Implications of choices for central bank balance sheets

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Monetary policy normalisation: scenarios and risks
To what extent will central banks unwind QE?

Maybe less than you think. 3 reasons:

• Monetary effects already unwound?
• Financial system no longer dysfunctional?
• The effect of the new liquidity and capital regimes.

This presentation is mainly focused on the latter.
10 year US real interest rates
Market Dysfunction 2007-13

Source:
2013 speech by Paul Fisher
Bank of England
The new liquidity regime

- **Liquidity Coverage Ratio** – hold HQLA to offset stressed cash outflow over 30 days. *ie hold liquid assets against liabilities that might run.*

- **Net Stable Funding Ratio** – hold stable funding to match illiquid assets. *ie hold long-term liabilities against long-term assets.*

**Interact with capital regime via:**

- **Leverage ratio** – capital requirement based on unweighted assets. *Liquid assets count in the latter …*
Balance sheet choices
Impact on LCR, NSFR, Leverage

• Size = demand for reserves? (LCR, LR)
• Excess vs shortage. Floor system vs corridor.
• Composition: loans vs outright purchases.
• Purchases: bank assets vs non-bank, HQLA vs non.
• Term of loans.
• Collateral eligibility: HQLA vs non-HQLA.
• Collateral differentiation: haircuts vs pricing.
Expansion of access to the central bank balance sheet: 

Bank of England

Source: 2018 IEO report, Bank of England
Term ‘funding’ from the Bank of England

Outstanding amounts lent in SMF liquidity facilities, the FLS and TFS, 2012–17

Source: 2018 IEO report, Bank of England
Conclusions

• CB balance sheet choices will affect *monetary conditions* – but unwinding QE will have less impact than the original expansion and room to unwind is probably limited given that the demand for reserve balances has expanded.

• CB balance sheet choices are becoming more important because of their impact on regulatory metrics for banks and hence *financial stability*.

• The central bank balance sheet has become a major *macroprudential* tool. (Which is helpful given a shortage of such tools.)

• All central banks need to be given, and be clear about, their *financial stability mandate* to guide these choices.