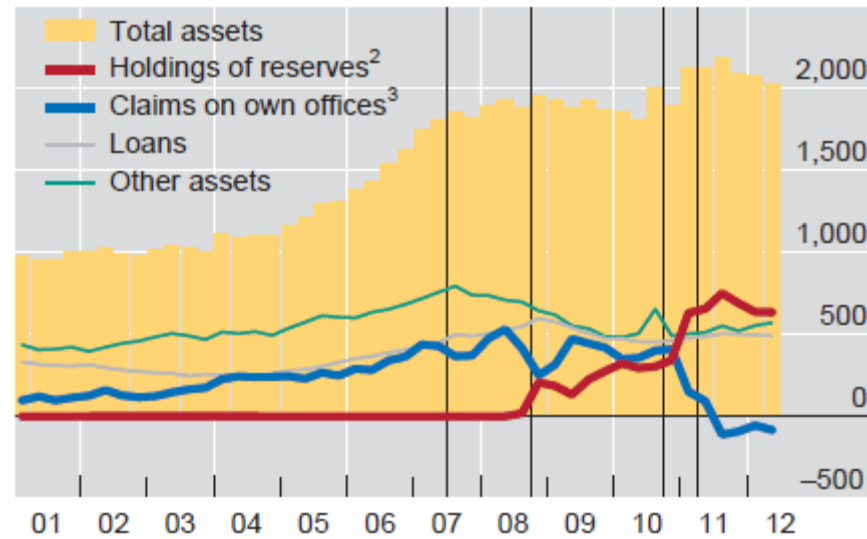
## Drilling-up

- The role of the US Dollar (and the Fed) for global liquidity
- The role of non-US banks in the global dollar funding market

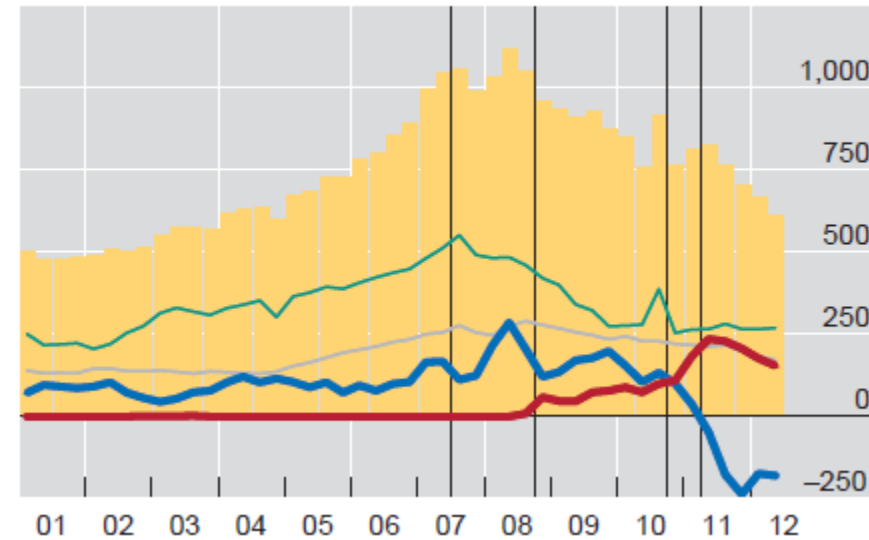


# Rewind - Foreign banks' branches and agencies in the US

All banks



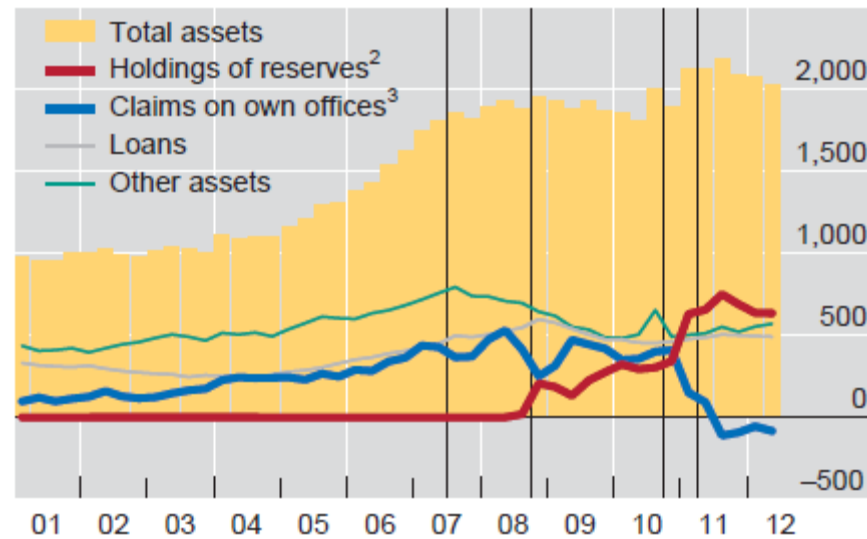
Euro area banks



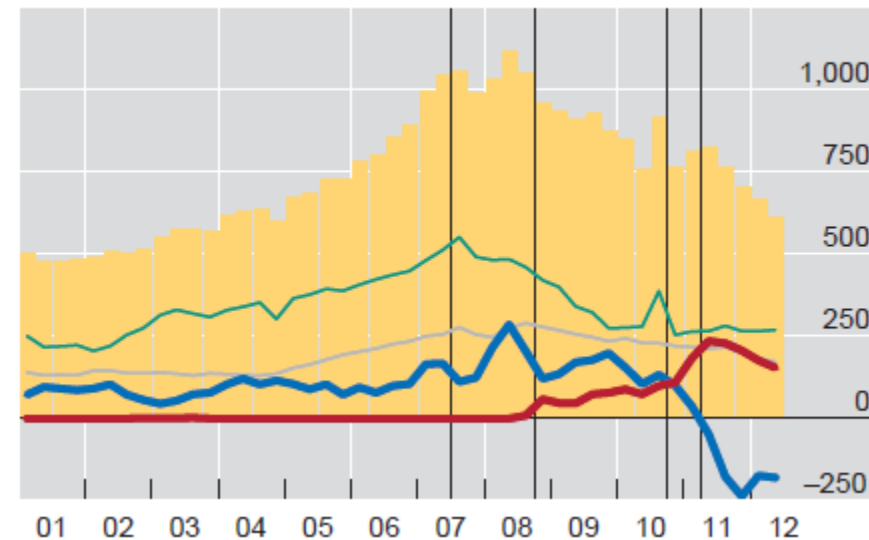
Source: Kreicher, McCauley, and McGuire, 2013, BIS Working paper 413

# Rewind - Foreign banks' branches and agencies in the US

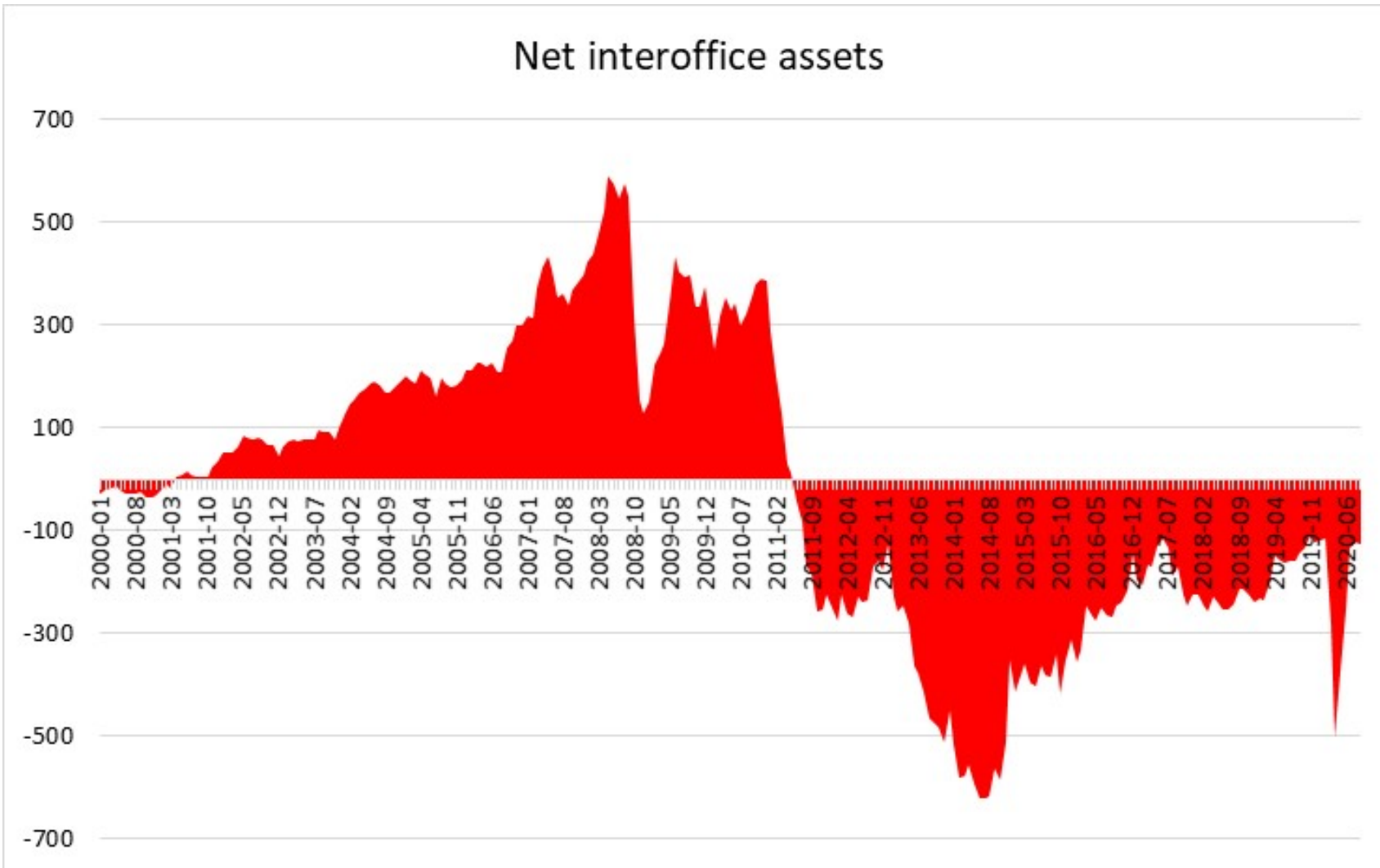
All banks



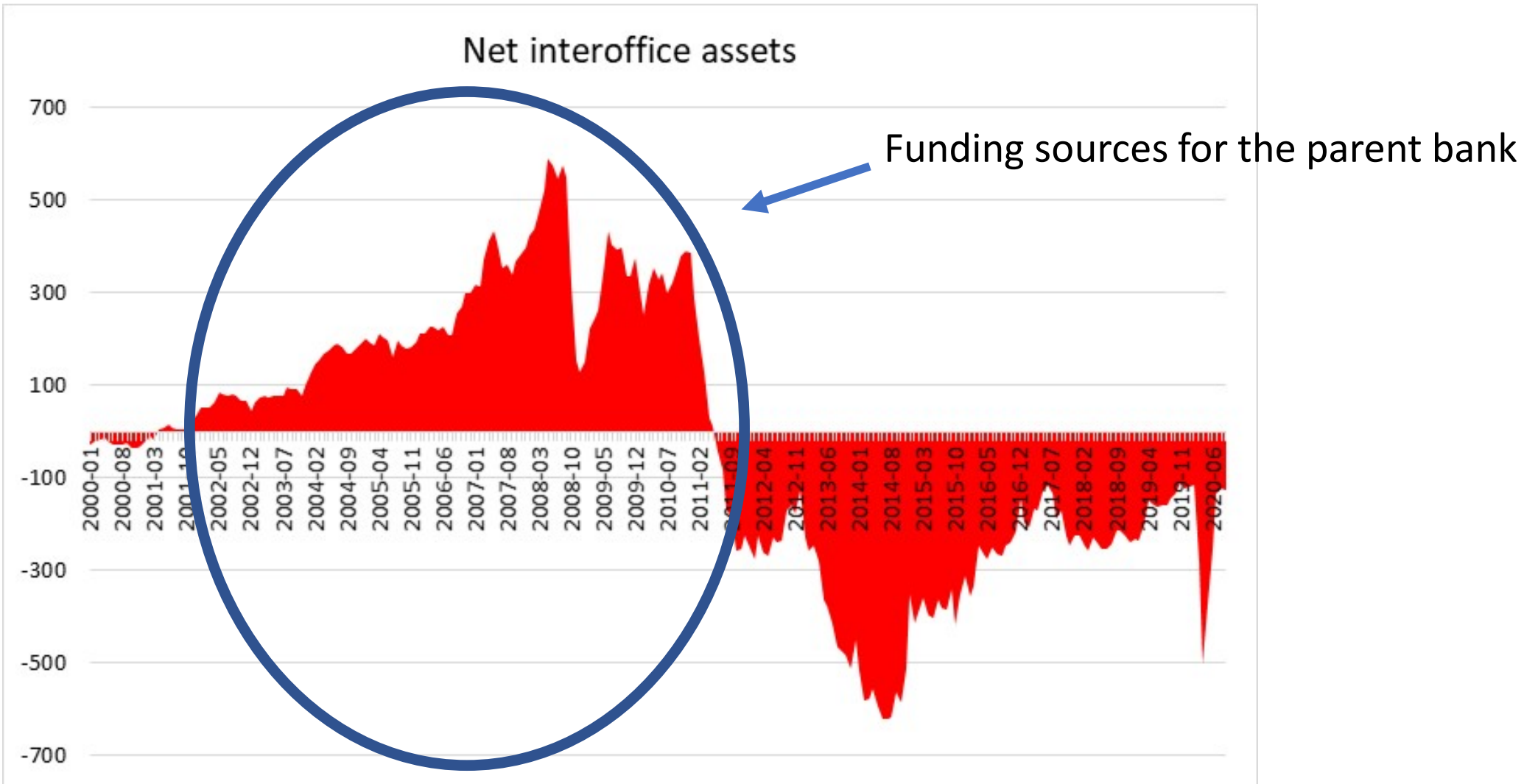
Euro area banks



For every dollar increase in holdings at the Fed, “net due to own offices” rose by 44 cents in the period 2008-12 (Kreicher, McCauley and McGuire, 2013)

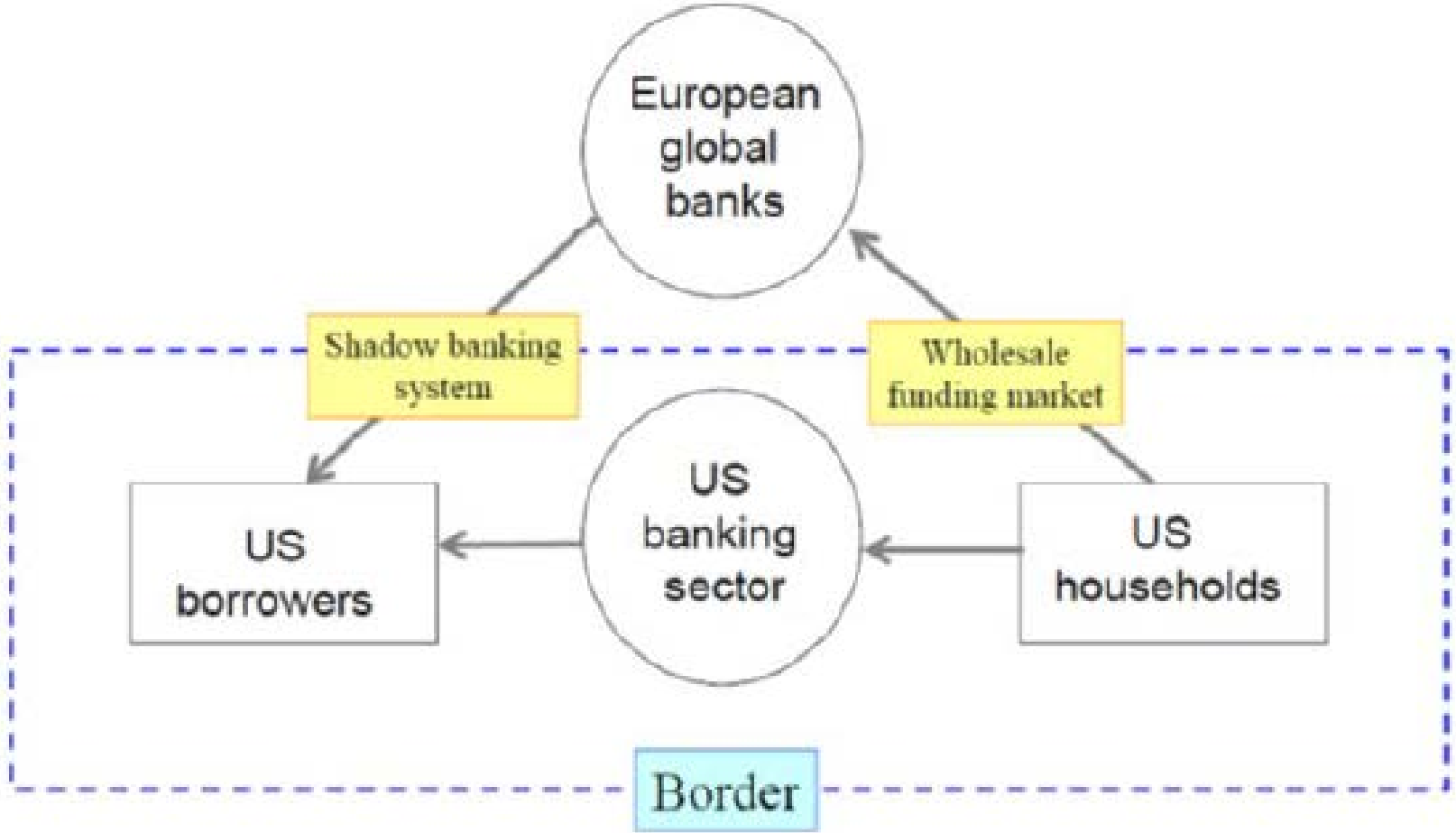


Net interoffice assets of foreign banks in U.S. measure the net claim of the branch or subsidiary on its parent. It is given by negative of Federal Reserve weekly H8 series on “net due to related foreign offices of foreign-related institutions” (billion of dollar)

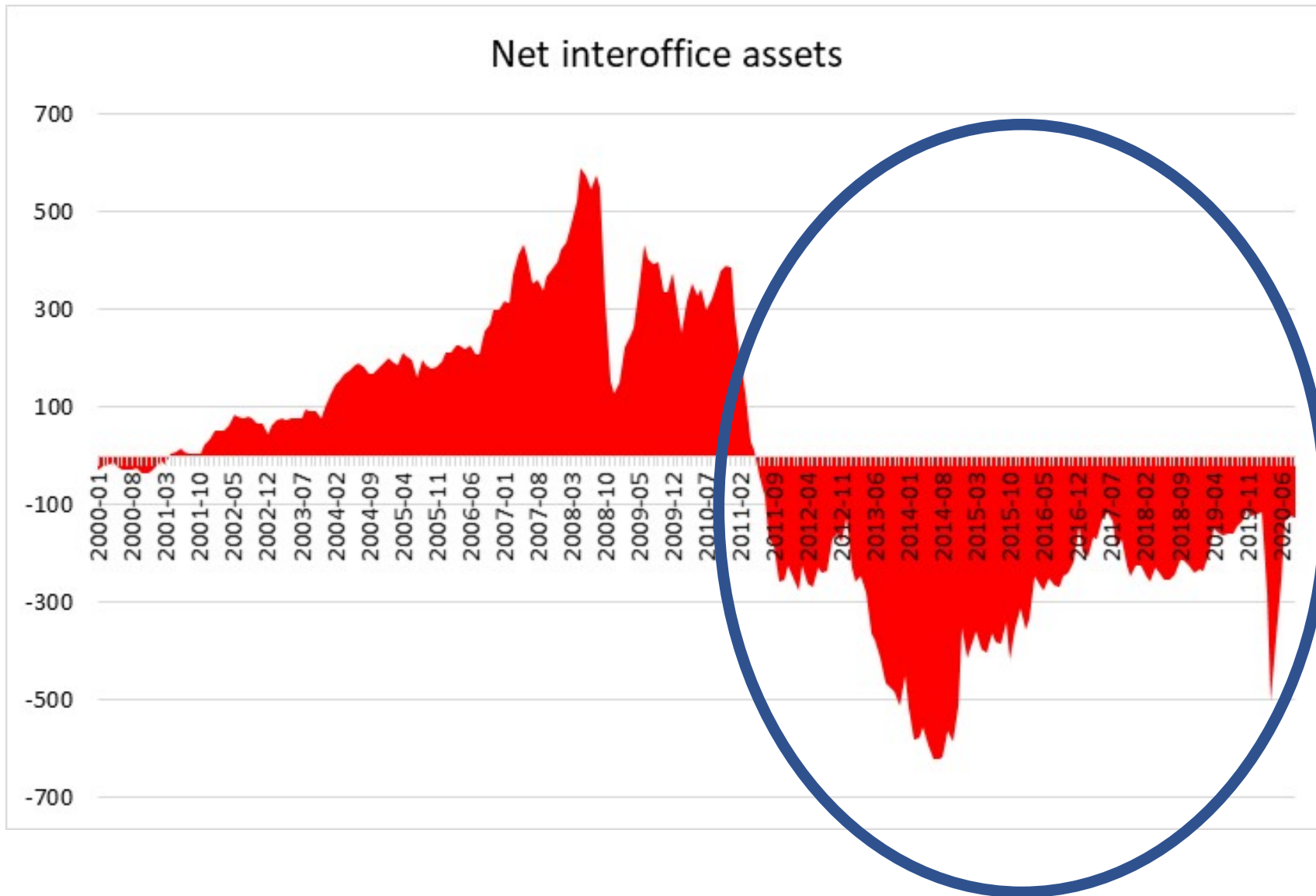


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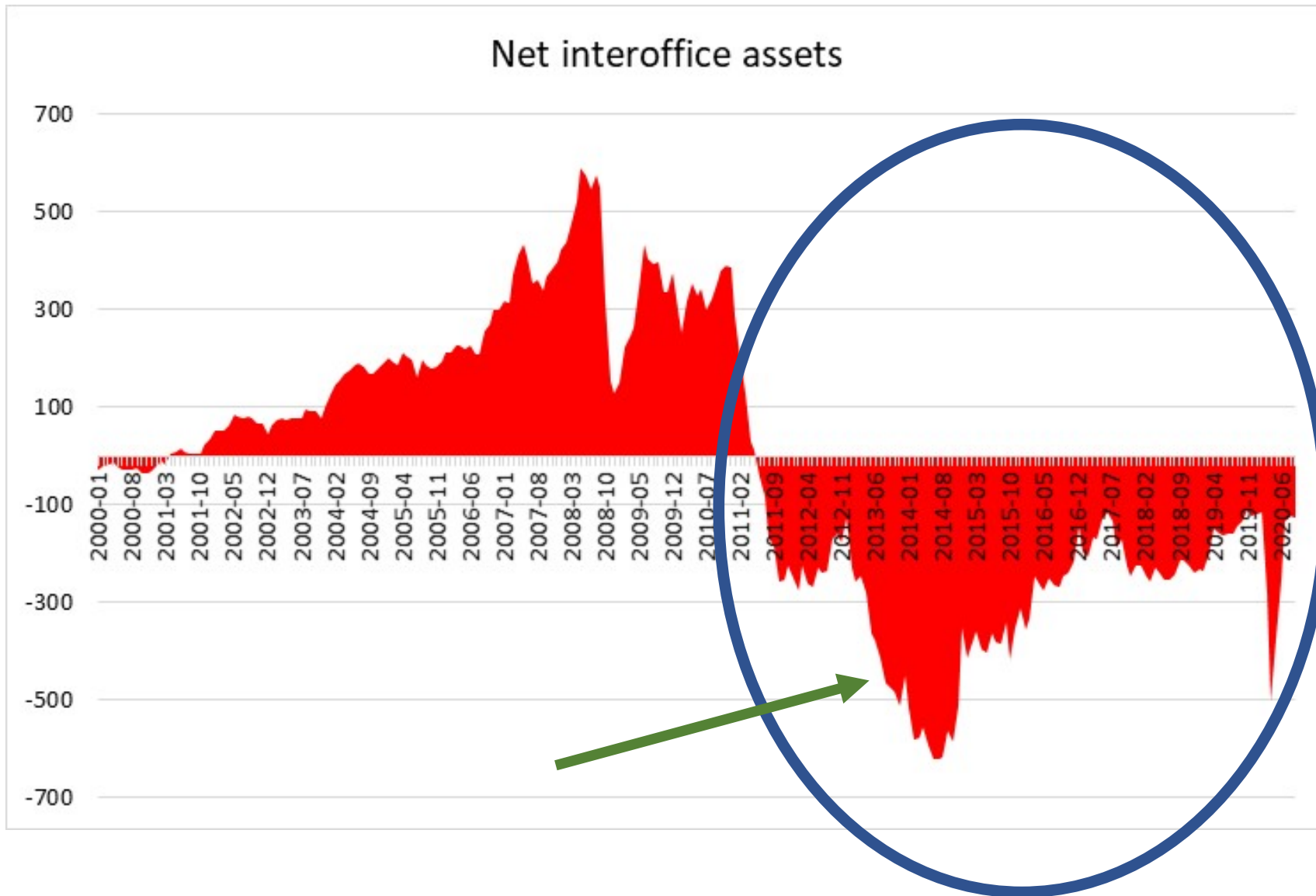
# Structure of the global banking system





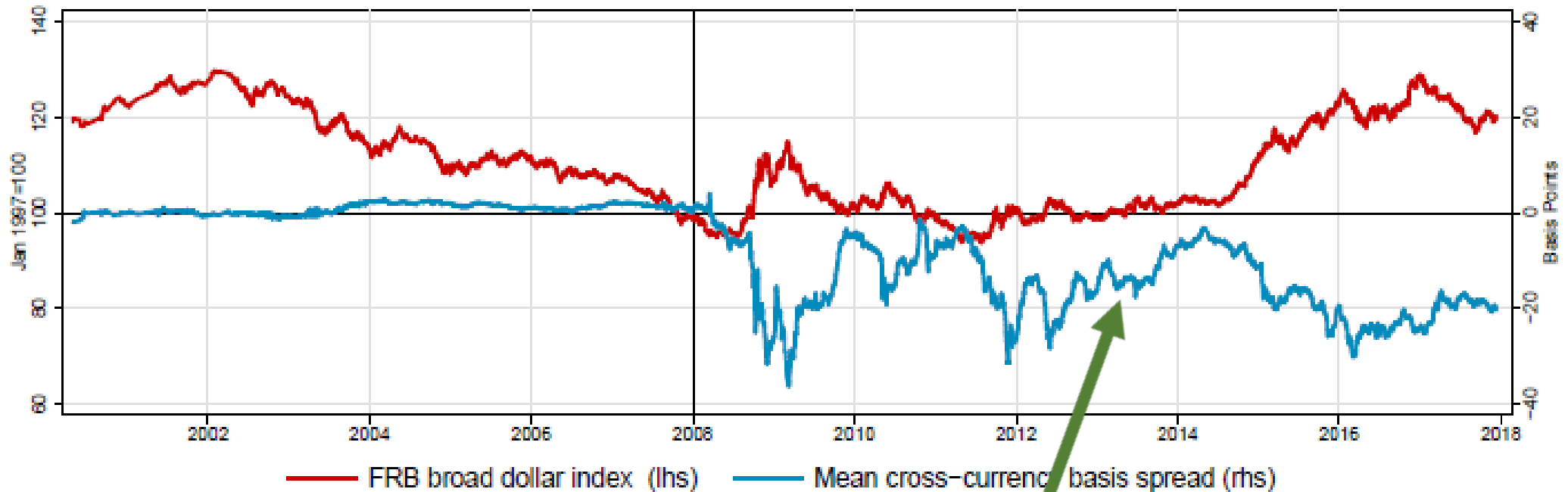


Net interoffice assets of foreign banks in U.S. given by negative of Federal Reserve weekly H8 series on “net due to related foreign offices of foreign-related institutions”



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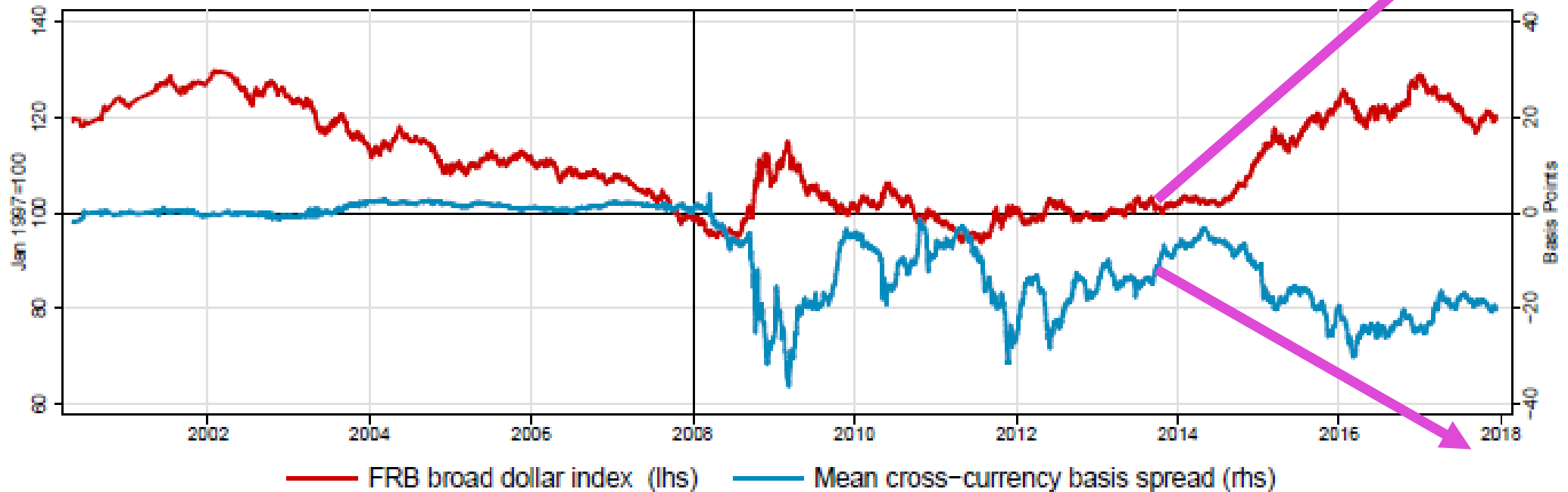
Figure 1: U.S. dollar broad index and the cross-currency basis (2000-2017)



Notes: This figure plots the Federal Reserve Board broad dollar index (in red) and the average five-year cross-currency basis (in blue) for G10 currencies from January 1, 2000 to December 8, 2017. The ten sample currencies are: the Australian dollar, the British pound, the Canadian dollar, the Danish krone, the euro, the Japanese yen, the New Zealand dollar, the Norwegian krone, Swedish krona, and the Swiss franc.

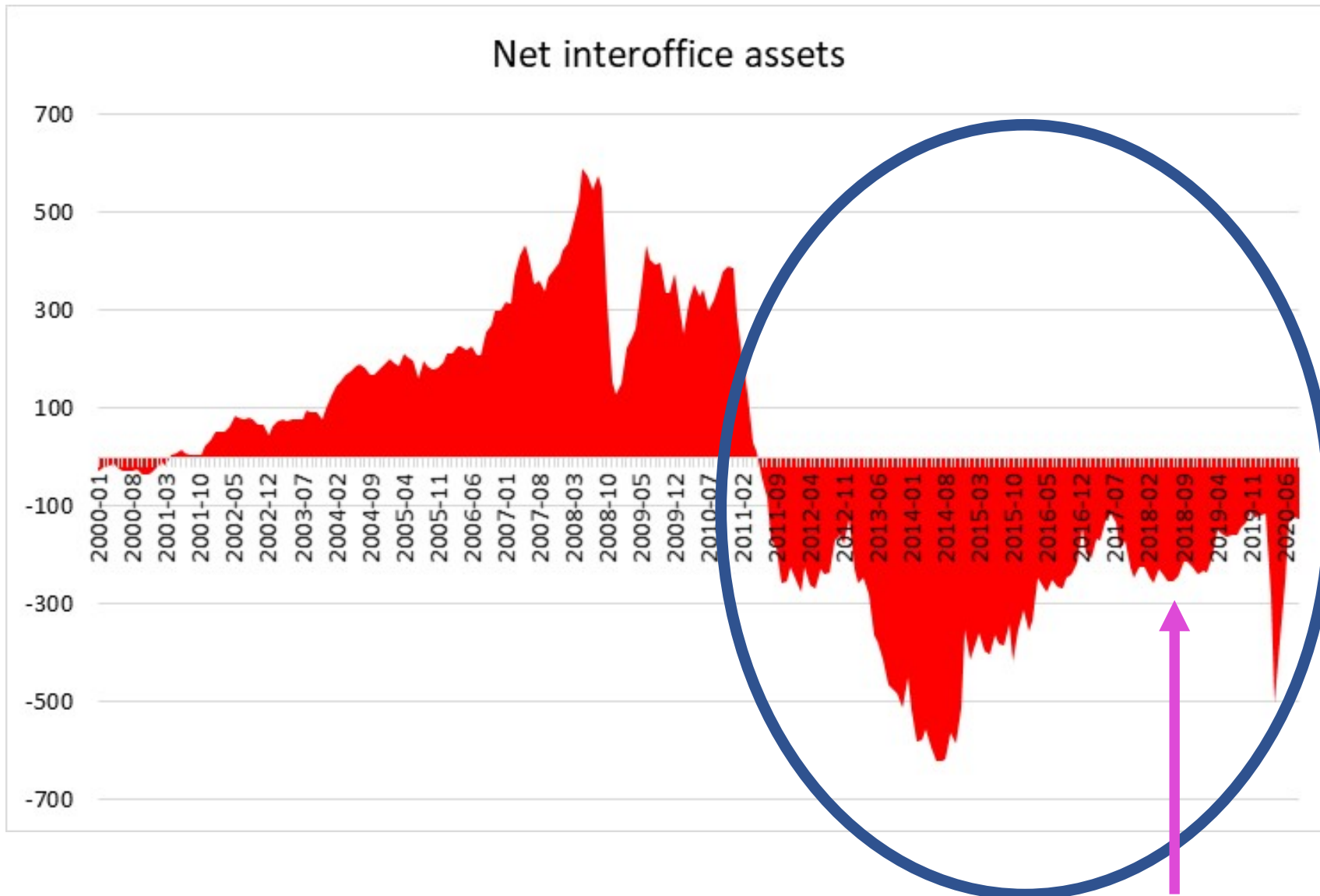
Source: Avdjiev, Du, Koch and Shin (2019)

Figure 1: U.S. dollar broad index and the cross-currency basis (2000-2017)



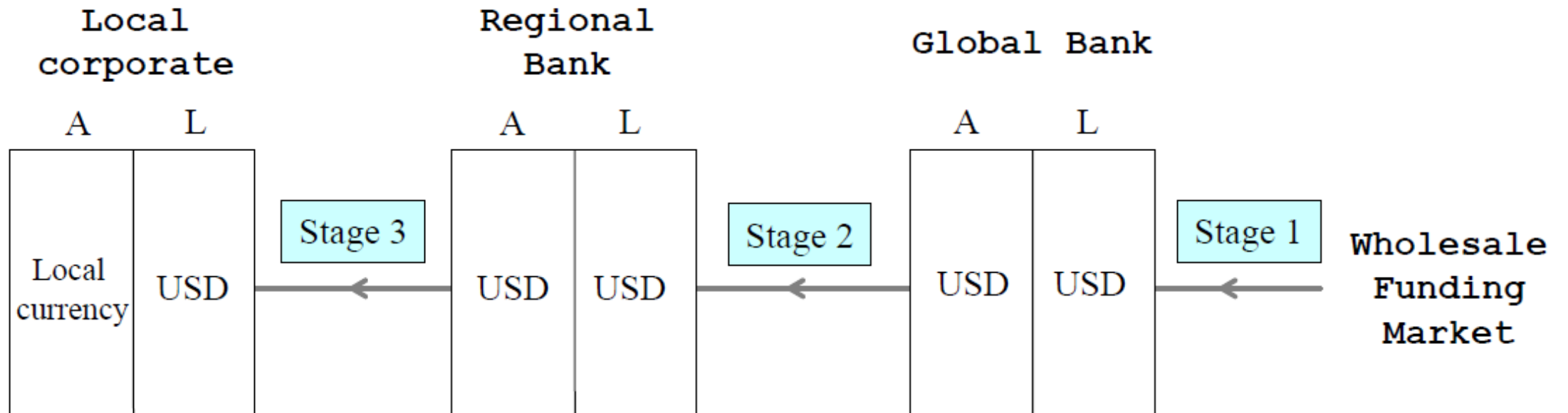
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Source: Avdjiev, Du, Koch and Shin (2019)



Net interoffice assets of foreign banks in U.S. given by negative of Federal Reserve weekly H8 series on “net due to related foreign offices of foreign-related institutions”

# Global banking story and Exchange rates

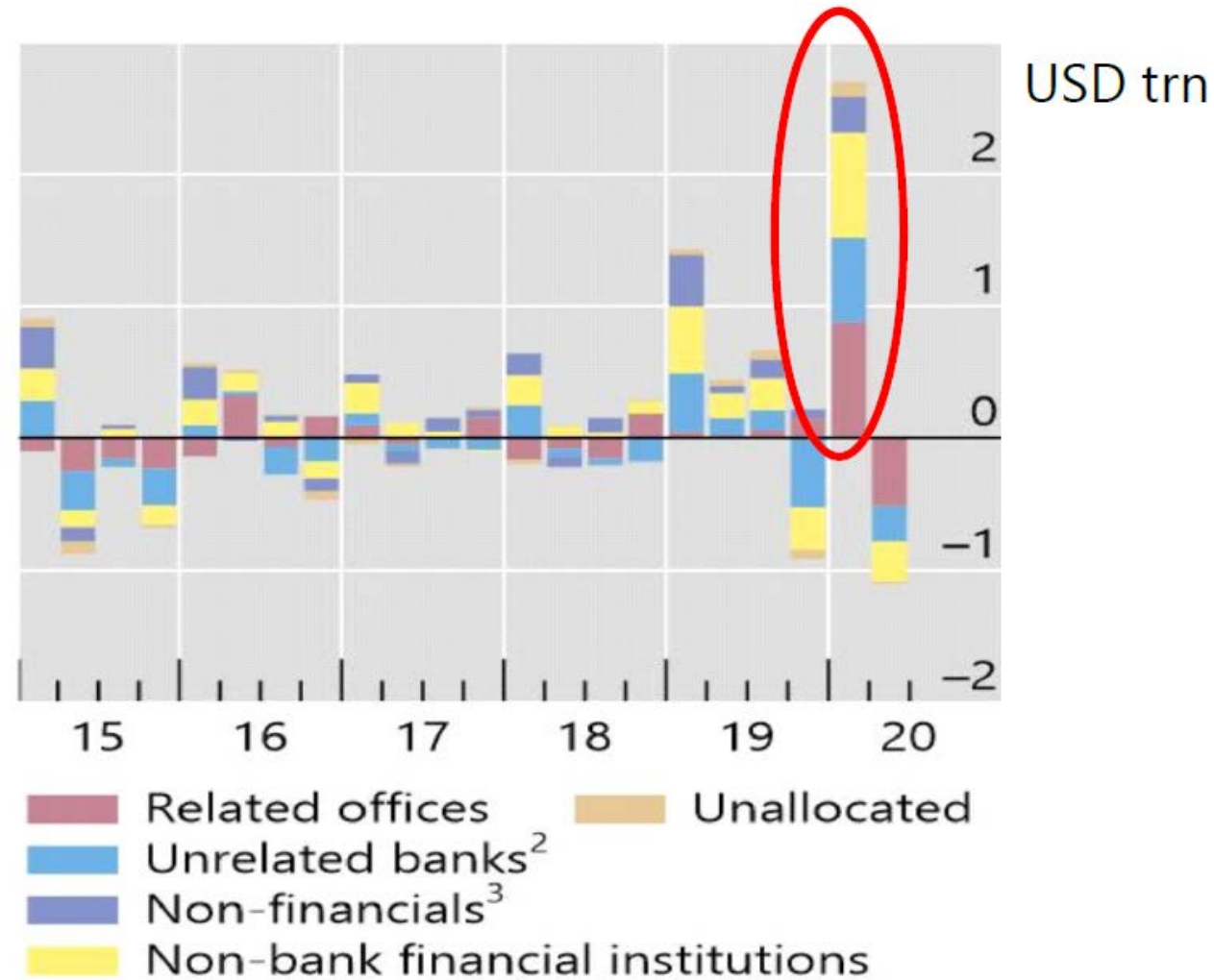


Bruno and Shin *Risk Taking Channel of Exchange Rates*

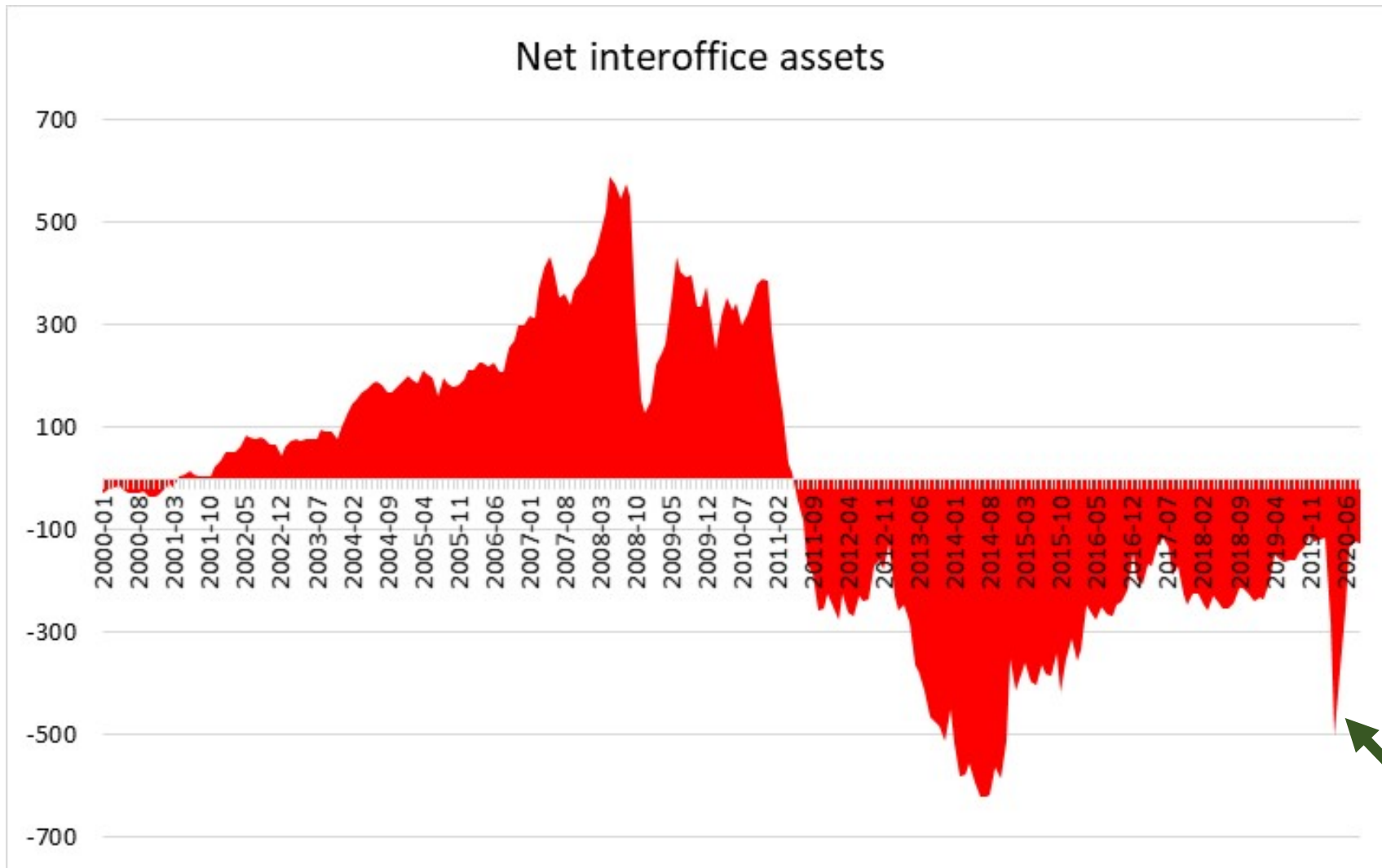
# Global banking story and Exchange rates

- There is positive association between the growth in net interoffice assets of foreign banks in the US and the growth in cross-border loans (Bruno and Shin, 2015, *Review of Economic Studies*)
- In 2010 Korea introduced a macropru levy applied to the foreign exchange denominated liabilities of the banking sector
  - with the result of dampening the fluctuations in the cross-border banking sector liabilities (Bruno and Shin, 2014, *The Scandinavian Journal of Economics*)

# Cross-border positions of BIS-reporting banks







Net interoffice assets of foreign banks in U.S. given by negative of Federal Reserve weekly H8 series on “net due to related foreign offices of foreign-related institutions”

# Concluding remarks

- Drilling-down (Reserve draining) vs. Drilling-up (Balance sheet management of global banks)
- Role of the US dollar and exchange rates
- Circular flow of money originated from the Fed (in whatever form, IOR, repo lending facility, or swap lines)
- “US Global banks and Global Liquidity” or “The Fed and Global Liquidity”?