A Discussion of **"Monetary Policy Transmission in Segmented Markets"**

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Overview

- This paper shows that banks have market power (*bargaining power*) using European OTC specific-collateral (SC) repo data. This market power affects monetary policy transmissions.
- New facts about the OTC repo market that suggests dealer market power.
- A stylized model with two main testable predictions confirmed in the data:
  - Higher rate dispersion in OTC repo is correlated with low monetary policy sensitivity.
  - For OTC customers with higher borrowing rate (or lower lending rate), the repo rate is less sensitive to monetary policy.
- Counterfactual analysis of introducing a reverse repo facility.

Repo Market Structure – Core-Peripheral Network

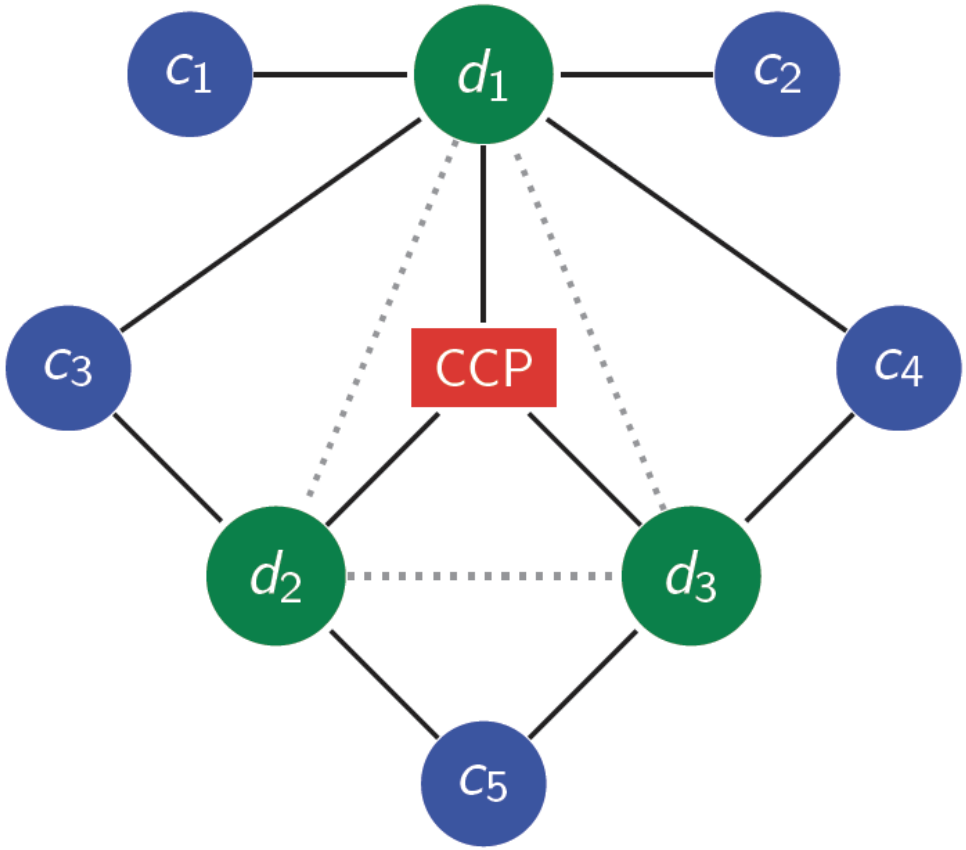
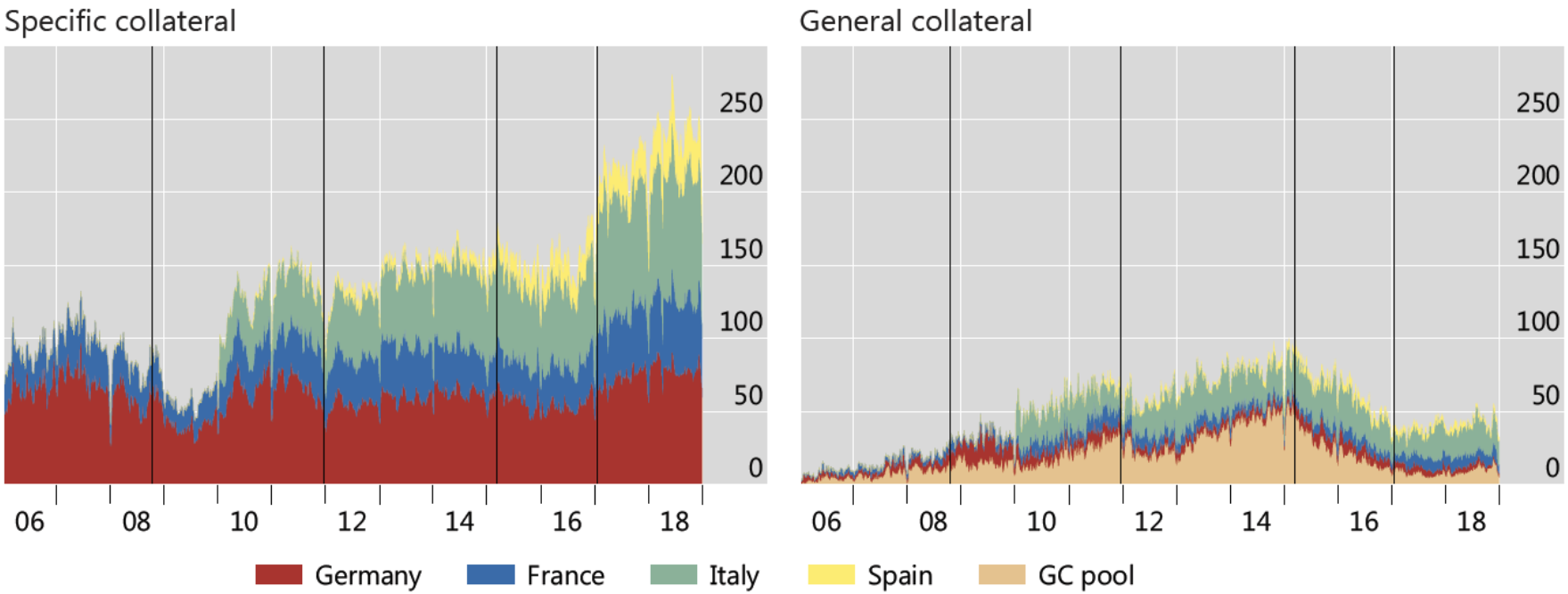


Figure from Duffie, D. (2020). Still the Worlds Safe Haven?. Redesigning the US Treasury market after the COVID-19 crisis, Hutchins Center on Fiscal and Monetary Policy at Brookings.

Types of Repo: GC and SC

- GC: general collateral. Mainly for financing, e.g., dealer financing from MMF.
- SC: specific collateral. Mainly for the underlying security, e.g., shorting the asset.
- This paper: focus on the SC segment.

Turnover,[1] in billions of euros — Graph 1



Source: Schaffner, Ranaldo, and Tsatsaronis (2019). Euro repo market functioning: collateral is king. BIS Quarterly Review.

Facts Indicating Market Power

- The median repo customer in the OTC market trades with only one dealer.
- Dealers obtain net interest margins in the OTC market: borrow rate $<$ lending rate
- After accounting for collateral and loan features, there is still about 6 bps standard deviation in repo rate residual, among the total deviation around 10 bps.
- ...

Two Forms of Market Power

- Dealer-client bargaining for each trade (this paper)
  - Key feature: both dealers and clients are determinants of markups. We expect the client-side to explain more variations due to its large number.
- Dealers leveraging market power in each security segment accounting for aggregate demand.
  - Key feature: only the dealer determines the markup.
- Q: In the data, after accounting for loan characteristics, what is the relative explanatory power of dealer v.s. client fixed effects?

Model and Empirical Tests

- The main model features an equation from Nash bargaining between dealer i and client j for a given security k,

$$r_{i,j,k} = \underbrace{(1-\theta_{i,j})}_{\text{customer's power}} \cdot r_{CCP} + \underbrace{\theta_{i,j}}_{\text{dealer's power}} \cdot v_{j,k}$$

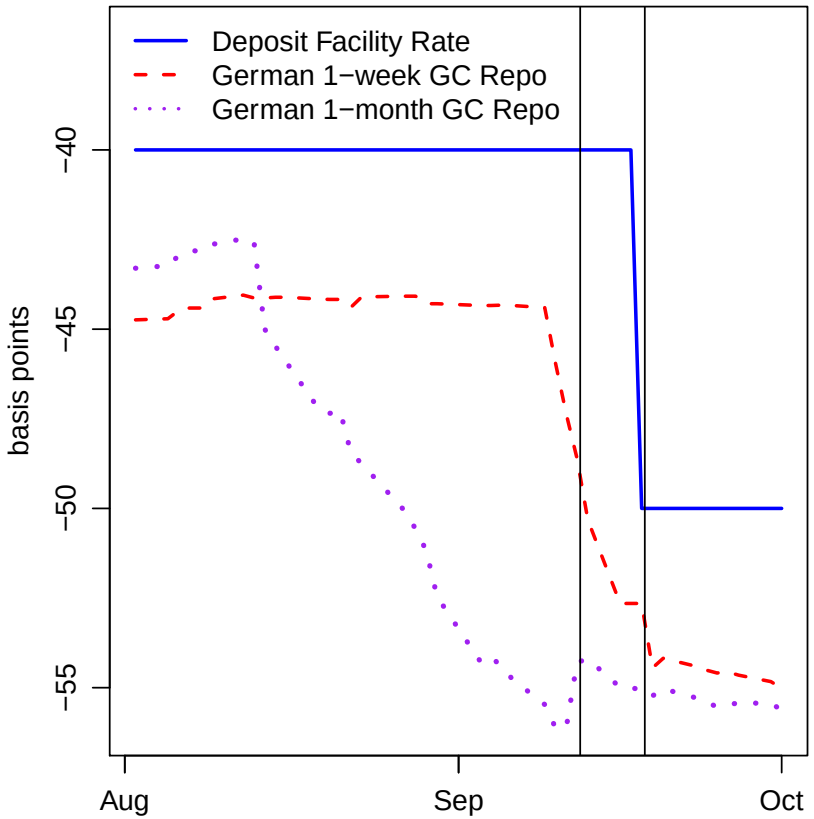
- **Prediction**: Conditional on larger dealer market power, there is higher cross-section dispersion of $r_{i,j,k}$ and less rate sensitivity $\partial r_{i,j,k}/\partial r_{CCP}$.
- Mapping to the empirics
  - Current approach: Measure the dispersion at security level.
  - What if we measure it at client/dealer level? Need the variation mainly coming from $v_{j,k}$, not $\theta_{i,j}$.
  - Why restricting the analysis at the SC market? Dealers in the OTC segment of GC market likely also have powers and it is a cleaner set up.

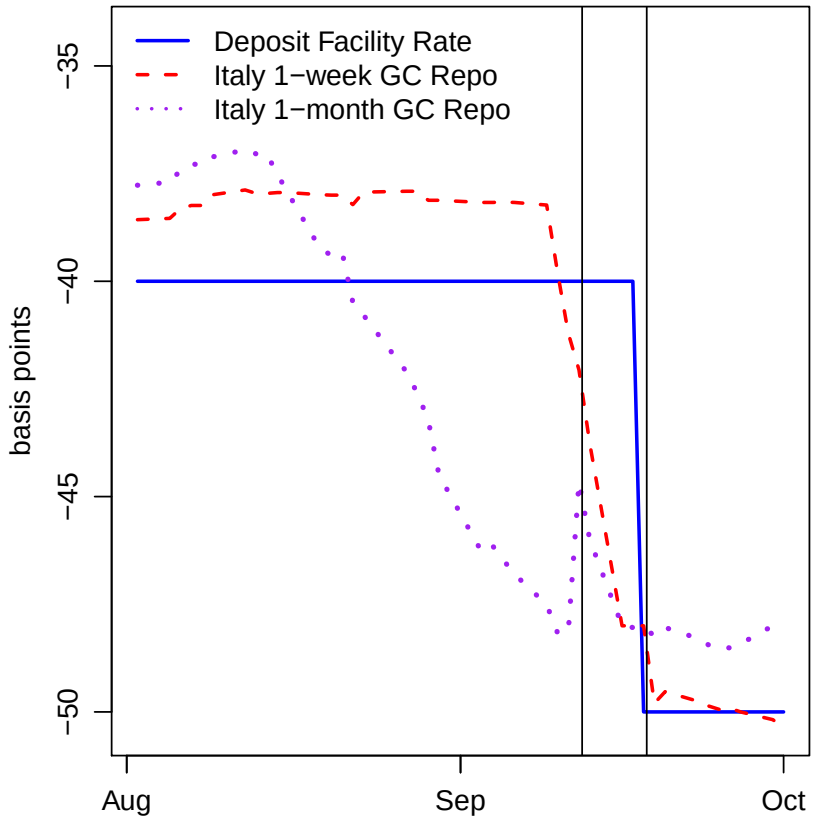
General Comments: Market Power and Monetary Policy Transmission

- How to extract market power in asset prices? Key confounding factors:
  - Risk premium. Different securities can have different risk premium, and different institutions may charge different risk premium for the same asset. – Add country fixed effects.
  - Balance sheet costs: asset transactions involve balance sheet costs, heterogeneous mainly across banks. – Add bank fixed effects.
- How to analyze monetary policy transmissions?
  - Anticipation effects v.s. monetary policy shocks.
  - Term structure and rate sensitivity.

ECB Deposit Facility Rate Cut in 2019 and Repo Rates

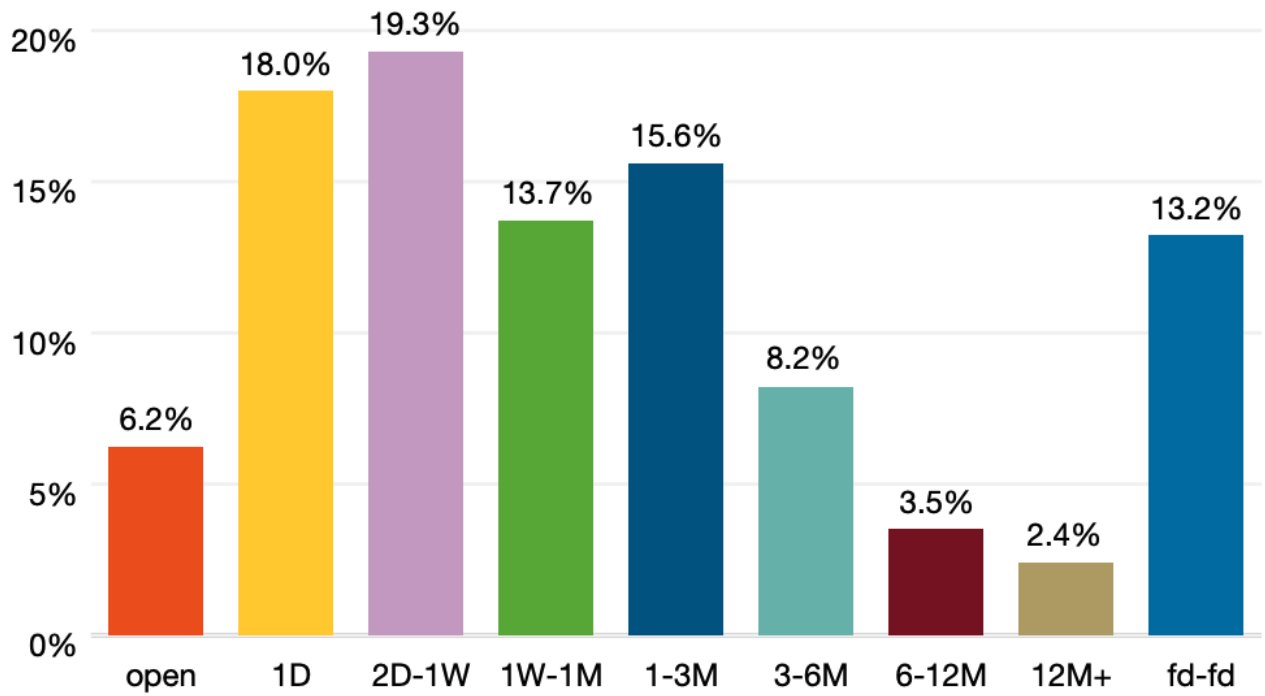
- The market well anticipated the 2019 monetary policy change by weeks.
- Suggestion: use Euribor interest-rate futures to extract the surprise component. Potentially more events than the 2019 rate cut, because no change during ECB council meeting could also be a surprise.





Maturity Heterogeneity

- Longer-maturity repos might have larger loan-rate dispersion and weaker policy pass throughs, confounding the prediction 1 in the paper.



Source: European Repo Market Survey 2021

Maturity and the Monetary Policy Passthrough Measure

- With U.S. repo data and FFR surprises around FOMC dates, I find that monetary policy passthrough declines with maturity.

	Dependent Variable: +7 Day Change in Repo Rates of Maturity at					
	1 week	2 weeks	1 month	3 months	6 months	12 months
	(1)	(2)	(3)	(4)	(5)	(6)
FFR Surprise	1.06***	0.90***	0.96***	0.84***	0.65***	0.49***
	(0.16)	(0.16)	(0.16)	(0.07)	(0.07)	(0.08)
Observations	177	177	177	177	177	177
R^2	0.20	0.16	0.18	0.49	0.36	0.18

Notes: *p<0.1; **p<0.05; ***p<0.01. FFR surprises are the differences between the total changes of FFR one day before and after the FOMC dates, minus the expected component extracted from the FF futures market following Kuttner (2001).

Summary

- A great paper with new facts and evidence on dealer market power and monetary policy transmission in the European repo market.
- Potential improvement on (1) exploring the type of market power; (2) adding country + bank fixed effects and maturity controls throughout specifications; (3) use monetary policy surprises.