Regulating Financial Markets

England

AUTHORS

REFERENCES

In section 4 summarises the results graphically by showing the differences in the average dollar bond and the average non-dollar bond for swap line countries. The swap rate cut likely contributed to an increase in dollar denominated assets. To test the second, Figure 5 shows the purchase of dollar denominated assets relative to other banks and to other recipients of swap lines. This increase in dollar purchases is consistent with the findings of other studies on the effects of swap lines.

CONCLUSION

The swap line therefore places a ceiling on CIP deviations. This aligns with the theory and evidence supporting the role of swap lines in the global economy. As a more direct test, consider CIP deviations before and after the swap line rate change. The evidence approach, in the form of histograms. In line with the notion of a ceiling, deviations approach zero with decreasing frequency and are negligible for most of the sample.

As a more direct test, consider CIP deviations before and after the swap line rate change. The evidence approach, in the form of histograms. In line with the notion of a ceiling, deviations approach zero with decreasing frequency and are negligible for most of the sample. The ceiling holds well. The only exceptions are around year-end, when markets are less liquid.

In Figure 2, we examine the macroeconomic effects of policy. Results show that swap lines serve as a substitute for conventional international monetary facilities. The typical features of the swap line are that the Fed gives dollars to the recipient central bank at the rate of the dollar swap line rate, which is below the US Federal Funds rate.

The presence of the sender central bank is the most important part of the global financial architecture. This column analyses their role, from the perspective of central banks, in the transmission of monetary policy, and in the differences in the role of interbank rates and forward rates. And it relies on similar no-arbitrage logic. There are details to monitor, picking the collateral, and enforcing repayment. This division of tasks is done by the sender central bank.

There are alternatives to swap lines. First, major foreign banks are likely to be able to have superior information on their solvency, and so on. Second, the recipient central bank could lend FX reserves. If these are insufficient, the third option is for recipient-country banks to borrow local currency from the sender central bank and engage in currency swaps.

As an example, borrowing in euros and converting the funding into dollars via a private swap line is more expensive than borrowing dollars directly. Further, a swap line gives no additional cost. But CIP broke down with the crisis (Du et al. 2018), so, for example, banks which had become reliant on US money markets needed liquidity assistance.

The Bank of England, and the ECB up to $90 billion through a swap line against their respective local currencies. Federal Reserve dollar lending through its swap line with a novel emergency liquidity facility – the Fed would lend the Bank of Canada, the Bank of Japan, and the Bank of England up to $700 billion.

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