# Implications of choices for central bank balance sheets


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**Monetary policy normalisation: scenarios and risks**

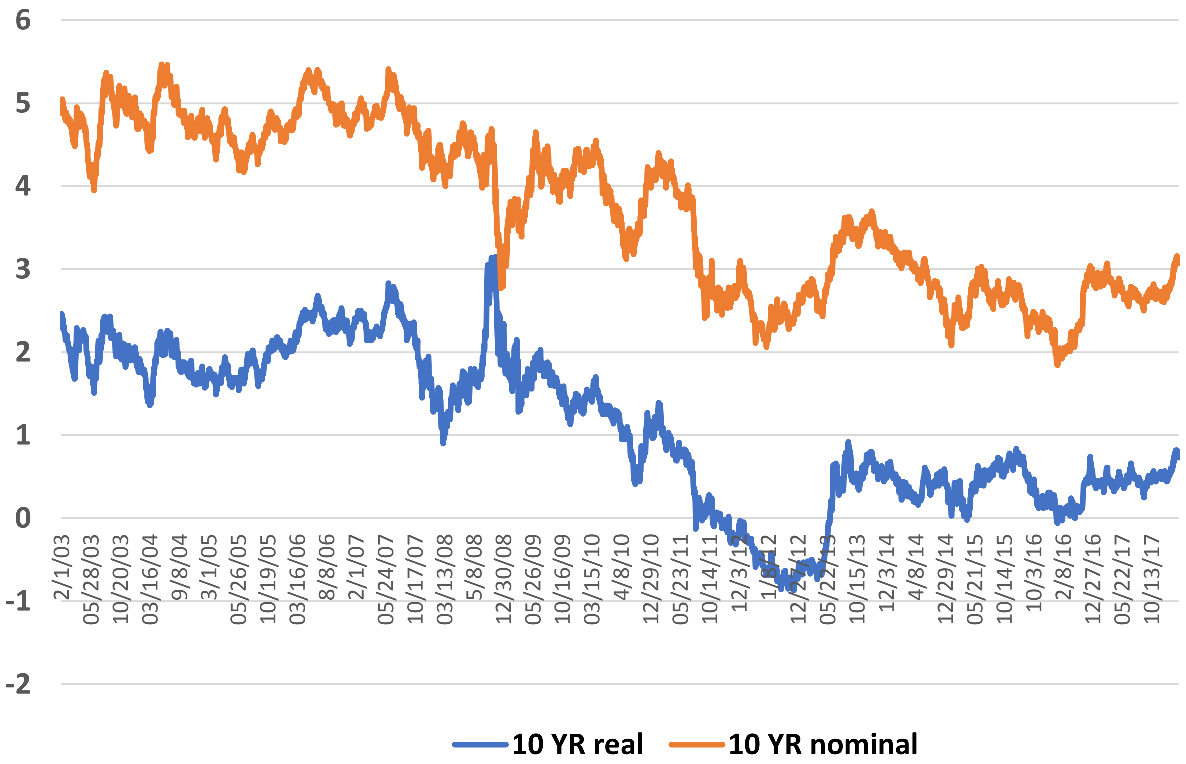
# To what extent will central banks unwind QE?

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.

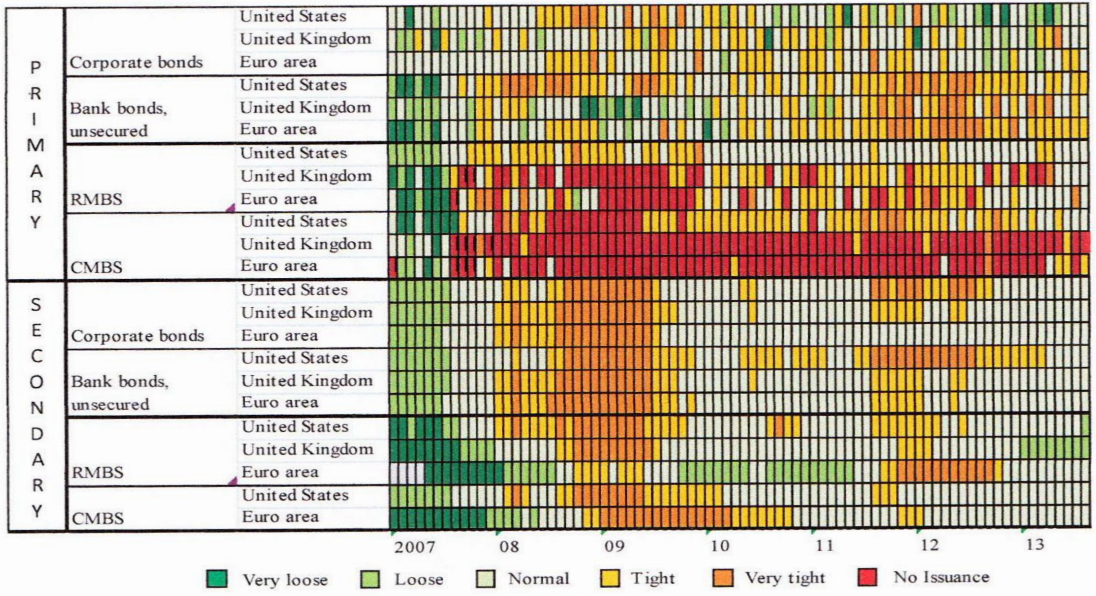
This presentation is mainly focused on the latter.

# 10 year US real interest rates



# Market Dysfunction 2007-13

**Chart 2: Market functioning 'heat map' based on issuance and spreads data[(a)(b)]**




Sources: Bloomberg, Dealogic, JP Morgan Chase & Co, Bank of America Merrill Lynch and Bank calculations.

(a) Shading is based on a score that reflects gross issuance (relative to nominal GDP) and spreads in primary markets, and spreads in secondary markets, expressed as a number of standard deviations from its historical averages, using as much data as available data from January 1998. Primary market indicators reflect the past three months, so smooth volatility. Where spreads are not available, indicators are based solely on issuance.

(b) Latest data point is August 2013.

**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:**

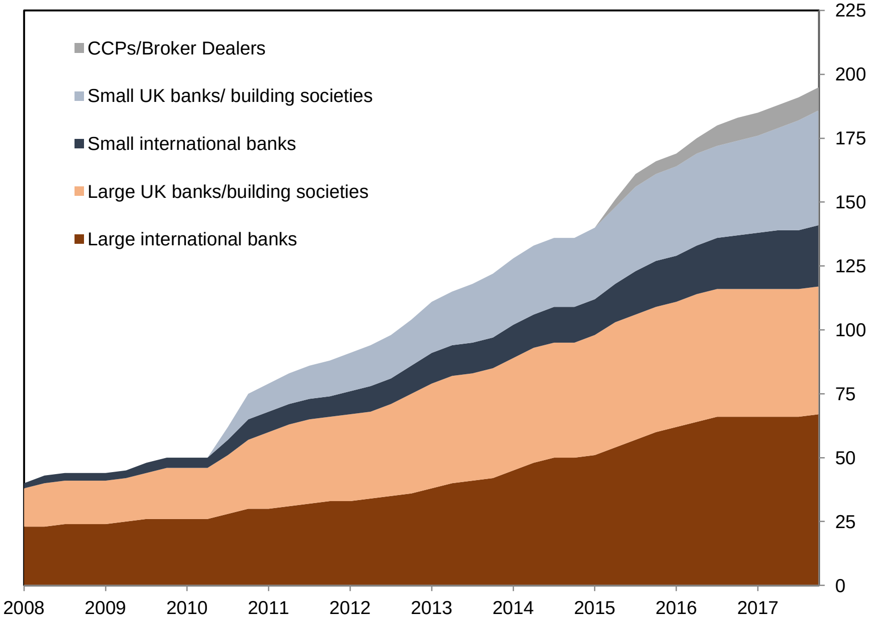
- **Leverage ratio – capital requirement based on unweighted assets.** ***Liquid assets count in the latter …..***

# Balance sheet choices

## Impact on LCR, NSFR, Leverage

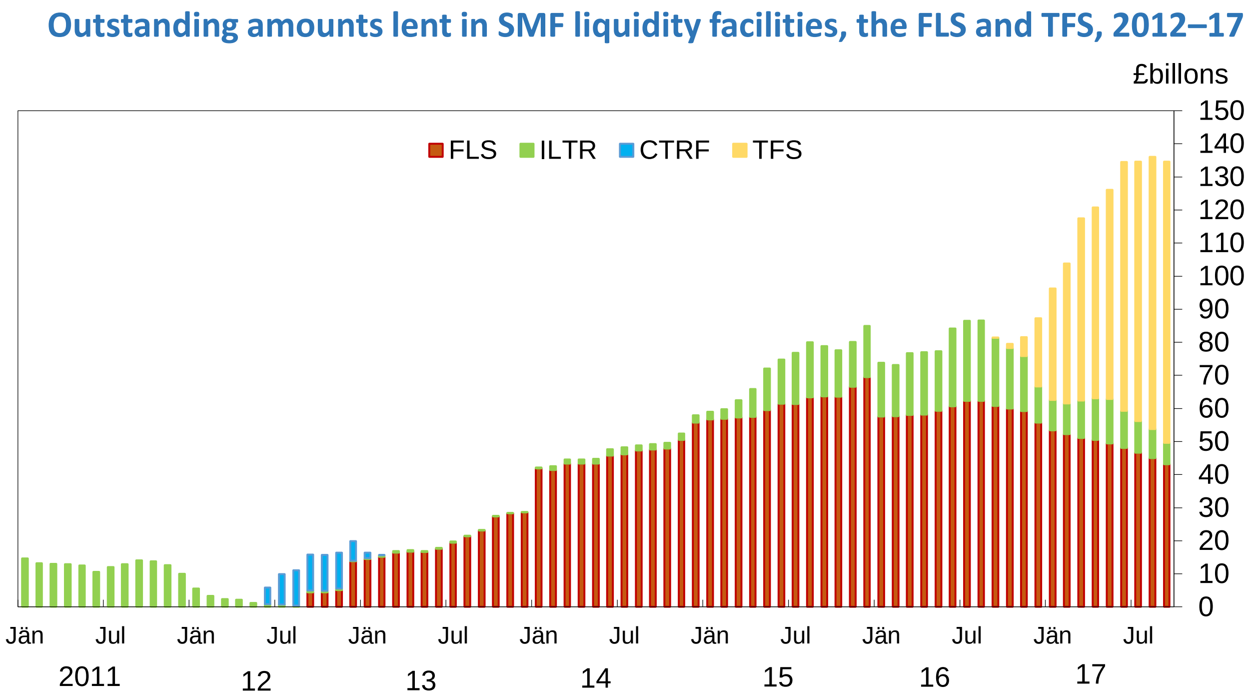
- Size = demand for reserves? (LCR, LR)
- Excess vs shortage.  Floor system vs corridor.
- Composition: loans vs outright purchases.
- Purchases: bank assets vs non-bank, HQLA vs non.
- Term of loans.
- Collateral eligibility: HQLA vs non-HQLA.
- Collateral differentiation: haircuts vs pricing.

# 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




**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.