Monetary Policy Transmission in Segmented Markets

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Motivation

- Since the GFC the transmission of monetary policy has been a crucial topic.
- New theories and datasets have illustrated that money markets are far from "smooth".
- Understanding frictions in money markets has important implications for monetary policy.
- This paper: focus on imperfect competition on repo markets.

This paper in a nutshell

- Repo market with two segments:
  - Core market: only dealers, trading centralized.
  - Periphery market: dealers bargain OTC with clients.
- In the core:
  - Trading is competitive.
  - Changes in policy rate transmitted one for one.
- In the periphery:
  - Dealers have market power.
  - Changes in policy rate transmitted less than one for one.
- Empirical evidence consistent with market power lowering pass-through of rate changes:
  1. Pass-through lower for collaterals with more dispersion.
  2. Pass-through lower for customers who get worse rates.

Assessment

- Interesting and timely paper.
- Stylized facts and empirical results clear, interpretation convincing.
- Model and the policy conclusions need some more work.

Theory - Do you need a model?

- Model illustrates a well-known fact: change in marginal cost is not fully passed on to consumers when competition is imperfect.
- I think this intuition is sufficient to derive the two testable predictions.
- The model gives little more than this intuition, most quantities of interest are exogenous and empirically not observable (e.g., the θs).

Theory - Two issues with the model

- Matching: there is no information on the population of customers and how they are matched with dealers.
- Market clearing: dealers trade in the periphery and offload their inventory in the core, then core market price should reflect the imbalance in the periphery.
- Because of these two issues it's not clear to me that the two pricing equations of the model are really microfounded.

Theory - Some useful models

To our knowledge, we are the first to apply a core-periphery network bargaining model to study the transmission of monetary policy in repo markets.

- Perhaps, but the model has nothing very specific about repo markets.
- Which results cannot be obtained by using existing models? Like:
  - Vari (JMCB 2020).
  - Chiu, Eisenschmidt, and Monnet (RED 2020).
  - Colliard, Foucault, and Hoffmann (JF Forthc.), and older WP version.
  - Eisfeldt, Herskovic, Rajan, Siriwardane (WP 2020).

Theory - Additional predictions

- Theory is actually close to being a special case of Colliard, Foucault, Hoffmann.
- Our model suggests additional predictions.
- In particular, impact of market power should depend on the imbalance between aggregate inventories of core dealers and peripheral customers. Suggests additional interaction terms.
- Interesting in the context of monetary policy: the way liquidity is distributed across banks may worsen market power frictions.

Theory - Good reasons to keep the model

- Interaction between market power and collateral scarcity. Explain why market power frictions vary across collateral types.
- Conduct a structural estimation (also possible in other models).

Policy - Mechanism

- Transmission is less than 1 for 1 due to market power frictions.
- This is the case for pretty much any interest rate (e.g. bank loans to firms).
- Why does this mechanism matter particularly?
  - Is the market power friction greater today than before? If so, why?
  - Is the pass-through more important near the ZLB, as pass-trough < 1 cannot be compensated by larger rate cut?

Policy - CCP

- Policy exercise 1: centralize all trading on a CCP.
- Not very realistic: costly for CCP and its members (monitoring, contributions to default fund, etc.).
- Current CCP fees actually quite high, probably a reason why most counterparties don't join.
- Trading could be centralized without being centrally cleared. Existing literature has thought about potential trade-offs (e.g., Dugast, Uslu, Weill, WP 2020).

Policy - RRP Facility

- Policy exercise 2: CB operates RRP facility, reduces the market power of dealers.
- There are costs for the CB as well, to be modeled.
- Fed is cited as an example but:
  - ECB deposit facility open to more counterparties than Fed equivalent.
  - RRP Facility expends list of counterparties but not to the extent implied in the paper.
- Paper needs to give more details on who are the counterparties of dealers in the OTC market (smaller banks? MMFs? Corporates? size?).
- Deeper question here: why is the CB not acting as a market-maker for all money markets? What's the trade-off?

Conclusion

- Promising paper at an early stage.
- Decision to take about the theory:
  - Clarify it is just a simple conceptual framework for the empirical exercise.
  - Or delete it and use predictions from the existing literature.
  - Or deepen the analysis, derive new results or go structural.
- Much to do on this topic, looking forward to the next version!