

# Contents

<i>List of Figures</i>	ix
<i>List of Tables</i>	xiv
<i>List of Abbreviations</i>	xv
<b>Introduction and Overview</b>	<b>1</b>
<b>Part I: Monetary Policy Operations in Normal Times</b>	
1. Basic Terminology and Relationship to Monetary Macroeconomics	9
1.1 Key Concepts and Terminology	9
1.2 Dichotomy Between Monetary Macroeconomics and Monetary Policy Implementation in Normal Times	11
2. Representing Monetary Policy Operations in Financial Accounts	15
2.1 Introduction to the Financial Accounts Model	15
2.2 Deposit Shifts between Individual Banks and the Interbank Market	19
2.3 Collateral Constraints	22
2.4 Reserves of Banks with the Central Bank and Required Reserves	23
2.5 Other Autonomous Factors and Types of Monetary Policy Operations	24
2.6 Liquidity Deficit of the Banking System vis-à-vis the Central Bank	28
2.7 Credit Money Created by Banks	30
2.8 The 'Real' Euro Area Financial Accounts	34
3. Operational Target of Monetary Policy	36
3.1 Concept of an Operational Target of Monetary Policy	36
3.2 Short-term Rate as Operational Target of Monetary Policy	38
3.3 Quantity-oriented Operational Targets of Monetary Policy in the Twentieth Century—A Brief History	43
4. Three Basic Techniques to Control Short-term Interest Rates	51
4.1 One-directional Standing Facility-based Monetary Policy Implementation	51
4.2 Symmetric Corridor Approach with Open Market Operations Volume Set by the Central Bank	54
4.3 Full Allotment Open Market Operations within a Corridor Set by Standing Facilities	59

5. Several Liquidity Shocks, Averaging, and the Martingale Property of Overnight Rates	62
5.1 Three Shocks and Three Trading Sessions on One Day	62
5.2 Three-day Reserve Maintenance Period with Averaging	66
6. Standing Facilities and the Interest Rate Corridor	70
6.1 Types of Standing Facilities and History	70
6.2 Optimal Width of the Corridor Set by Standing Facilities in the Symmetric Corridor Approach	73
6.3 Idea of a ‘Target Rate—Limited Access’ (Taralac) Facility	80
7. Open Market Operations in Normal Times	84
7.1 Origins and History	84
7.2 Open Market Operations as Determinants of the Monetary Policy Implementation Approach	86
7.3 Tender Procedure for Credit Open Market Operations	89
7.4 Liquidity-absorbing Open Market Operations	93
8. Reserve Requirements	96
8.1 Introduction	96
8.2 Basic Specifications of Reserve Requirements	97
8.3 Key Functions of Reserve Requirements (Including Historical)	99
9. Collateral	108
9.1 Importance of the Collateral Framework for Monetary Policy Implementation	108
9.2 Logic of Establishing a Collateral Framework	112
9.3 Risk Management Techniques	115
9.4 Market Impact of the Collateral Framework and Collateral as Monetary Policy Instrument	119
9.5 Segregation of Collateral Sets, Adverse Selection in Collateral Use, and Pricing	127
10. Optimal Monetary Policy Operations Frameworks in Normal Times	130
10.1 Hundred Ways to Skin a Cat	130
10.2 Potential Objectives of the Design and Use of the Monetary Policy Implementation Framework	130
10.3 Statements of Central Banks on their Objectives and Principles	133
10.4 Four Examples of Frameworks	135
10.5 Conclusions	140

## **Part II: Monetary Policy Operations in Times of Crisis**

<b>11. The Mechanics of Liquidity Crises</b>	<b>145</b>
11.1 Introduction	145
11.2 Increased Credit Risk, Adverse Selection, and Funding Market Breakdown	147
11.3 Bank Runs and Investor Strikes	153
11.4 Increase of Margin	161
11.5 Asset Liquidity in a Market Maker Model	165
11.6 Asset Fire Sales	167
11.7 Interaction Between Crisis Channels	168
11.8 The Role of the Central Bank: Monetary Policy and LOLR	170
<b>12. Collateral Availability and Monetary Policy</b>	<b>179</b>
12.1 Collateral Scarcity and Effective Term Funding Costs of Banks	180
12.2 Collateral Scarcity, Stigma, and the Control of the Overnight Rate	189
12.3 The Asset Encumbrance Problem	193
12.4 The Bank Run Problem and Central Bank Collateral	197
12.5 Securities Lending Programmes by Central Banks	200
<b>13. Open Market Operations and Standing Facilities</b>	<b>203</b>
13.1 The Use and Width of the Standing Facilities Corridor	203
13.2 Adjusting Credit Open Market Operations	215
13.3 Outright Purchase Programmes	219
13.4 Dangers of Too Accommodating Policies	228
Annex: Central Bank Balance Sheets during the Crisis	230
<b>14. The Central Bank as Lender of Last Resort (LOLR)</b>	<b>235</b>
14.1 The Nineteenth-century Heritage	235
14.2 Why Should Central Banks Be Lender of Last Resort?	236
14.3 Central Bank Inertia and Beyond	240
14.4 Emergency Liquidity Assistance as Special Type of LOLR	242
<b>15. LOLR and Central Bank Risk-Taking</b>	<b>248</b>
15.1 Exogenous Risk	248
15.2 Endogenous Risk	252
<b>16. LOLR, Moral Hazard, and Liquidity Regulation</b>	<b>264</b>
16.1 Moral Hazard and Negative Externalities of Inadequate Bank Liquidity Management	264
16.2 Liquidity Regulation	267
16.3 A Framework with Financial Incentives against Disproportional Reliance on the Central Bank	275

17. The International Lender of Last Resort	280
17.1 The Case of a Fixed Exchange Rate System	280
17.2 Provision of Foreign Currency by Central Banks to Domestic Counterparties in 2009–2013	285
Annex A: Current Account Transactions as Origin of Foreign Reserves	289
Annex B: TARGET2 Balances in the Euro Area	289
18. Optimal Monetary Policy Operations in Crisis Times	294
<i>References</i>	299
<i>Index</i>	315