THE FED'S INTERNATIONAL DOLLAR LIQUIDITY FACILITIES: NEW EVIDENCE ON EFFECTS

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Discussion by Diana Bonfim

WE_ARE_IN 2022

BANCO DE PORTUGAL
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SUMMARY OF THE PAPER

In the early stages of the **pandemic**, the **Federal Reserve** adopted several **measures** to avoid strains in global dollar funding markets and US Treasury markets:

- terms on **existing** swap lines with other central banks were **eased**
- **temporary** swap agreements were **reactivated**
- **new** repo facilities were **introduced**.

These dollar swap lines are designed to provide foreign central banks with US dollar liquidity (which then they can distribute to financial institutions in their country).

SUMMARY OF THE PAPER

What were the effects:

- on foreign exchange swap basis spreads?
- on the risk sensitivity of global funding strains?
- on foreign exchange reserves of other central banks?
- on Treasury holdings abroad?
- on cross-border flows for banks and non-banks?
- on the risk sensitivity of equity and bond fund flows?

SUMMARY OF THE PAPER

What were the effects:

- on foreign exchange swap basis spreads?

  - **declined**

- on the risk sensitivity of global funding strains?

  - **declined**

- on foreign exchange reserves of other central banks?

  - **no effects**

- on Treasury holdings abroad?

  - **no effects**

- on cross-border flows for banks and non-banks?

  - **declined strains**

- on the risk sensitivity of equity and bond fund flows?

  - **declined**

SUMMARY OF THE PAPER

Thorough *post-mortem* analysis of the Fed's international dollar liquidity facilities.

Important insights on the many dimensions that these facilities can influence.

In a nutshell:

Access to the facilities allows for the normalization of funding patterns.

The effects differ depending on whether there were pre-existing facilities.

MY COMMENTS

01

TYPES OF FACILITIES VS TYPES OF COUNTRIES

02

NORMALIZATION AND THE ROLE OF EXPECTATIONS

03

GFC VS COVID

04

MINOR COMMENTS

1. TYPES OF FACILITIES VS TYPES OF COUNTRIES

There were three types of swap lines:

- **existing** swap lines: Bank of Canada, ECB, Bank of Japan, Swiss National Bank, and Bank of England (**SSCB**).

- **temporary** swap agreements that were reactivated: Reserve Bank of Australia, Banco Central do Brasil, Bank of Korea, Banco de Mexico, Monetary Authority of Singapore, and Sveriges Riksbank (**TSCB**).

- **new** repo facilities: ??? (**other**)

1. TYPES OF FACILITIES VS TYPES OF COUNTRIES

The results differ depending on the type of lines. Funding strains seem to have been eased mostly in countries with new facilities.

But is it about the **type of lines**… or the **type of countries**?

- **Closer** to the US economy/financial system vs others?
- **Advanced** vs **emerging**?

How do the results look like if instead of <u>**grouping**</u> observations by type of lines, they are grouped by type of countries?

- the two dimensions above can be explored.
- also, the heterogeneity in the intensity, timing and reaction to the **pandemic** can be explored.

2. NORMALIZATION AND THE ROLE OF EXPECTATIONS

Access to official dollar liquidity backstop:

- lowers strains
- reduces risk sensitivity
- lowers incentives to hoard liquidity
- stabilizes credit and real economic activity.

Do these effects come from the actual **use** of the lines OR from the **safety net** they provide?

Should they be permanent?

Should there be a credible "swap line of last resort" commitment exist?

What would be the consequences?

3. GFC VS COVID

The central bank dollar swap facilities were introduced during the global financial crisis (GFC).

This was a period of exceptional demand for dollar funding.

It was a financial shock, with origins in the US financial system.

The existing literature shows that they were effective in many dimensions.

3. GFC VS COVID

COVID is a different shock.

- not financial
- not originating in the US
- ample liquidity environment
- sharp and synchronous drop in global demand (including demand for dollars)
- sharp adjustments in international capital flows.

What is different this time?

What can we learn from these differences?

4. MINOR COMMENTS

- The **contribution** of this paper to the existing literature can be more explicitly discussed.

- Is **VIX** the best indicator to capture risk sentiment? What about risk sentiment in each of the countries with swaps?

- "These results are suggestive but not necessarily causal, as **controls** are not in place…" – why not?
- This can be helpful to understand **why** the swap lines were effective.

- Cross-border bank flows: what is the role of **demand**? Do all banks/countries face the same type of borrowers?

- For cross-border flows and US Treasury holdings, it is possible to add **another group**: countries without swap lines.

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