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Recent BIS publications¹

BIS Papers

Proceeding with caution - a survey on central bank digital currency

BIS Papers No 101, January 2019

The hypothetical benefits and risks of central bank digital currencies are being widely discussed. This BIS paper adds to these discussions by taking stock of how progress and plans in this area are developing, based on a global survey of central banks. Responses show that central banks are proceeding with caution and most are only at a conceptual stage with their work. However, a handful have moved to considering practical issues and a couple of central banks with idiosyncratic circumstances might issue a digital currency in the short or medium term

Globalisation and deglobalisation

BIS Papers No 100, December 2018

Globalisation has had a profound effect on economic outcomes, especially in emerging market economies (EMEs). In particular, it is widely acknowledged to have been a major driver of the strong income growth and reduction in poverty witnessed in EMEs in the past few decades. Despite these benefits, there has recently been a backlash against globalisation and growing support for inward looking policies in many parts of the world. Against this backdrop, this volume takes stock of the EME experience with two facets of globalisation-trade and migration. It summarises different country experiences with regard to the aggregate as well as distributional consequences. In doing so, it highlights several examples and avenues for policy action to continue to harness the benefits of globalisation while limiting the costs.

BIS Working Papers

Macroprudential policy with capital buffers

Josef Schroth

February 2019, No 771

This paper studies optimal bank capital requirements in a model of endogenous bank funding conditions. I find that requirements should be higher during good times such that a macroprudential "buffer" is provided. However, whether banks can use buffers to maintain lending during a financial crisis depends on the capital requirement during the subsequent recovery. The reason is that a high requirement during the recovery lowers bank shareholder value during the crisis and thus creates funding-market pressure to use buffers for deleveraging rather than for maintaining lending. Therefore, buffers are useful if banks are not required to rebuild them quickly.

¹ Requests for publications should be addressed to Bank for International Settlements, Press & Communications, Centralbahnplatz 2, CH-4002 Basel. These publications are also available on the BIS website (<http://www.bis.org/>).

The expansionary lower bound: contractionary monetary easing and the trilemma

Paolo Cavallino and Damiano Sandri

February 2019, No 770

We provide a theory of the limits to monetary policy independence in open economies arising from the interaction between capital flows and domestic collateral constraints. The key feature is the existence of an "Expansionary Lower Bound" (ELB), defined as an interest rate threshold below which monetary easing becomes contractionary. The ELB can be positive, thus binding before the ZLB. Furthermore, the ELB is affected by global monetary and financial conditions, leading to novel international spillovers and crucial departures from Mundell's trilemma. We present two models in which the ELB may arise due to either carry-trade capital flows or currency mismatches.

Safe assets: made, not just born

Robert N McCauley

February 2019, No 769

Official reserve managers have a big stake in the debate over safe assets: their portfolios just about define such assets. This paper conveys the message that reserve managers need not worry about a shortage of safe assets. The debate turns first on whether demand for dollar safe assets will grow as rapidly as emerging market economies (EMEs). Second, it turns on whether the supply of dollar safe assets only grows with US fiscal deficits. Neither holds. On the demand side, EMEs' growth does not require ever higher dollar reserves. Indeed, the global economy may have reached "peak reserves" in 2014. On the supply side, law and policy extend state backing to various IOUs, thereby creating safe assets. US government support for the housing agencies Fannie Mae and Freddie Mac has made their debt into safe assets, albeit with wobbles. Federal Reserve liquidity, Federal Deposit Insurance Corporation insurance, and, in extremis as in 2008, Treasury equity also work to make US bank deposits safe. Elsewhere, government support of banks allows those from well rated countries to compete with US banks in issuing safe dollar deposits. Moreover, supranational organisations, non-US sovereigns and their agencies all compete with the US Treasury in issuing safe dollar bonds. In allocating their dollar foreign exchange reserves, central banks make room for such competitors. In particular, they hold more than a third of such reserves in instruments other than US Treasury securities.

Over-the-counter market liquidity and securities lending

Nathan Foley-Fisher, Stefan Gissler and Stéphane Verani

February 2019, No 768

This paper studies how over-the-counter market liquidity is affected by securities lending. We combine micro-data on corporate bond market trades with securities lending transactions and individual corporate bond holdings by U.S. insurance companies. Applying a difference-in-differences empirical strategy, we show that the shutdown of AIG's securities lending program in 2008 caused a statistically and economically significant reduction in the market liquidity of corporate bonds predominantly held by AIG. We also show that an important mechanism behind the decrease in corporate bond liquidity was a shift towards relatively small trades among a greater number of dealers in the interdealer market.

Central counterparty capitalization and misaligned incentives

Wenqian Huang

February 2019, No 767

Financial stability depends on the effective regulation of central counterparties (CCPs), which must take account of the incentives that drive CCP behavior. This paper studies the incentives of a for-profit CCP with limited liability. It faces a trade-off between fee income and counterparty credit risk. A better-capitalized CCP sets a higher collateral requirement to reduce potential default losses, even though it forgoes fee income by deterring potential traders. I show empirically that a 1% increase in CCP capital is associated with a 0.6% increase in required collateral. Limited liability, however, creates a wedge between its capital and collateral policy and the socially optimal solution to this trade-off. The optimal capital requirements should account for clearing fees.

Risk endogeneity at the lender/investor-of-last-resort

Diego Caballero, André Lucas, Bernd Schwaab and Xin Zhang

January 2019, No 766

We address to what extent a central bank can de-risk its balance sheet by unconventional monetary policy operations. To that end, we propose a novel risk measurement framework to empirically study the time variation in central bank portfolio credit risks associated with such operations. The framework accommodates a large number of bank and sovereign counterparties, joint tail dependence, skewness, and time-varying dependence parameters. In an application to selected items from the consolidated Eurosystem's weekly balance sheet between 2009 and 2015, we find that unconventional monetary policy operations generated beneficial risk spillovers across monetary policy operations, causing overall risk to be non-linear in exposures. Some policy operations reduced rather than increased overall risk.

Beyond the doomsday economics of "proof-of-work" in cryptocurrencies

Raphael Auer

January 2019, No 765

This paper discusses the economics of how Bitcoin achieves data immutability, and thus payment finality, via costly computations, ie "proof-of-work". Further, it explores what the future might hold for cryptocurrencies modelled on this type of consensus algorithm. The conclusions are, first, that Bitcoin counterfeiting via "double-spending" attacks is inherently profitable, making payment finality based on proof-of-work extremely expensive. Second, the transaction market cannot generate an adequate level of "mining" income via fees as users free-ride on the fees of other transactions in a block and in the subsequent blockchain. Instead, newly minted bitcoins, known as block rewards, have made up the bulk of mining income to date. Looking ahead, these two limitations imply that liquidity is set to fall dramatically as these block rewards are phased out. Simple calculations suggest that once block rewards are zero, it could take months before a Bitcoin payment is final, unless new technologies are deployed to speed up payment finality. Second-layer solutions such as the Lightning Network might help, but the only fundamental remedy would be to depart from proof-of-work, which would probably require some form of social coordination or institutionalisation.

Global Banking, Financial Spillovers, and Macroprudential Policy Coordination

Pierre-Richard Agénor and Luiz Awazu Pereira da Silva

January 2019, No 764

The gains from international macroprudential policy coordination are studied in a two-region, core-periphery macroeconomic model with imperfect financial integration and cross-border banking. Financial frictions occur at two levels: between firms and banks in each region, and between periphery banks and a global bank in the core region. Macroprudential regulation takes the form of a countercyclical tax on bank loans to domestic capital goods producers, which responds to real credit growth and is subject to a cost in terms of welfare. Numerical experiments, based on a parameterized version of the model, show that the welfare gains from macroprudential policy coordination are positive, albeit not large, for the world economy. In addition, these gains tend to increase with the degree of international financial integration. However, depending on the origin of financial shocks, they can also be highly asymmetric across regions.

On money, debt, trust and central banking

Claudio Borio

January 2019, No 763

This essay examines in detail the properties of a well functioning monetary system - defined as money plus the mechanisms to execute payments - in both the short and long run, drawing on both theory and the lessons from history. It stresses the importance of trust and of the institutions needed to secure it. Ensuring price and financial stability is critical to nurturing and maintaining that trust. In the process, the essay addresses several related questions, such as the relationship between money and debt, the viability of cryptocurrencies as money, money neutrality, and the nexus between monetary and financial stability. While the present monetary system, with central banks and a prudential apparatus at its core, can and must be improved, it still provides the best basis to build on.

A key currency view of global imbalances

Robert N McCauley and Hiro Ito

December 2018, No 762

This working paper contributes to a growing body of work that breaks free of the "triple coincidence" often assumed in international finance. A currency's domain does not coincide with the borders of the jurisdiction that issues it. Instead, key currencies enjoy global use. A key currency perspective can change how global imbalances look to economists, policymakers and market participants.

Non-monetary news in central bank communication

Anna Cieslak and Andreas Schrimpf

December 2018, No 761

We quantify the importance of non-monetary news in central bank communication. Using evidence from four major central banks and a comprehensive classification of events, we decompose news conveyed by central banks into news about monetary policy, economic growth, and separately, shocks to risk premia. Our approach exploits high-frequency comovement of stocks and interest rates combined with monotonicity restrictions across the yield curve. We find significant differences in news composition depending on the communication channel used by central banks. Non-monetary news prevails in about 40% of policy decision announcements by the Fed and the ECB, and this fraction is even higher for communications that provide context to policy decisions such as press conferences. We show that non-monetary news accounts for a significant part of financial markets' reaction during the financial crisis and in the early recovery, while monetary shocks gain importance since 2013.

Gross capital flows by banks, corporates and sovereigns

Stefan Avdjiev, Bryan Hardy, Sebnem Kalemli-Ozcan and Luis Servén

December 2018, No 760

We construct a new data set of quarterly international capital flows by sector, with an emphasis on debt flows. Using our new data set, we establish four facts. First, the co-movement of capital inflows and outflows is driven by inflows and outflows vis-à-vis the domestic banking sector. Second, the procyclicality of capital inflows is driven by banks and corporates, whereas sovereigns' external liabilities move acyclically in advanced and countercyclically in emerging countries. Third, the procyclicality of capital outflows is driven by advanced countries' banks and emerging countries' sovereigns (reserves). Fourth, capital inflows and outflows decline for banks and corporates when global risk aversion (VIX) increases, whereas sovereign flows show no response. These facts are inconsistent with a large class of theoretical models.

Basel Committee on Banking Supervision

An examination of initial experience with the global systemically important bank framework

February 2019

This paper presents a first analysis of the experience to date with the global systemically important bank (G-SIB) framework, the methodology for assessing the systemic importance of G-SIBs. Several issues are examined. First, we investigate whether G-SIBs and non-G-SIBs have behaved differently since the implementation of the G-SIB framework and if observed differences in behaviour are in accordance with the framework's aims. Next, we ask whether there are regional differences in the behaviour of G-SIBs and non-G-SIBs.

Minimum capital requirements for market risk

January 2019

The Minimum capital requirements for market risk replaces an earlier version of the standard as published in January 2016.

The standard has been revised to address issues that the Basel Committee identified in the course of monitoring the implementation and impact of the framework. This final standard

incorporates changes that were proposed in a March 2018 consultative document and has been informed by a quantitative impact based on data as of end-December 2017.

As in the January 2016 framework, the core features of the standard include:

- a clearly defined boundary between the trading book and the banking book;
- an internal models approach that relies upon the use of expected shortfall models and sets out separate capital requirements for risk factors that are deemed non-modellable; and
- a standardised approach that is risk-sensitive and is designed and calibrated to serve as a credible fallback to the internal models approach.

Revisions to the January 2016 framework include the following key changes:

- a simplified standardised approach for use by banks that have small or non-complex trading portfolios;
- clarifications on the scope of exposures that are subject to market risk capital requirements;
- refined standardised approach treatments of foreign exchange risk and index instruments;
- revised standardised approach risk weights applicable to general interest rate risk, foreign exchange and certain exposures subject to credit spread risk;
- revisions to the assessment process to determine whether a bank's internal risk management models appropriately reflect the risks of individual trading desks; and
- revisions to the requirements for identification of risk factors that are eligible for internal modelling.

This revised standard comes into effect on 1 January 2022.

Revisions to leverage ratio disclosure requirements **December 2018**

The Basel III leverage ratio standard comprises a 3% minimum level that banks must meet at all times, a buffer for global systemically-important banks and a set of public disclosure requirements. For the purpose of disclosure requirements, banks must report the leverage ratio on a quarter-end basis or, subject to approval by national supervisors, report a measure based on averaging (eg using an average of exposure amounts based on daily or month-end values).

Heightened volatility in various segments of money and derivatives markets around key reference dates (eg quarter-end) has alerted the Basel Committee to potential regulatory arbitrage by banks. A particular concern is "window-dressing", in the form of temporary reductions of transaction volumes in key financial markets around reference dates resulting in the reporting and public disclosure of elevated leverage ratios. In this regard, the Committee published a newsletter in October 2018 in which it indicated that window-dressing by banks is unacceptable, as it undermines the intended policy objectives of the leverage ratio requirement and risks disrupting the operations of financial markets.

Pillar 3 disclosure requirements - updated framework **December 2018**

Pillar 3 of the Basel framework seeks to promote market discipline through regulatory disclosure requirements. The revised Pillar 3 framework reflects the Committee's December 2017 Basel III post-crisis regulatory reforms and pertains to the following areas:

- credit risk, operational risk, the leverage ratio and credit valuation adjustment (CVA) risk;
- risk-weighted assets (RWAs) as calculated by the bank's internal models and according to the standardised approaches; and
- an overview of risk management, RWAs and key prudential metrics.

Cyber-resilience: range of practices

December 2018

The Basel Committee on Banking Supervision today published the report. It identifies, describes and compares the range of observed bank, regulatory and supervisory cyber-resilience practices across jurisdictions.

Based on analysis of authorities' responses to previous international surveys and on exchanges between international experts, the report gains insight into the effective practices and expectations in place. It also benefited from industry participants' input.

Committee on the Global Financial System

Establishing viable capital markets

January 2019, No 62

The Capital markets provide an important channel of financing for the real economy, they help allocate risk, and they support economic growth and financial stability. Moreover, capital markets have played an important part in financing the recovery from the Great Financial Crisis (GFC), a reminder of their "spare tyre" role in the financial system. This report examines recent trends in capital market development and identifies the factors that foster the development of robust capital markets.

The report finds that large differences persist in the size of capital markets across advanced and emerging economies. Emerging-economy markets have been catching up with their more advanced peers, but the gap has not yet been closed.

The analysis highlights the importance of macroeconomic stability, market autonomy, strong legal frameworks and effective regulatory regimes in supporting market development. Better disclosure standards, investor diversity, internationalisation, and deep hedging and funding markets, as well as efficient and robust market infrastructures, also play a key role.

The report's recommendations across six broad areas outline practical ways to support the development of robust and efficient markets.

Committee on Payments and Market Infrastructure

Implementation monitoring of PFMI: Assessment report for Switzerland

January 2019 No 183

The Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) closely monitors the implementation of the Principles for financial market infrastructures (PFMI). This report presents the conclusions drawn by the CPMI and IOSCO from a Level 2 assessment of whether, and to what degree, the legal, regulatory and oversight frameworks for financial market infrastructures (FMIs) in Switzerland, including rules and regulations, any relevant policy statements, or other forms of implementation, are complete and consistent with the Principles.

The assessment found that - as of 30 June 2017 - Switzerland has generally implemented the PFMI. For PSs, CSDs/SSSs and CCPs, the Principles have been implemented in a complete and consistent or broadly consistent manner with the exception of Principle 7 on liquidity risk management and Principle 22 on communication procedures and standards, as well as Principle 19 (as applicable for PSs) on tiered participation arrangements. For TRs, a number of gaps were identified with varying severity. Principles 1, 3, 15, 17, 20, 22 and 24 on legal basis, the framework for the comprehensive management of risks, general business risk, operational risk, FMI links, communication procedures and standards, and disclosure of market data, respectively, have not been fully implemented.

Market Committee

Monitoring of fast-paced electronic markets

September 2018 No 10

The Foreign exchange and other fast-paced electronic markets (FPMs) have undergone a wide range of structural changes in recent years. Trading in FPMs has become increasingly electronic and automated, significantly changing the market ecosystem. Against this background, the report explores aspects of structural change with immediate relevance for central banks' market monitoring approaches.

The three key structural changes include greater speed and fragmentation of trading activity; greater concentration of liquidity provision among the largest banks and the new set of non-bank intermediaries; and the rise in volume and commoditisation of large quantities of high-frequency data on the back of greater electrification.

At the same time, the market-monitoring capacities of market participants in both the public and private sector have been transformed. Central banks have striven to adapt their near-time and medium-term monitoring approaches to these changes. Monitoring needs naturally vary according to central bank mandates and how far markets have been electrified. Central banks' monitoring requirements will also naturally differ from those of the private sector.

Speeches

Distributed ledger technology and large value payments: a global game approach

Lecture by Mr Hyun Song Shin, Economic Adviser and Head of Research of the BIS, • University of Cambridge, 22 January 2019.

Payment systems built around distributed ledger technology (DLT) operate by maintaining identical copies of the history of payments among the participant nodes in the payment system. Cryptocurrencies are perhaps the best-known example of the application of DLT, but the applicability of the technology is much broader. Payment systems based on DLT are compatible with oversight by the central bank, and several central banks have conducted successful trials of interbank payments. In these trials, payment system participants transfer digital tokens that are redeemable at the central bank and use DLT to transfer them to other system participants. Decentralised consensus is achieved through agreement of a supermajority of the participants (typically 75-80%) who collectively validate payments.

Nevertheless, the technology by itself does not overcome the credit needs of the payment system to maintain settlement liquidity. In conventional real-time gross settlement (RTGS) payment systems, the value of daily payments can be over 100 times the deposit balance maintained by the system participant at the central bank. As such, incoming payments are recycled into outgoing payments, and credit provided by the central bank supplements private credit from outside the payment system for the smooth functioning of the system as a whole.

We examine the liquidity properties of decentralised payment systems in an economic model of payments, in which the cost of credit to finance payments enters explicitly.

Claudio Borio interview with Capital

Original quotes from interview with Mr Claudio Borio, Head of the Monetary and Economic Department of the BIS, with Capital, conducted by Mr Lukas Zdrzalek and published on 24 January 2019.

BIS Quarterly Review, December 2018 - media briefing

Remarks by Claudio Borio and Hyun Song Shin.

Shelter from the storm

Remarks by Mr Agustín Carstens, General Manager of the BIS, at a seminar at the European Stability Mechanism, Luxembourg, 7 December 2018.

Getting one's house in order, building a resilient and flexible economy, and reducing vulnerabilities - all these things are of first-order importance. But it would be naive to believe that we can avoid all future crises. And when they do occur, having a shelter from the storm is very important. This speech reviews the achievements and unintended consequences of the policy response to the Global Financial Crisis and the subsequent European debt crisis. It then sketches the challenges authorities might face in the years to come and discusses what can be done to safeguard economic and financial stability.

Big tech in finance and new challenges for public policy

Keynote address by Mr Agustín Carstens, General Manager of the BIS, at the FT Banking Summit, London, 4 December 2018.

Large technology companies with established user networks ("big tech") are challenging traditional finance. Having started with payments, in some markets such companies have been expanding into the provision of credit, insurance and even wealth management. They have been doing so either directly or in cooperation with incumbent financial institutions. This raises a host of questions around competition, financial inclusion, data protection and financial stability. Will this growth lead to a more diverse financial system or to new forms of concentration? Is the expansion of big tech driven by efficiency gains, or by arbitrage of the current regulatory system? And how should public policy adapt to these developments in order to protect client data and help sustain strong and balanced growth?

Financial instability: can Big Data help connect the dots?

Remarks by Mr Luiz Awazu Pereira da Silva, Deputy General Manager of the BIS, and Goetz von Peter, Principal Economist at the BIS, based on a speech delivered at the Ninth European Central Bank Statistics Conference on "20 years of ESCB statistics: what's next?", Frankfurt am Main, 11 July 2018.

The Great Financial Crisis fuelled a broad-based expansion of financial statistics. A second, much larger wave of data hits the shores as central banks and the financial sector embrace Big Data. Collecting more data or dots is necessary, but connecting the dots is the critical step for understanding the implications for financial stability. It is the lens that matters: it takes purposeful analysis to turn data into useful information. Financial markets are flush with data, yet the bigger picture can slip out of sight. This is where policymakers and market participants fall short time and again: in run-ups to previous crises, simple aggregates would signal problems yet warnings went unheeded. The onset of a crisis then sharpens the focus on critical data for the management and resolution of the crisis. Later, when the financial cycle turns again, innovation and changing structure make financial risks harder to locate using the existing data.