

The case for abundant reserves

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Excess reserves: scarcity vs. abundance

- Debate is sometimes framed as a corridor vs. a floor
- In my experience this terminology has confused general listeners
 - Old system wasn't a corridor, nor is the new system a floor

Going from abundance to scarcity

- Is it feasible? That is, would it work as smoothly as it did prior to 2007?
- Is it optimal? If we can get scarcity to work smoothly, would that be the best system?

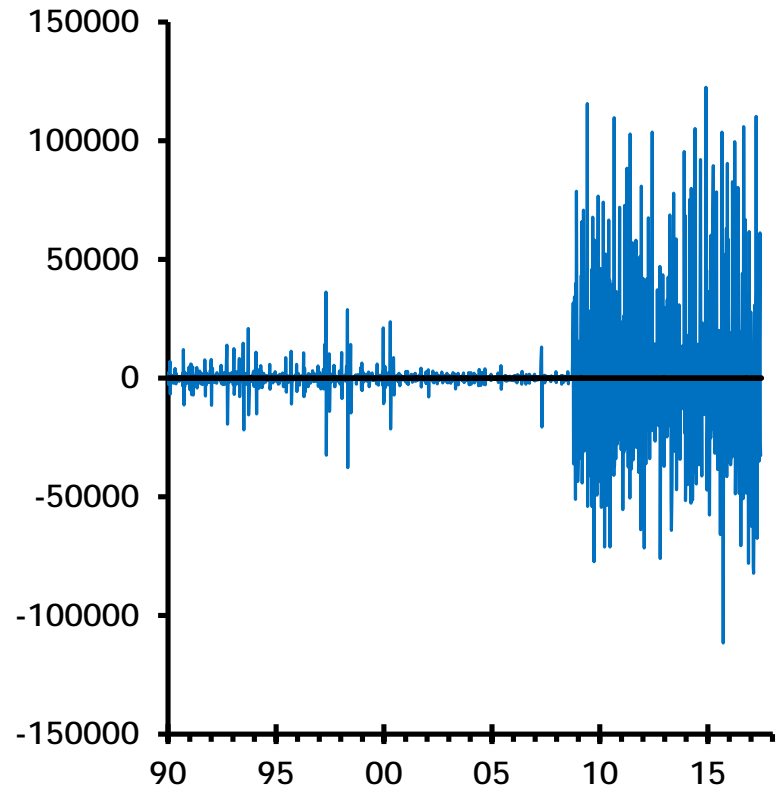
Preview of conclusions

- Returning to scarcity would be feasible, but would require coordination with other official bodies
- Harder to argue scarcity is optimal
 - Historical precedent seems less compelling, as historically the Fed didn't have an IOR facility
 - Abundance protects the Fed balance sheet, improves payment system functioning, and may have other benefits as well

Feasibility: what is different from 2006?

- Payment volumes haven't increased much
- Autonomous factor volatility has increased, particularly Treasury's general account

Factors Absorbing Reserve funds:
Treasury deposits with F.R. Banks
weekly change, million USD (eop)



Source: Federal Reserve Board, J.P. Morgan

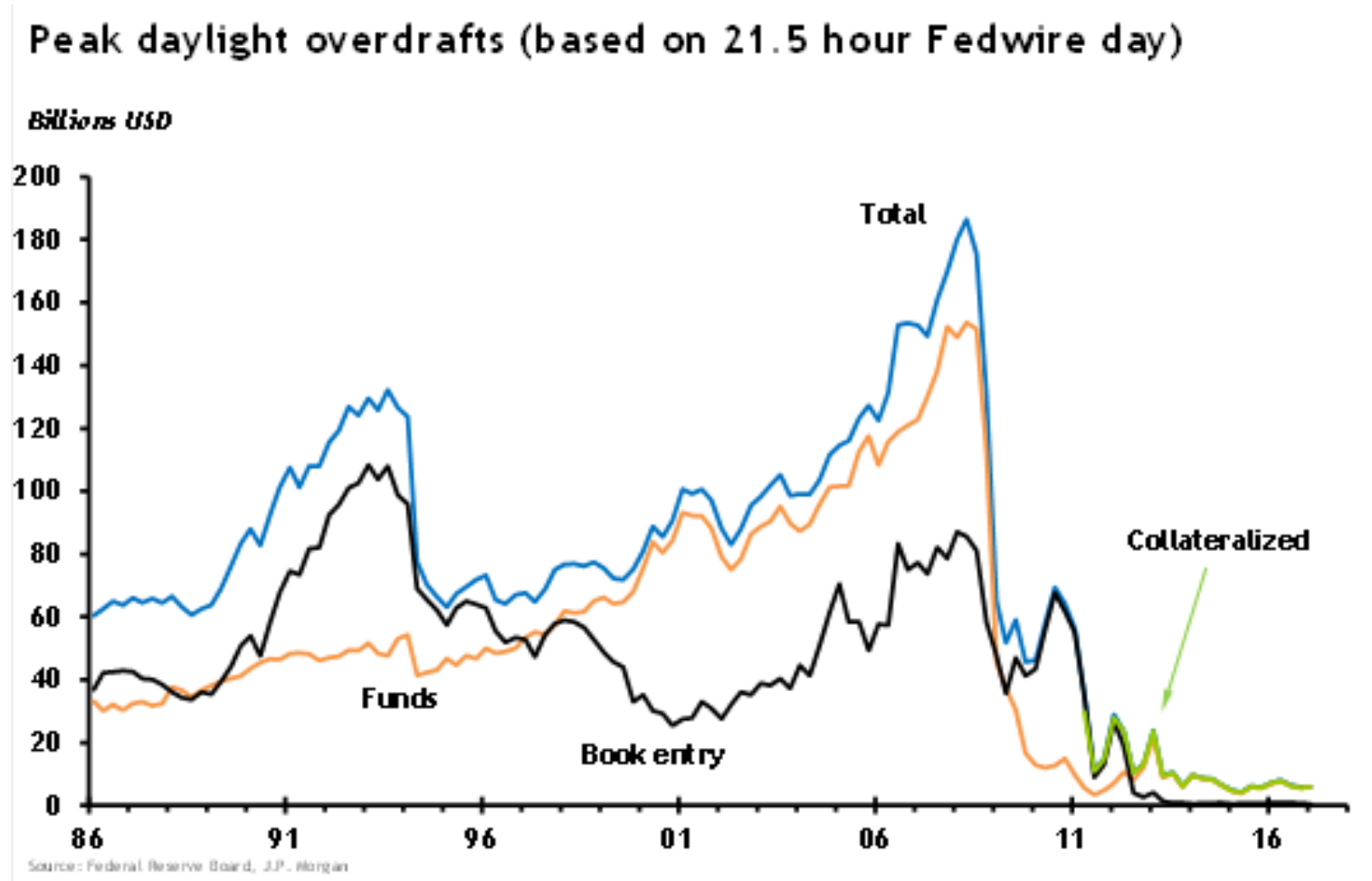
Feasibility: what is different from 2006?

- Regulatory regime shift
 - LCR: replacing reserves with other (mostly) HQLA
 - CLAR: Comprehensive Liquidity Assessment and Review
 - Public documents indicate tests of liquidity stress scenarios
 - Not all HQLA created equally. Reserves have settlement immediacy that even Treasuries lack
 - Banks internal liquidity standards may have changed, particularly with respect to intraday liquidity

Optimality: if we can go back, should we?

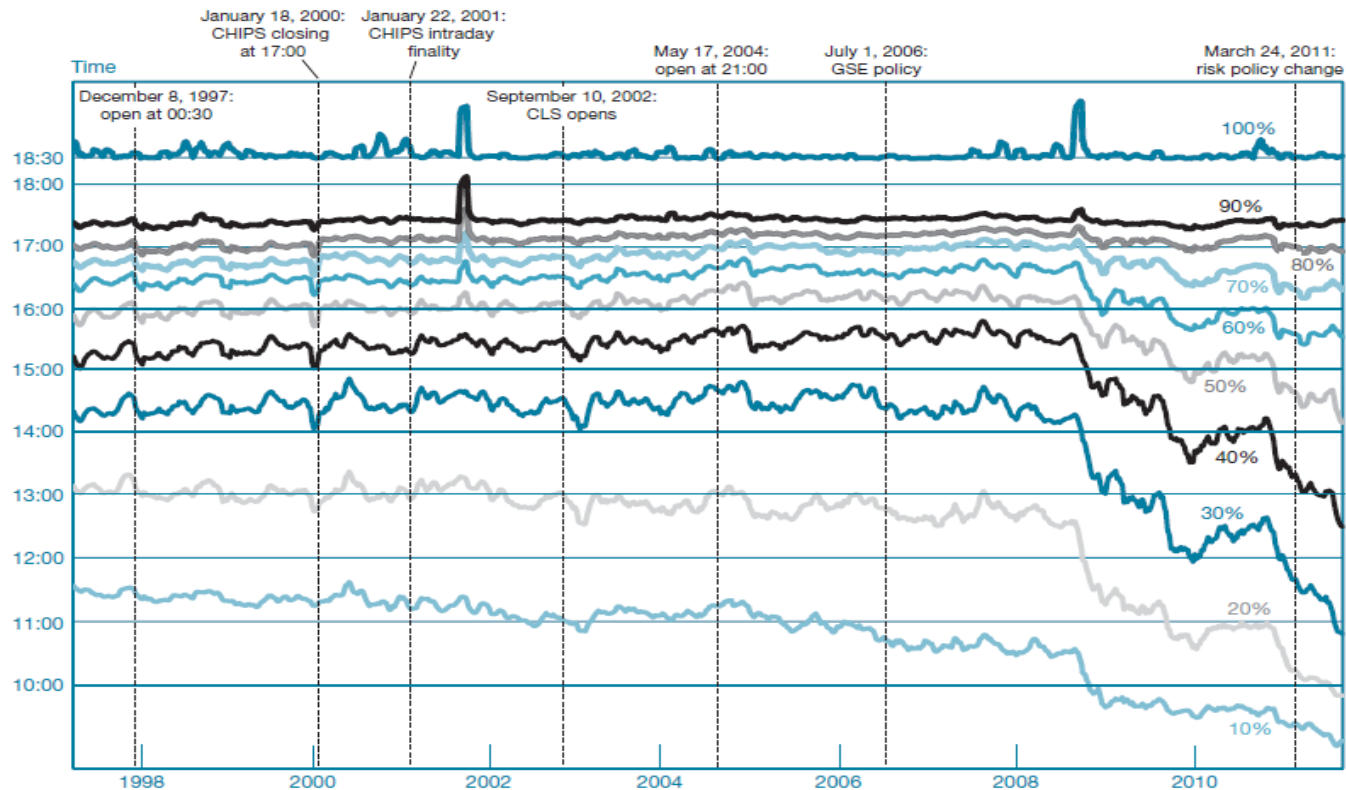
- Arguments for abundant reserves:
 - Operational simplicity
 - Reduced credit risk to the Fed
 - Reduced settlement risk in the banking system
 - Less inter-day interest rate volatility
 - Public provision of safe, short-term assets

Reducing Fed credit risk: with abundance, reserves are bought, not borrowed



Improved payments liquidity (borrowing from Bech, Martin, and McAndrews)

Deciles of Fedwire Value Settled throughout Day
Deciles of Fedwire Value Time Distribution

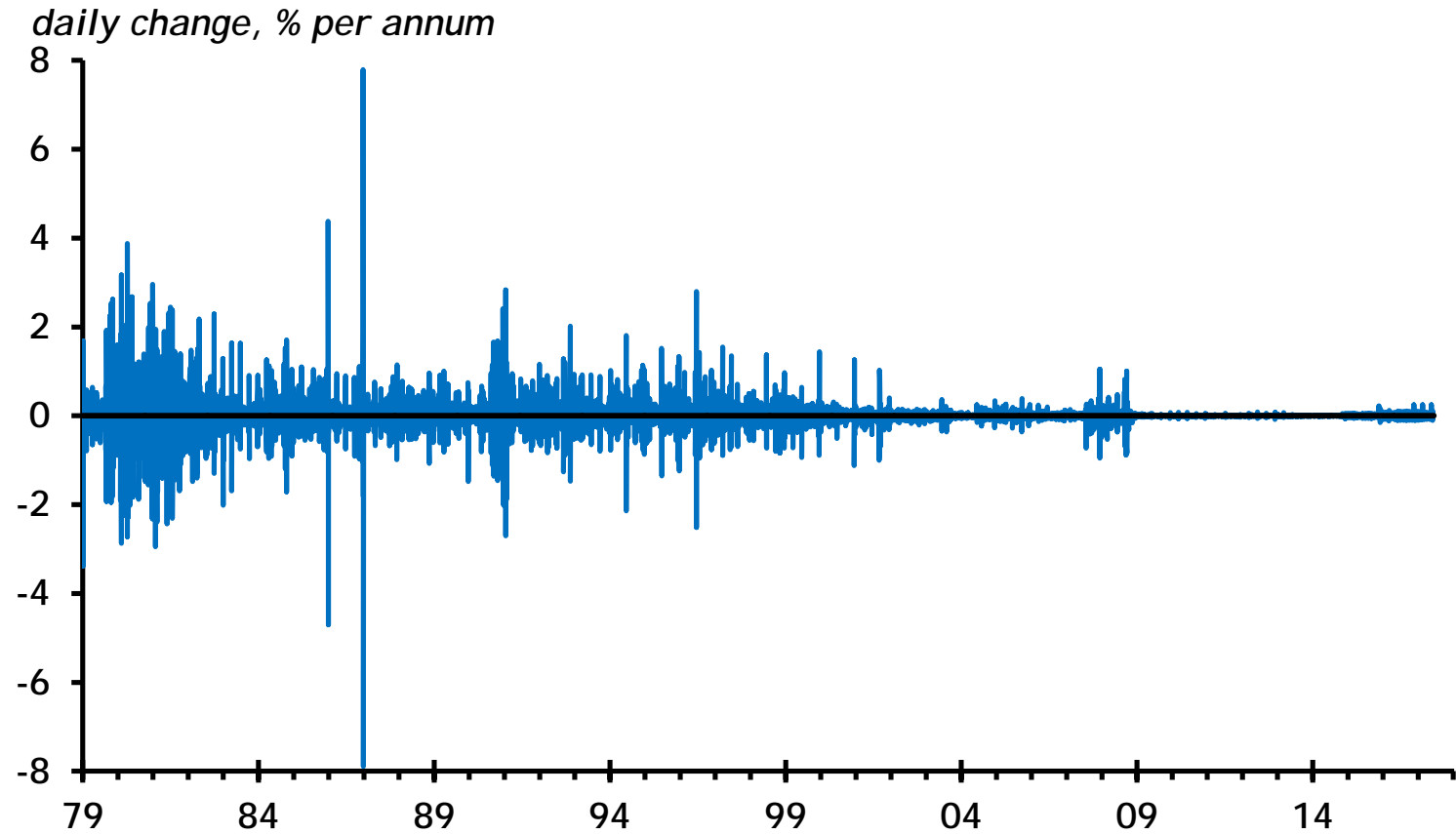


Sources: Federal Reserve Bank of New York; authors' calculations.

Notes: A twenty-one-day centered moving average is used. Values exclude payments related to CHIPS, CLS, DTC, and principal and interest payment funding.

Lower inter-day interest rate volatility

Federal funds rate



Source: Federal Reserve Board, J.P. Morgan

Conclusions

- Staying with the current system would be operationally simpler, particularly in the transition period
- Abundant reserve balances minimize the Fed's credit risk
- They would also support better functioning of the payments system, with associated benefits
- Interest rate volatility can be expected to be lower with abundant reserves
- Public provision of safe, short-term assets: this may get too close to mission creep