



FEDERAL  
RESERVE  
BANK  
*of* ATLANTA

## Is there an Optimal Implementation Framework?

November 2016

Central Bank Conference Day-Ahead, Nashville

**Paula Tkac, VP and Senior Economist**

The views expressed here are my own and do not necessarily reflect the views of the Federal Reserve Bank of Atlanta or the Federal Reserve System

# Components of a Monetary Policy Implementation Framework



- Balance Sheet – active policies and financial stability
- Policy Rate/Target Rate – unsecured v. secured
- Operating Regime – flat v. steep portion of the reserve demand curve
- Liquidity provision – separation from or integration into operating regime

## Subject to Normalization Principles (Sept. 2014)

- Holding no more securities than necessary to implement monetary policy efficiently and effectively.
- The assets held by the FRS will consist mainly of US Treasury Securities.



# Assessing the Options

## Framework Objectives



- I. Achieving appropriate control over short-term interest rates including during periods of financial distress and in a manner robust to structural changes in the financial system.
- II. Enhancing the ability of the FRS to achieve macroeconomic and financial stability objectives at the zero bound.
- III. Supporting the System's ability to address liquidity strains in money markets and support overall financial stability.
- IV. Reduce burdens and deadweight losses associated with reserve requirements.
- V. Promote efficient, active and resilient money markets and government securities markets.
- VI. Promote and efficient and resilient payment system.

# Assessing Alternative Policy Rates

## Choices and Criteria



### Choices

- Market Rates
  - Unsecured: Fed Funds Rate and Overnight Bank Funding Rate
  - Secured: GC Treasury Repo Rate
- Administered Rates
  - Interest on Reserves
  - ON RRP offering rate

### Criteria

Controllability

Transmission

Robustness

Clarity

# Is there an Optimal Policy Rate Choice?

No



- Staff are confident control can be achieved with either unsecured or secured rates
- US money market rates are highly correlated + Foreign experience suggests transmission is good with market or administered rates
- Changes in business models and regulations may change patterns of interconnectedness
  - GLIR
  - Administered Rates
- Clarity of communication involves intentions and response functions

- Ceiling – standing lending facility
- Floor – deposit facility or interest on reserves
- Discretionary open market operations – move the supply curve
- Level of reserves and use of voluntary or mandatory reserve targets – shape the demand curve for reserves

# Operating Regime – Case 1 (Current)



Case 1  
Unsecured or IOER rate /  
Flat portion of reserve demand curve

Case 2  
Unsecured or IORR rate /  
Steep portion of reserve demand curve

Case 3  
Repo Rate

- Floor tools would be particularly important
- Ceiling tools could be useful to contain rate volatility
- Reserve requirements would be unnecessary
- What is the appropriate level of reserves?

Details:

FFR or OBFR?

Political economy concerns with IOER/ON RRP spread

## Assessment:

Sufficient Control  
Liquidity easy since  
reserves unrelated to rate  
control

Can eliminate DW  
loss of reserve  
requirements

Supports active  
money markets

Supports early  
payment settlement



# Operating Regime – Case 2 (pre-Crisis)

Case 1  
Unsecured or IOER rate /  
Flat portion of reserve demand curve

Case 2  
Unsecured or IORR rate /  
Steep portion of reserve demand curve

Case 3  
Repo Rate

- Key tool is reserve requirements, either mandatory or voluntary
- Discretionary OMOs would play an important role in offsetting volatile autonomous factors
- Ceiling and floor tools help limit the volatility of interest rates

## Details:

FF market would likely return but could disappear again at ZLB

DIRF and FIRF as ceiling tools

Could eliminate need for ON RRP

## Assessment

Sufficient control  
with OMO

Tools needed to  
sterilize liquidity or  
transition to Case 1

VRT reduces  
DWL

Support money  
market activity

Support payment  
activity with VRT





# Operating Regime – Case 3 (repo)

Case 1  
Unsecured or IOER rate /  
Flat portion of reserve demand curve

Case 2  
Unsecured or IORR rate /  
Steep portion of reserve demand curve

Case 3  
Repo Rate

- Key tools are ceiling and floor: ON RP and ON RRP facilities
- Level of reserve balances may impact unsecured rates volatility
- Reserve requirements and discretionary OMOs may not be necessary
- Counterparties and parameter settings of the facilities could affect interest rate control

## Assessment:

Can target successfully but may require large/frequent ops

Ample provision of liquidity with ON RRP  
Can eliminate DWL  
Supports money market activity broadly  
Supports payment system efficiency



# Overall Assessment

## Comparing Cases 1-3



- All likely achieve rate control
  - Case 2 requires OMO and FF market comes back
  - Cases 1 and 3, FF market vulnerable
- Providing liquidity is easy in Case 1 and Case 3 (if large reserves)
  - Case 2 requires sterilization, as does Case 3 if scarce reserves
  - Transition to ZLB/flat portion would require restart of RRP facility if decommissioned
- Cases 1 and 3 can operate w/o reserve requirements, Case 2 would use VRT
- All cases support money markets
- All frameworks have sufficient reserves to support payment efficiency

- Governance: BoG has authority over IOER, FOMC over ON RRP
- Political economy considerations: counterparties and interest on reserves
- Are expanded counterparties needed? Frictions may be high in times of stress
- Liquidity provision tools:
  - Full integration
  - Conditional
  - Inactive
  - Counterparties and Collateral: moral hazard and liquidity transformation