Central Bank Support for Financial Markets

Central Bank Operations Division
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

1. Cumulative Nonresident Portfolio Flows to Emerging Markets
(Percents of GDP, based on daily observations)

4. Bond Fund Flows across Categories
(Billions of US dollars; four-week rolling sum)

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

<table>
<thead>
<tr>
<th>Income Group</th>
<th>Exchange Rate</th>
<th>Inflation Targeting</th>
<th>Monetary Targeting</th>
<th>Other</th>
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- **AE**: Advanced Economies
- **EM**: Emerging Markets
- **LIC**: Low Income Countries

Legend:
- **Intervention**
- **No intervention**
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

Number of central banks

- Exchange Rate
  - AE
  - EM
  - LIC

- Inflation Targeting
  - AE
  - EM
  - LIC

- Monetary Targeting
  - EM
  - LIC

- Other
  - AE
  - EM
  - LIC

Ease stress in FX market
Easing stress in longer term funding markets
Easing stress in short-term funding markets
Easing Monetary Policy
Easing stress in securities markets
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
- Increased interventions in derivatives market (floating arrangement)
- Frequent intervention in funding markets both in AEs and EMs.
- Relatively less frequent intervention in long-term funding market and securities market in EM/LIC than in AE
- But increased popularity of funding for lending scheme in EM/LIC
Central Bank Interventions Data

**Intervention objectives by EUR central banks**

- Easing monetary policy
- Easing stress in short-term funding markets
- Easing stress in FX market
- Easing stress in longer term funding markets
- Easing stress in securities markets

Exchange Rate | Inflation Targeting
## Interventions by Select Central and Eastern European Central Banks

<table>
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<th>Ease stress in FX market</th>
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References

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  • Central Bank Support to Financial Markets in the Coronavirus Pandemic
  • Expanding the Central Bank's Collateral Framework in Times of Stress