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Central Bank Support for Financial Markets

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Monetary and Capital Markets Department

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Disclaimer

The views expressed in this presentation are those of the authors and do not necessarily represent the views of the IMF or its Executive Board.

Coverage

- Objectives of interventions
- Which markets?
- When to support a market?
- How to design market support programs?
- Market support programs?

Which markets?

Interventions should typically be aimed at markets which play a crucial role in financial intermediation and interconnected markets.

As a starting point, relevant markets will generally be large, liquid and of high credit quality in normal times.

In *disintermediated jurisdictions*, more markets become important.

Funding markets

Interbank markets

Bank credit

Debt issuances (government, banks, and non - financial corporations)

FX funding

Securities markets

FX Spot/derivatives

Government Securities

Bank bonds

Commercial papers

Interconnected market

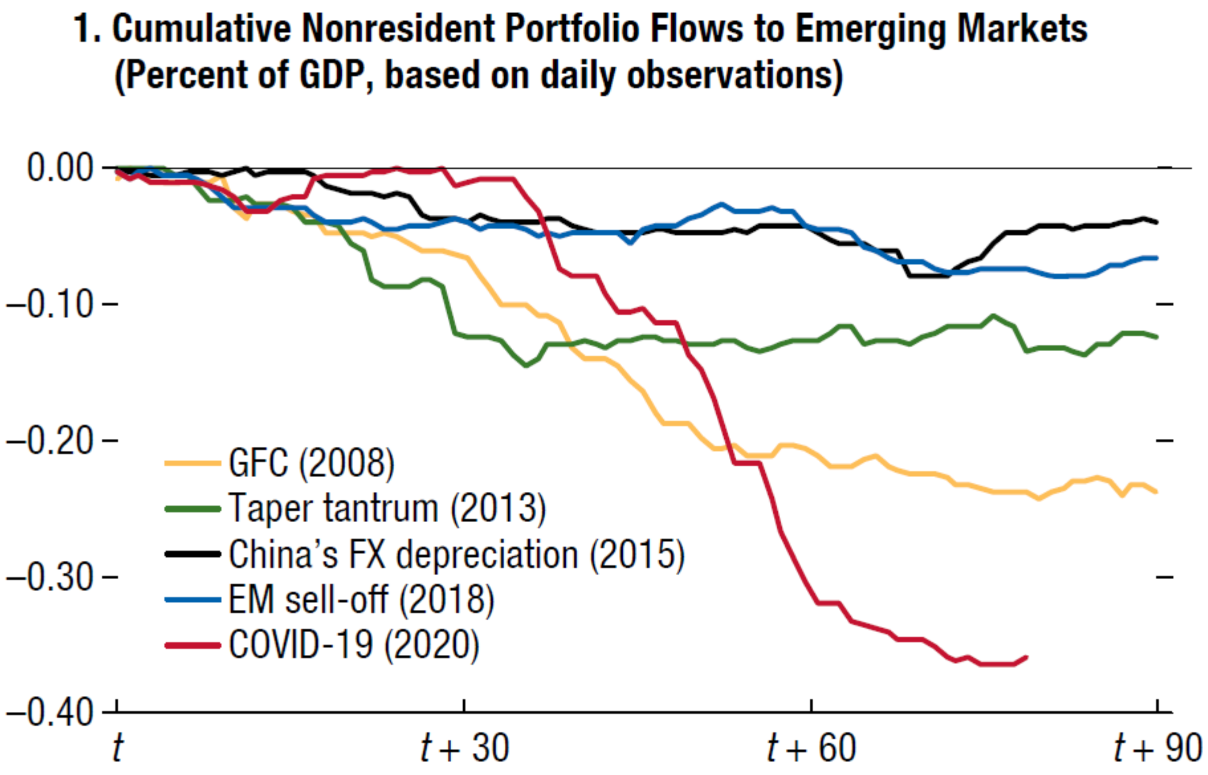
Repo

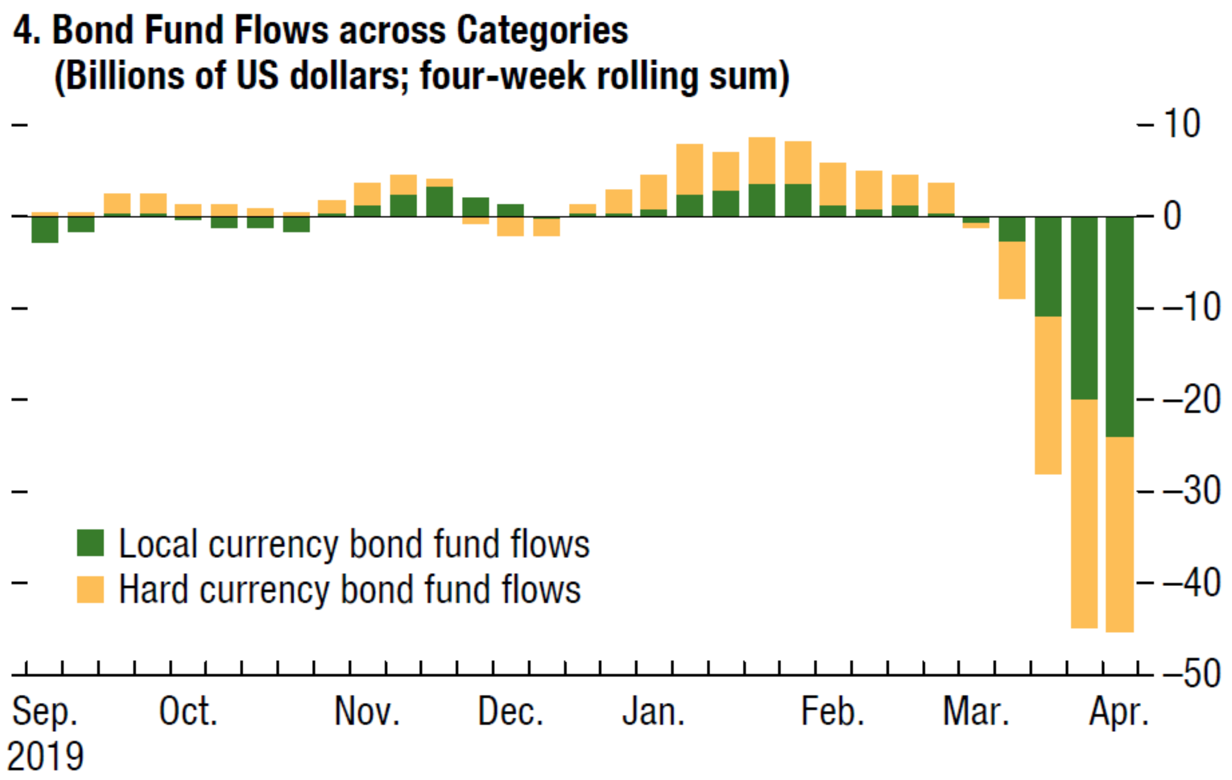
Swaps

Q1: Please mark the 2 most important financial markets in your economy

- Interbank market
- Government securities market
- Private debt securities market
- Bank’s credit market
- FX spot market
- FX derivative markets
- FX funding markets

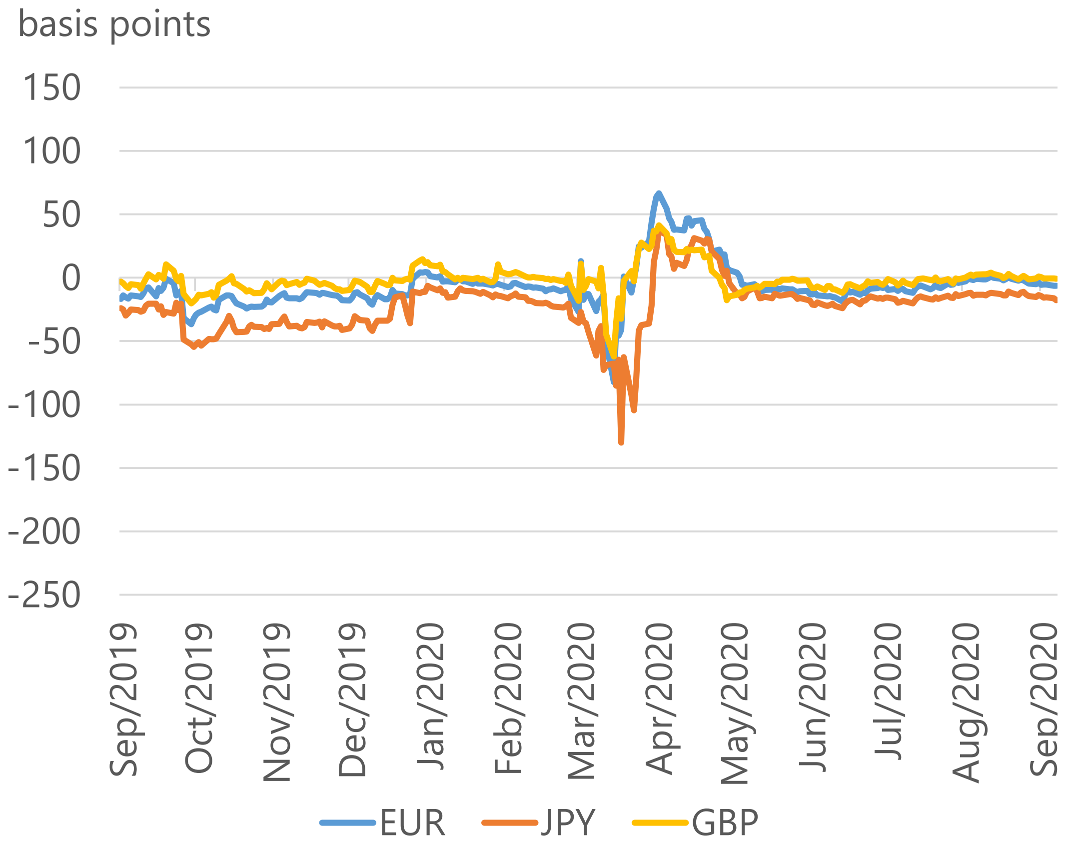
Portfolio Flows to Emerging Markets

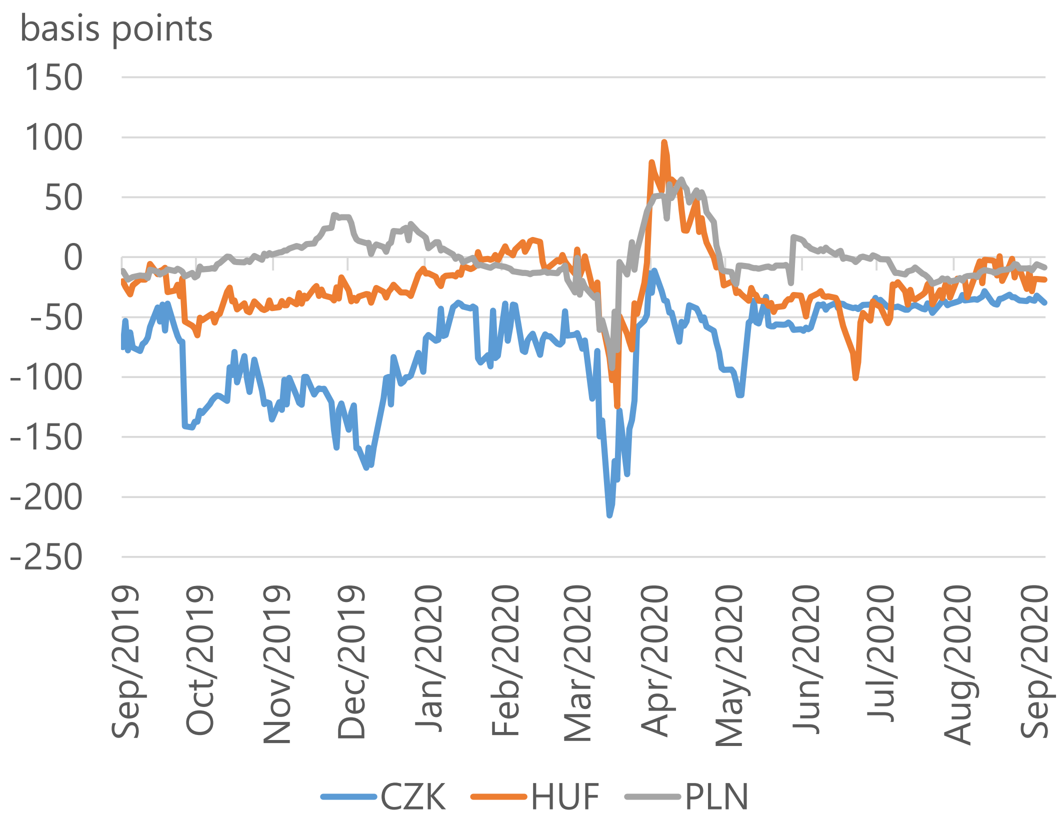




Sources: Bloomberg Finance L.P.; EPFR Global; Haver Analytics; Institute of International Finance; and IMF staff calculations.

Three-month FX swap basis against the US dollar





Sources: Haver Analytics, Bloomberg Finance L.P., and IMF staff calculations.

Triggers for Interventions

There should be a clear understanding when to intervene.

The triggers should help identify conditions in which market liquidity has deteriorated substantially relative to normal conditions.

The triggers may be linked to indicators that are either price-based or quantity-based.

Price-based indicators: day-to-day volatility, bid/ask spreads, and spreads vis-à-vis a risk-free rates.

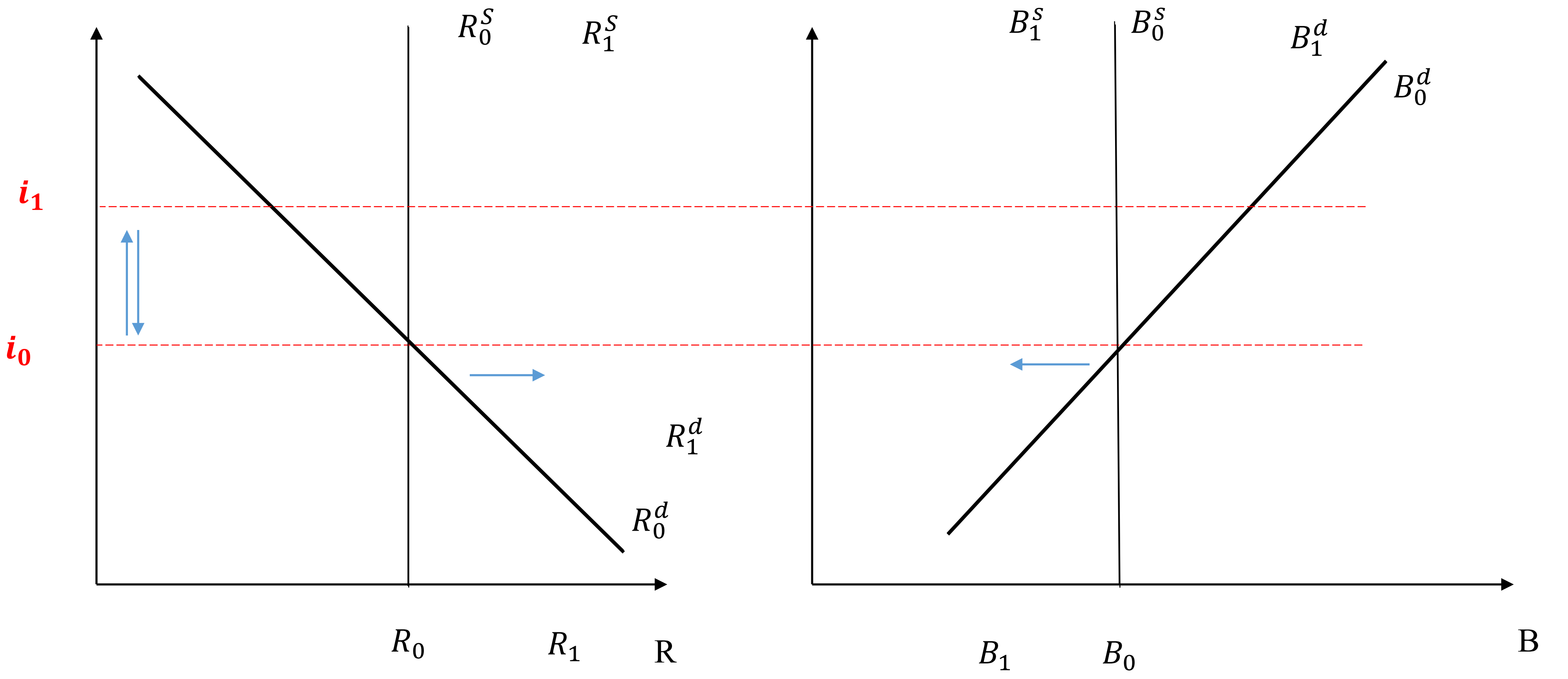
Volume-based indicators: order book depth, turnover, ratio of the change in price to the change in volume, demand for the central bank refinancing operations

The indicators signal distress when the measure moves sufficiently far into the tail of the distribution. Historic data or VaR model could be used.

Q2: Please mark the 2-3 most relevant market stress indicators by order of relevance in your economy

- Intra-day price change
- day-to-day price changes
- Conditional volatility
- Spreads (bid/ask, credit,…)
- Order flows/books
- Traded volume
- News flow

The impact of increasing precautionary demand for reserves



How to design a market support program?

Interventions transfer two risks

Funding liquidity risk, whereby market participants experience a shortage of funding

Market liquidity risk, trading in assets results in excessive price fluctuations

Key features

maximize positive spillovers

minimize the risk transfers, moral hazard, and excessive recourse

contain an exit strategy, self liquidate

Program types

Price-based programs

Quantity-based programs

Operational considerations

Collateral framework

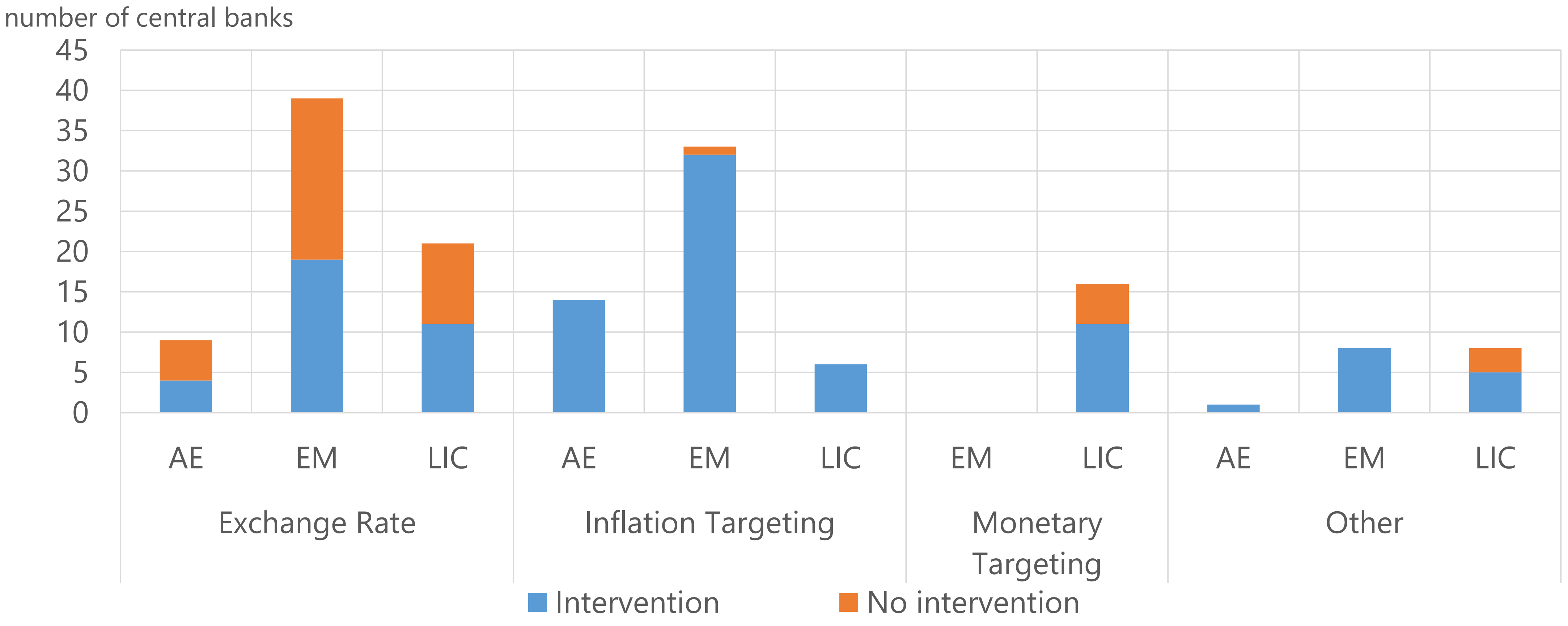
Eligible counterparties

Q3: Please mark the 2 most important objectives by the perceived order of priority during the last few months

- easing stress in short-term funding markets
- easing stress in longer-term funding markets
- easing stress in securities markets
- easing stress in FX spot or forward markets
- easing stress in FX funding markets
- none

Central Bank Interventions Data

Central banks' activity by income groups and monetary policy frameworks



Central Bank Interventions Data

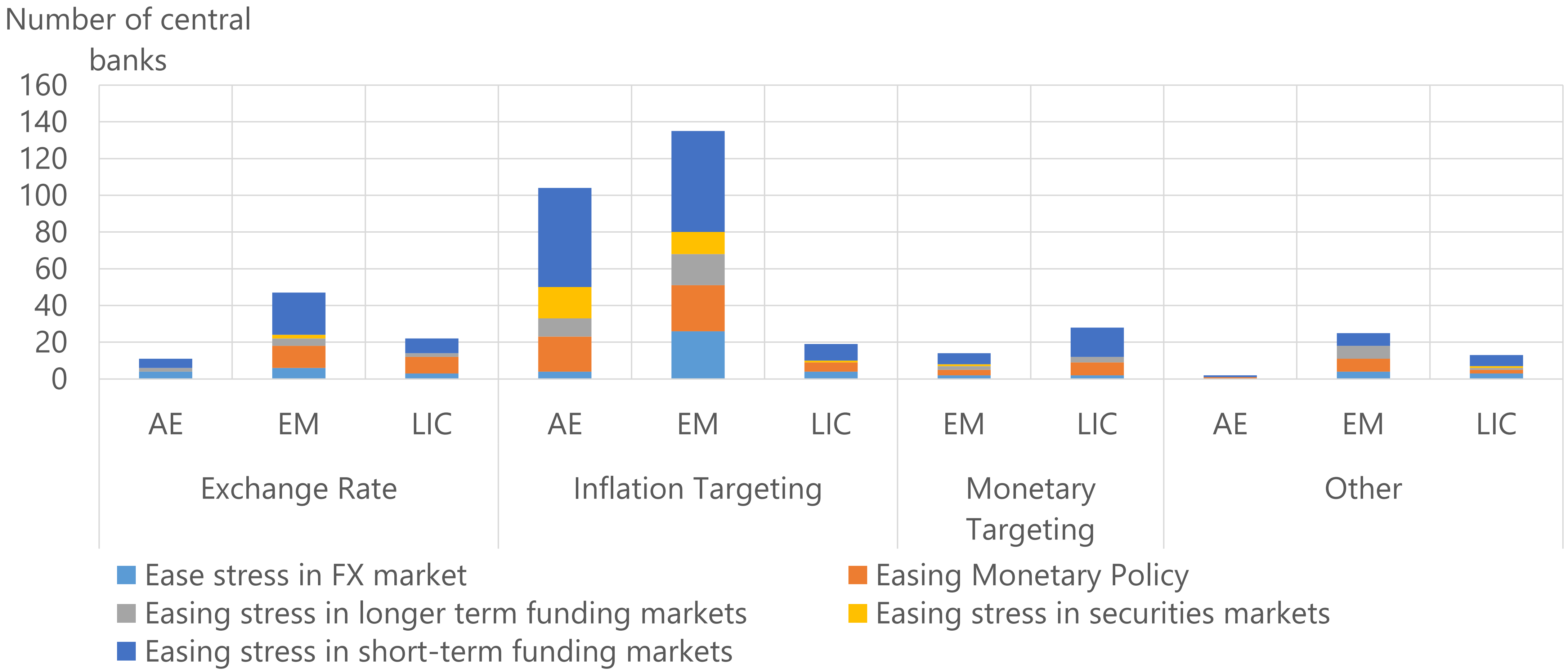
Interventions are more frequent in inflation targeting advanced economies.

Why?

- More disintermediated markets which increase the number of important markets
- More interconnected markets which increase contagion risk
- Less ground for negative spillovers; e.g., impact of domestic liquidity injection on FX market

Central Bank Interventions Data

Intervention objectives by central banks' monetary policy frameworks and income groups



Central Bank Interventions Data

The most frequent intervention concerns short-term funding markets, mainly for intermediaries, due to financial stability concerns.

Frequent intervention in FX markets in EMs due to capital outflows

Relatively less frequent intervention in long-term funding market and securities market in EM/LIC than in AE

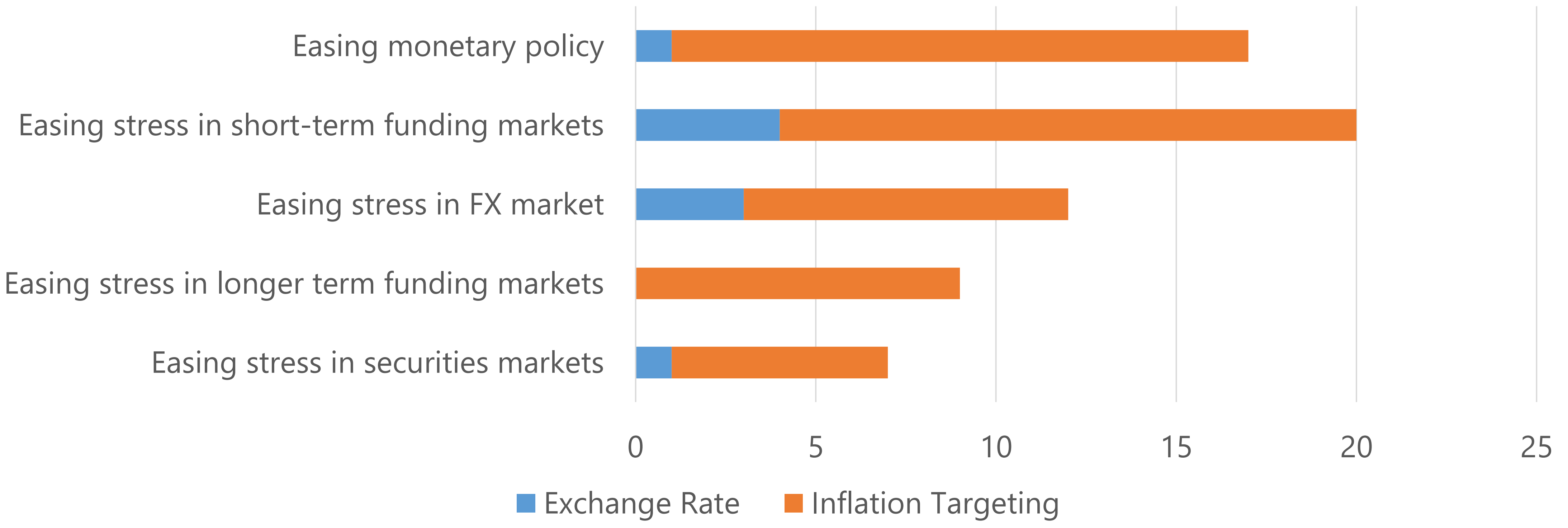
Increased interventions in derivatives market (floating arrangement)

Frequent intervention in funding markets both in AEs and EMs.

But increased popularity of funding for lending scheme in EM/LIC

Central Bank Interventions Data

Intervention objectives by EUR central banks



Interventions by Select Central and Eastern European Central Banks

	Easing monetary policy	Easing stress in short-term funding markets	Ease stress in FX market	Easing stress in securities markets	Easing stress in longer term funding markets
Albania	X		X		
Bulgaria		X	X		
Croatia		X	X	X	
Czech Republic	X	X			
Hungary	X	X		X	X
Moldova	X	X			
North Macedonia	X	X	X		
Poland	X	X			X
Romania	X	X	X	X	
Russia	X	X	X		X
Serbia	X	X	X		
Turkey	X	X			
Ukraine	X	X			X

References

- IMF COVID-19 Policy Tracker
- IMF Special Series on COVID-19
  - Monetary and Financial Policy Responses for Emerging Market and Developing Economies
  - Central Bank Support to Financial Markets in the Coronavirus Pandemic
  - Expanding the Central Bank's Collateral Framework in Times of Stress