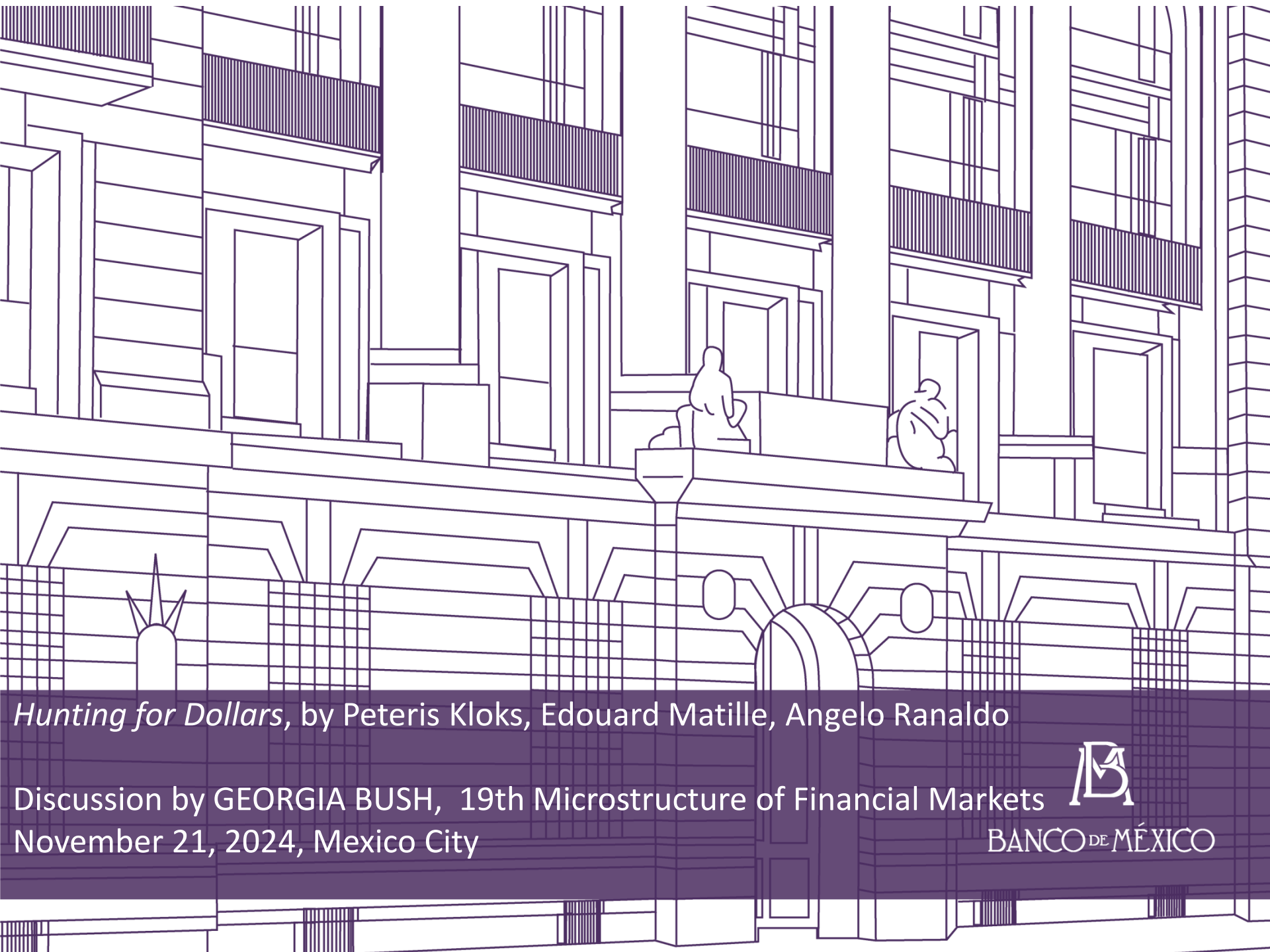




Hunting for Dollars, by Peteris Kloks, Edouard Matille, Angelo Ranaldo

Discussion by GEORGIA BUSH, 19th Microstructure of Financial Markets
November 21, 2024, Mexico City



BANCO DE MÉXICO

Summary

Builds on literature on

- regulatory constraints affecting dealer banks,
- the end-quarter surges in FX swap volume and
- deviations from CIP

Data for two “markets”

- Terrific FX swap data from CLS
- US tri-party repo
- European repo

The Mexican peso part of CLS since May 2008. The central bank participates in the CLS oversight committee comprising the central banks of issue of the 17 CLS participating currencies, with the Federal Reserve Bank of New York as lead overseer.

2018 Banco Monex, first Mexican bank joined.



Summary

A number of empirical exercises:

- document period-end surges in FX swaps;
- European banks more than UK banks;
- European banks exit US tri-party repo but not European repo
- regression analysis/granular IV to show non-US banks flows affect cross-currency basis

Contribution:

- CLS data analyzed by “Nationality” framework versus locational
- Evidence that European G-SIBS substitute FX swaps for US repo at end-quarter, linking these two markets

Two main comments: 1) CLS data part, 2) motivation and exposition/weaving together

CLS includes 18 currencies

 Australia	AUD	 New Zealand	NZD
 Canada	CAD	 Norway	NOK
 Denmark	DKK	 Singapore	SGD
 Eurozone	EUR	 South Africa	ZAR
 Hong Kong	HKD	 South Korea	KRW
 Hungary	HUF	 Sweden	SEK
 Israel	ILS	 Switzerland	CHF
 Japan	JPY	 United Kingdom	GBP
 Mexico	MXN	 United States	USD

18 currencies to 6 regions, n institution types to 2

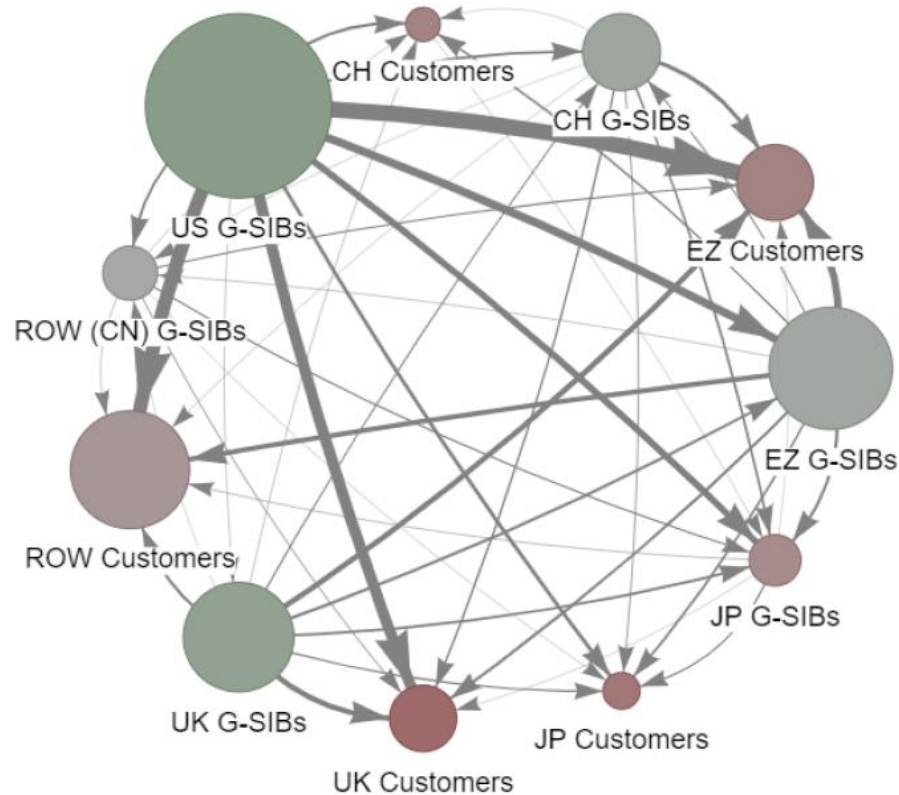


Fig. 1: The edges of the network show absolute net US dollar positions when considering participants' domestic currency pairs. The nodes' color represents the extent to which they are an overall dollar lender (green) or borrower (red) in their domestic currency pairs. Size of the nodes is determined by participants' trading volume in all dollar pairs. The plot is based on daily average positions and volumes for the 2012-2022 period.

Comment 1: data choices link to hypotheses

Suggest tightening the link between the paper's hypothesis and the categorization, hard to follow the logic of nationalities and institution types (6 "regions", 2 types: GSIBs and "customers"=banks and non-banks)

Classifying "nationality" vs "locational" view is not novel

- BIS banking statistics are available on a consolidated and locational view
Supervisors and policymakers consider Home-Host issues, definition of GSIB depends on cross-jurisdictional activity
- Post GFC, some countries have changed their rules to only allow subsidiaries, requiring consolidated accounts in the Host country (and other ring-fencing)

Example: Santander is a GSIB for Europe, Mexico sub is?

If the hypothesis is about European G-SIBs

-because they are market makers in Euros, and

-because their deposit base is in Euros,

-because GSIBs have higher regulatory requirements,

then emphasize this is driving your nationality definitions/institution categories

Paper focuses on two regs/market structure details

- 1) End-period reporting in Europe versus averages in US and UK
 - repo is included in the Leverage Ratio calculations, but not FX swaps, therefore European reporting banks can change repo positions at end periods and generate a lower Leverage Ratio
- 2) Centralized clearing in European money market, versus NCCBR in US
 - \$4.5 trillion per day, only about \$1 trillion centrally cleared in US, therefore netting more complex in US market while central clearing reduces liquidity requirements in European repo

If US repo becomes entirely centrally cleared and netting improves OR if Eurozone shifts to average reporting, will the European G-SIBs end-quarter rush to FX swaps disappear?

How do the two different market characteristics interact (amplifying?) to affect the end-period dynamics? Is it necessary to have both?

For financial stability, window dressing is bad

Normal seasonal declines in activity versus decline to “appear safer”, the latter is “window dressing”

Bank perspective: mismeasurement of risk → systemic and at the bank level

- Misleading, mismeasurement of individual bank risk and thus inappropriate capital allocation
- Contribute to systemic risk because GSIBs categorizations are relative, so window-dressing by one bank can affect others bucket assignments

Market perspective: reduced participation in a given market → liquidity problems

- Liquidity shortage can arise, marring market functioning
- Amplification of shocks during period end

Of course for banks, allows more risk taking and potential profits

G-SIBs Nov. 2023 list, by buckets 5 through 1, according to required additional capital buffers

5 (3.5%)	(Empty)
4 (2.5%)	JP Morgan Chase
3 (2.0%)	Bank of America Citigroup HSBC
2 (1.5%)	Agricultural Bank of China Bank of China Barclays BNP Paribas China Construction Bank Deutsche Bank Goldman Sachs Industrial and Commercial Bank of China Mitsubishi UFJ FG UBS

1 (1.0%)	Bank of Communications (BoCom) Bank of New York Mellon Groupe BPCE Groupe Crédit Agricole ING Mizuho FG Morgan Stanley Royal Bank of Canada Santander Société Générale Standard Chartered State Street Sumitomo Mitsui FG Toronto Dominion Wells Fargo
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Comment 2: link to the policy debates

Unintended consequences of Basel III are always top of mind, suggest tighten the motivation and link to the policy debates

1) risk-weight based **capital requirements** versus overall balance sheet based measures, and reporting frequency

...ECB Macroprudential Bulletin, October 2, 2018 (removing repo from leverage ratio), Dec. 6, 2023 (policies to address window-dressing in G-SIBs), BCBS consultation March-June 2024.

2) moves to **central clearing** to better manage counterparty risk, and netting to better manage liquidity (eg. CLS = Herstatt Risk)

...SEC extensive consultation in 2023, finalized deadline for central clearing of US treasury securities, repo June 2026, by end March 2025 covered CCPs to meet interim requirements. (Nellie Liang speech Nov 18, 2024)

Other comments...

- Write one research question/hypothesis and state it up front, then your method for testing it, then your evidence, right now it is like a treasure hunt
- streamline/adjust the literature review to better highlight contribution
- clarify/use consistent groupings/labels to help the reader keep it clear (dealer-banks or GSIBs?)
- Figure 1, I found the description confusing, could benefit from more exposition to match directly to the hypotheses; “based on daily average” means average of daily averages over the 10 year sample period?
- Table 2 statistics quite interesting, wondering if any time variation
- was not entirely sure why year end was excluded from analysis since evidence of window dressing extensive for year-end reporting as well
- European banks are choosing this behavior, and the quarter-end requirement gives them an advantage the rest of the quarter, the language reads as if they are desperately searching for dollars, whereas their profits during the quarter may offset the expected end-quarter price effect, (and thus their constraint is state dependent)

This paper European GSIBs, next papers...further exploit data on all 18 currencies...?

CLS has 18 central banks (issuers of the 18 currencies, plus 5 Eurosystem banks (Belgium, France, Germany, Italy, Netherlands), data back to 2002? Set up by consortium of banks in NYC, Mexico became a member in 2008

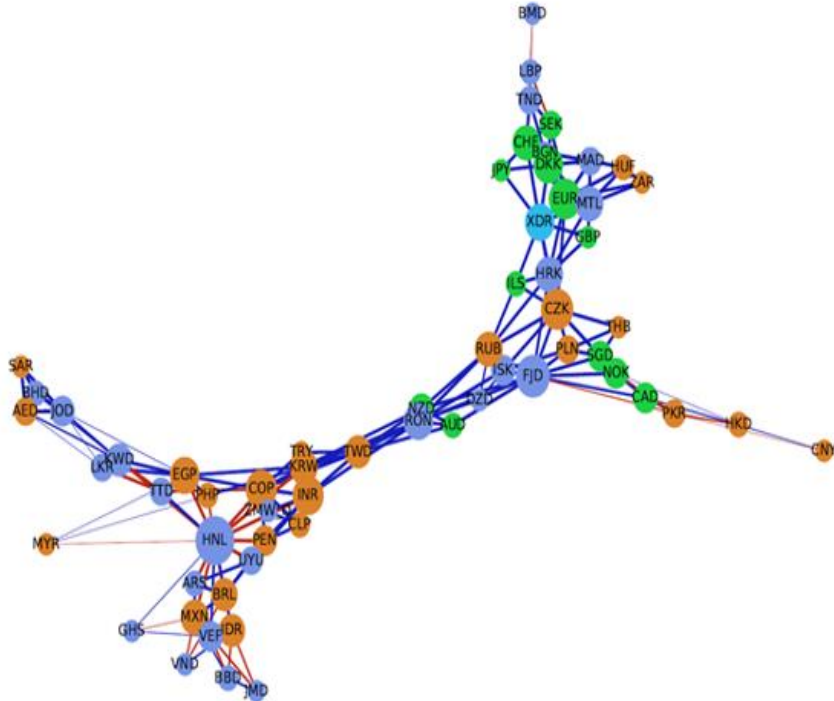
-international macro and policy questions around financial geography, eg. capital flows and tax regs on non-financial firms, on NBFIs, degree of financial integration, understanding/defining systemic risk, policy coordination and jurisdiction, emerging markets and developed markets

Perhaps deploy graphs, network analysis tools such as

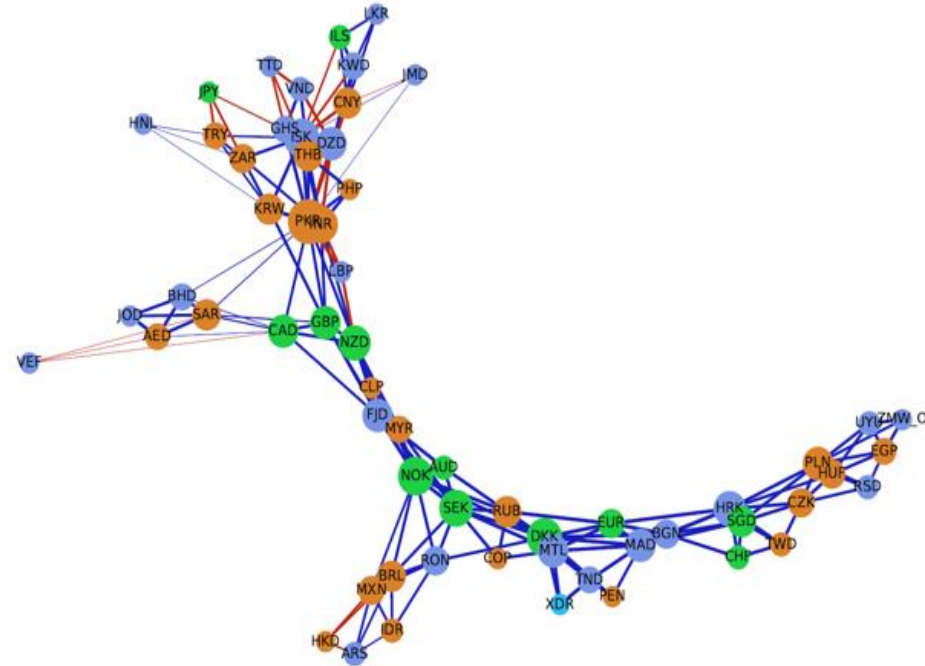
- Centrality measures, filtering techniques,
- multilayered networks (nationality, markets, institution types)

Exchange rates, 2 dates of a dynamic network

Pre crisis, July 13, 2005



Start of crisis in US, October 15, 2008

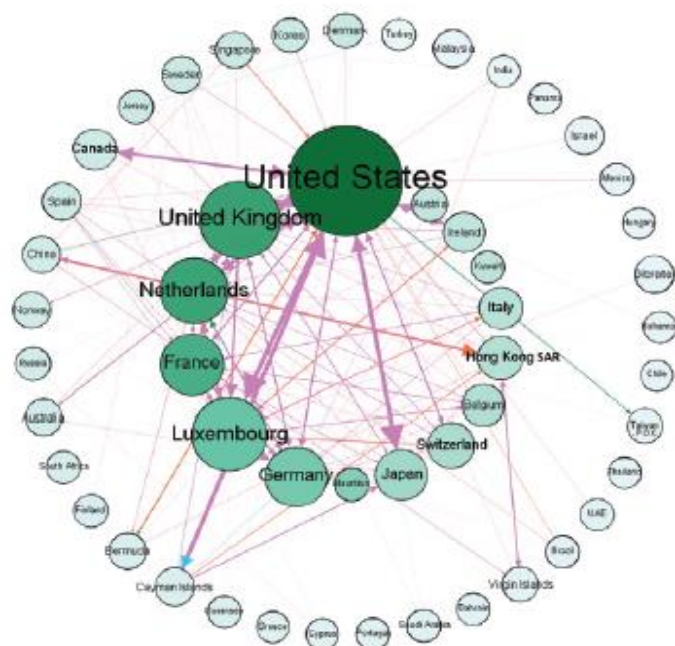


Source: Bush, G., Martínez-Jaramillo, S., Escobar-Farfán, L. O. L., & Flores-Tamés, E. (2023). "Chapter 5: Currency relationships over time: a network analysis and case study of Mexico".

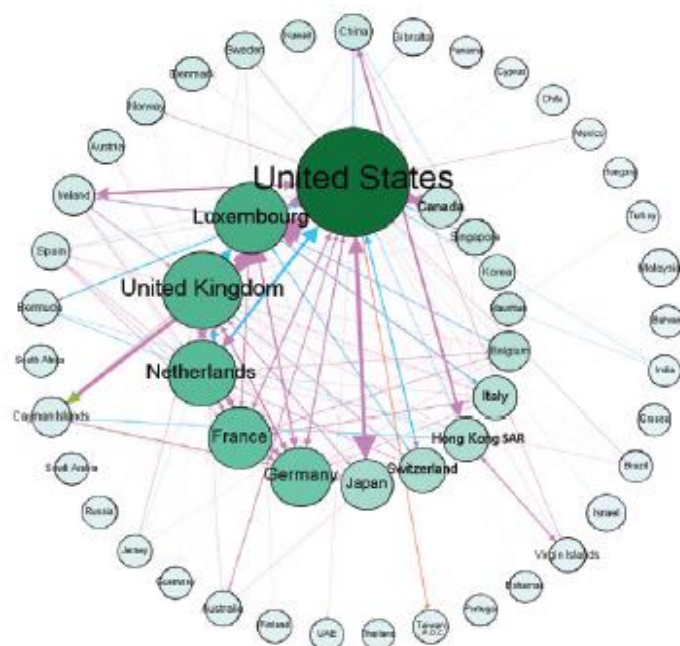
Multiplex network, 5 asset types/layers

Figure 1. Global Financial Network Map

(a) Global Financial Network 2009



(b) Global Financial Network 2015



Source: IMF, BIS, authors' calculations. The node size and color intensity is determined by its PageRank centrality; edge width is defined based on total bilateral claims; the edge color represents the major portion (75%) of total claims (in green for banking; blue for equity; red for debt; and pink for mixed claims' edges (with share of banking, equity, or debt instruments in the total bilateral claims less than 75%).

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