BIS

Financial stability and policy coordination

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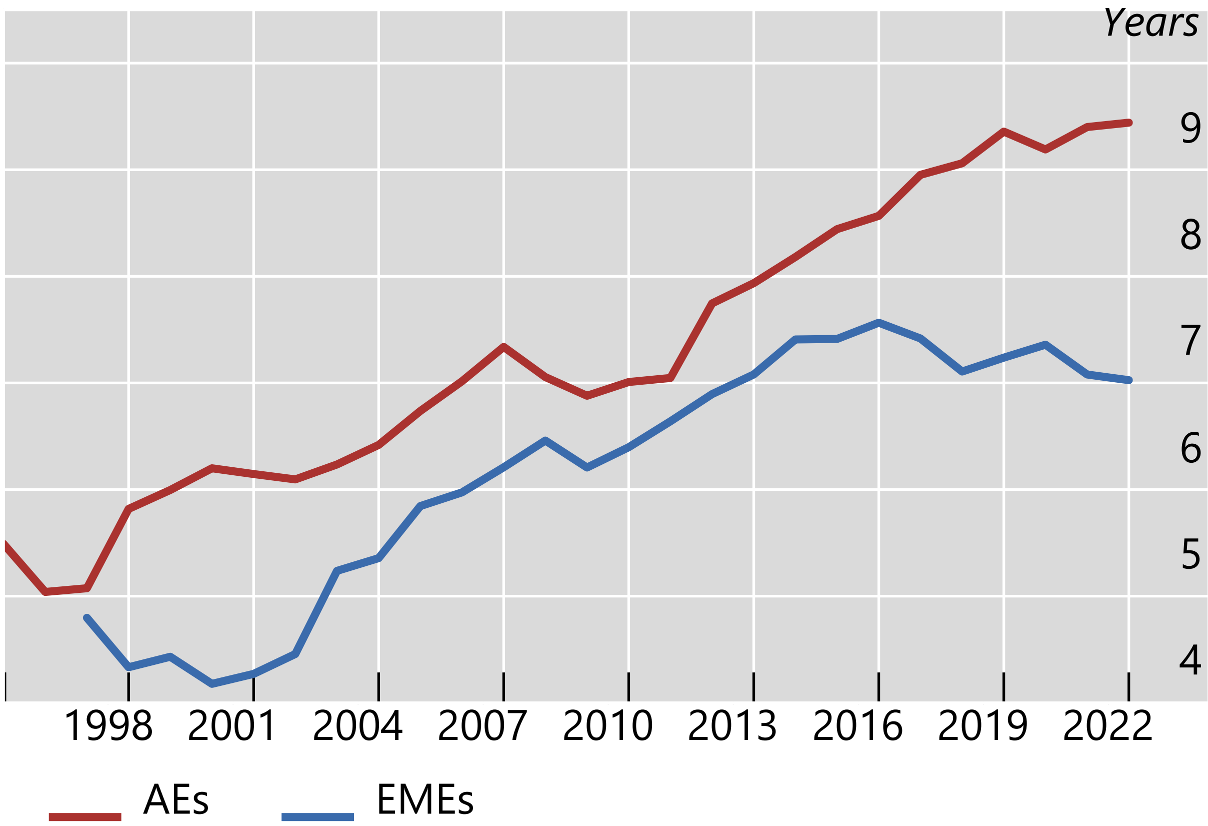
Banco de Portugal Conference on Financial Stability, Lisbon, 2 October 2023

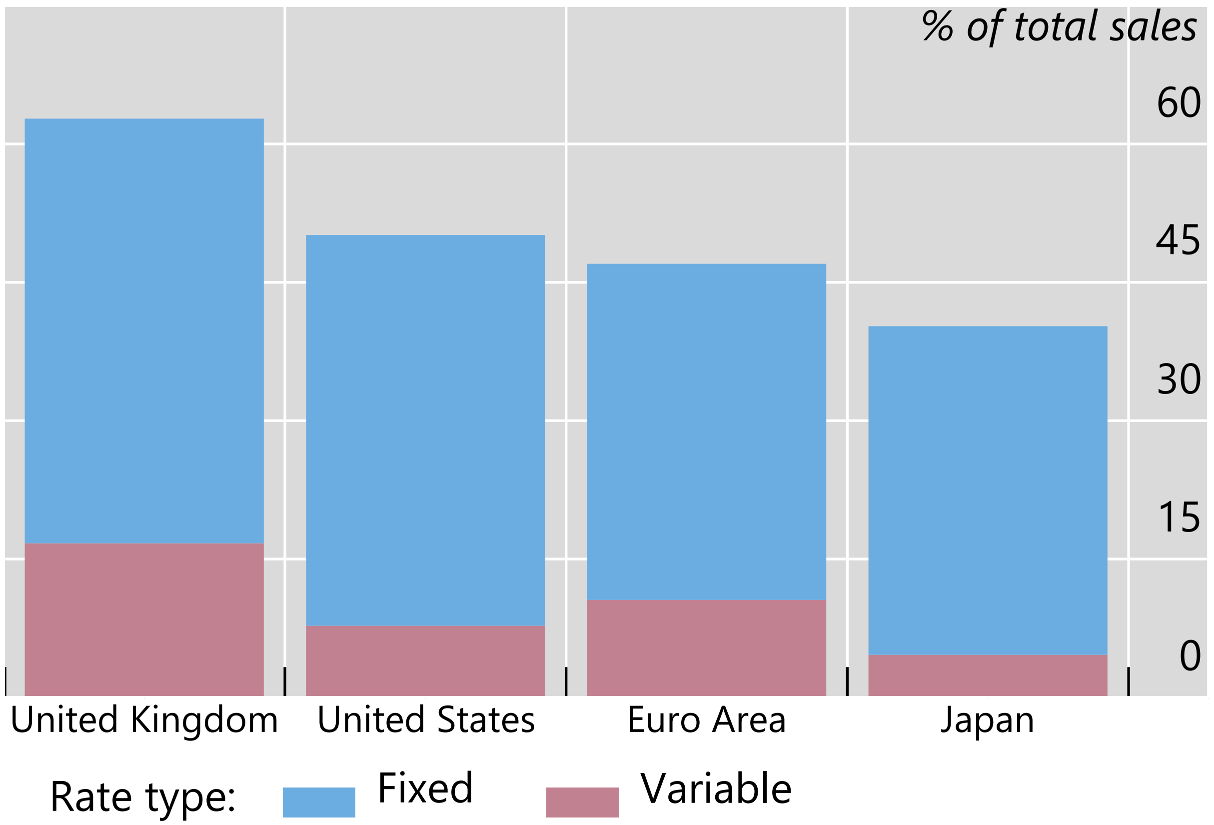
*The views expressed are those of the speaker and not necessarily those of the Bank for International Settlements

Inflation has risen in the context of the "terming out" of debt, following a long period of low-for-long interest rates, as seen in the remaining maturity of government bonds



Sources: Bloomberg; BIS.

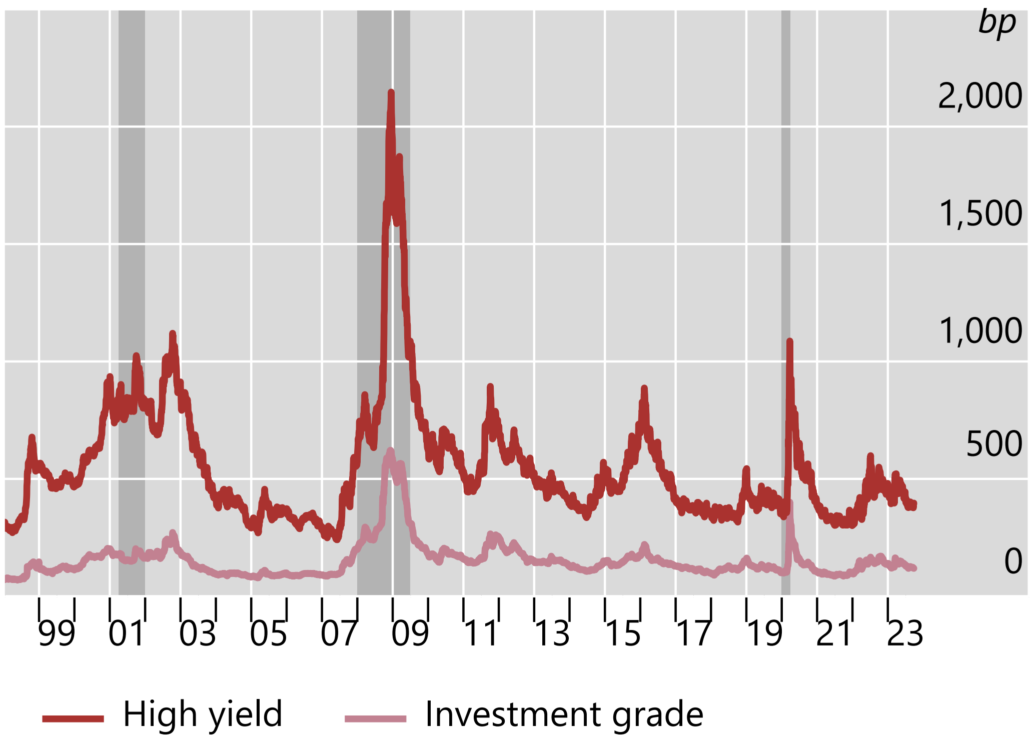
"Terming out" of debt has also shielded non-financial corporates from the impact of tighter monetary policy in response to inflation



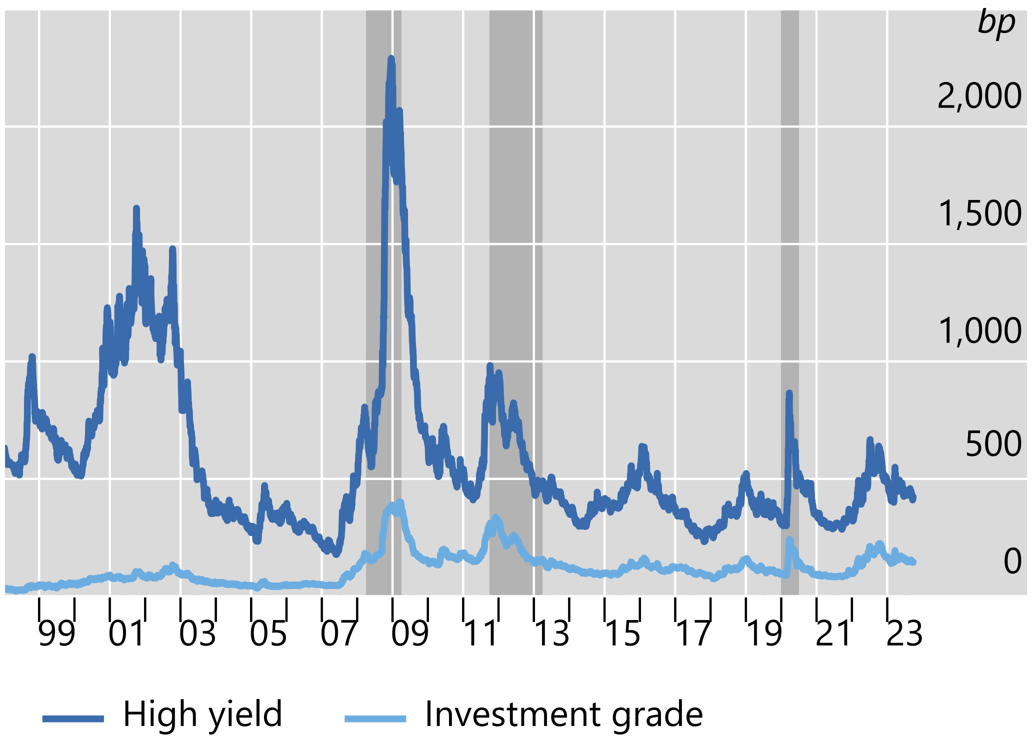
Sources: S&P Capital IQ; BIS.

This is one possible reason for why corporate credit spreads have been contained in spite of rapid monetary tightening

United States



Europe

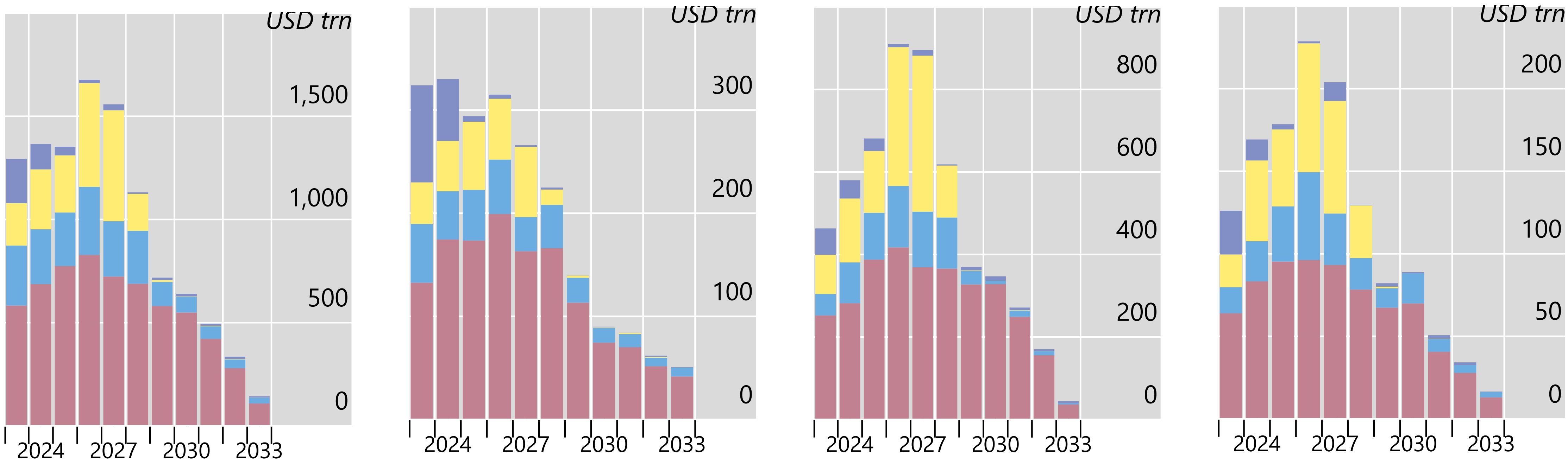


Shaded areas indicate recessions.

Sources: ICE BofAML indices; BIS.

Terming out of corporate borrowing is reflected in the long maturity profile of debt repayments of non-financial corporates

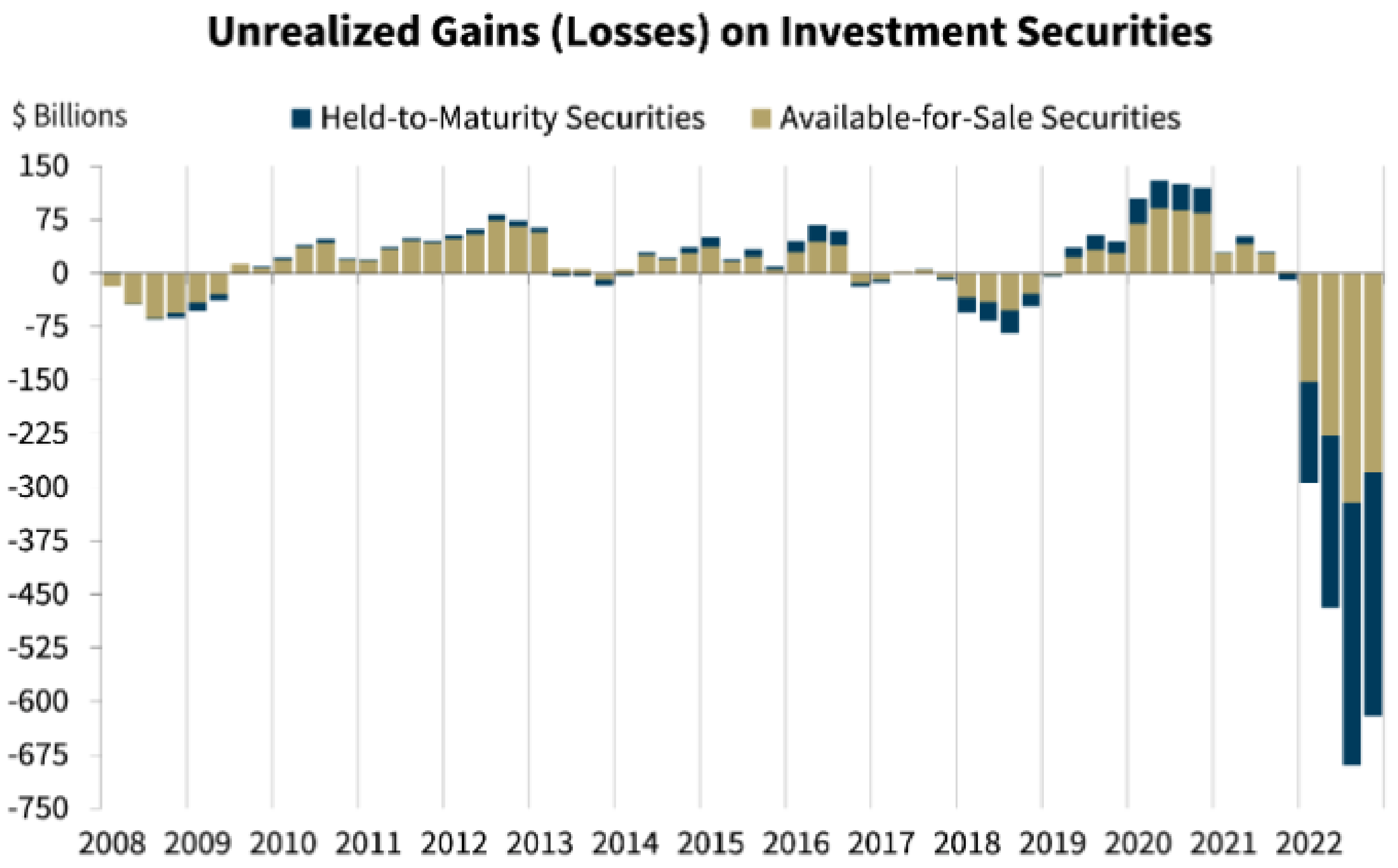
World excluding China | European Union | United States | Other AEs



Bonds and notes | Term loans | Revolving credit | Other borrowings

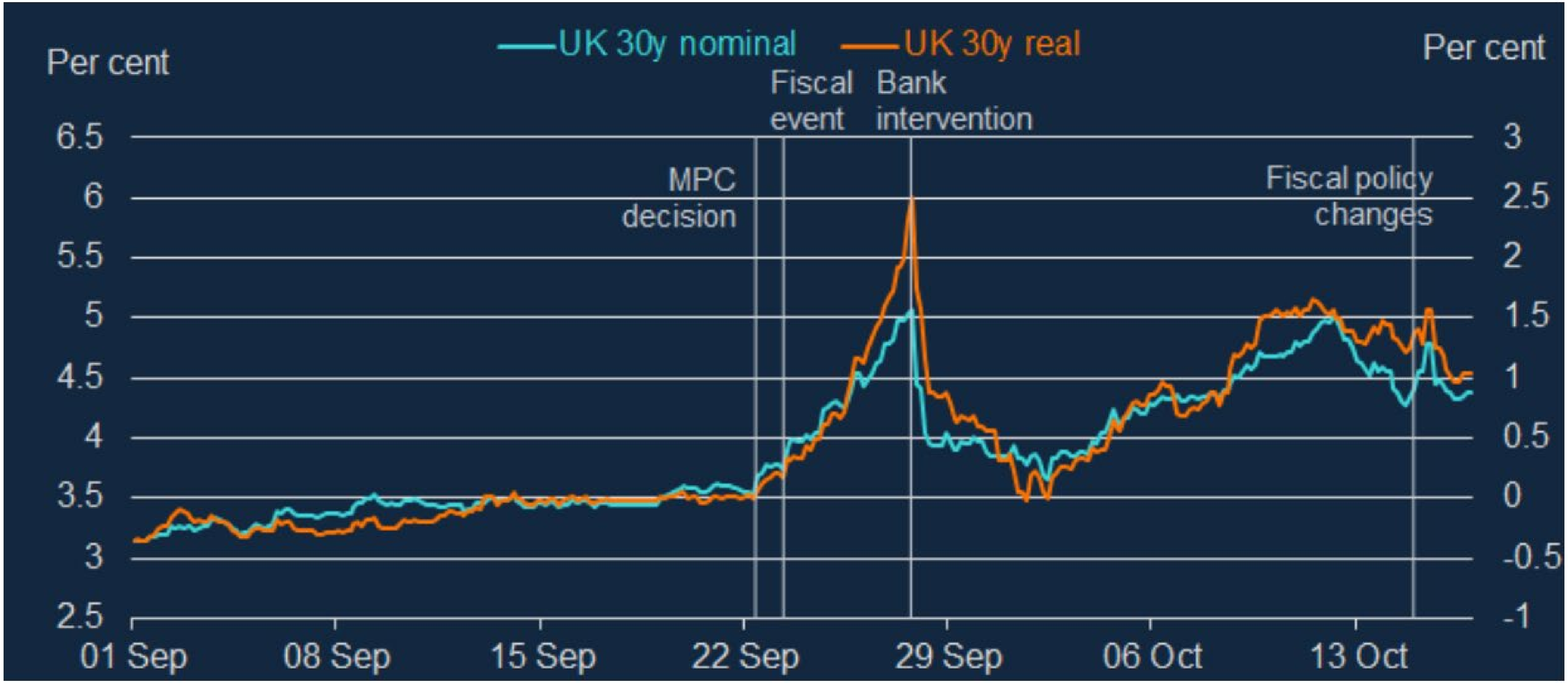
Sources: S&P Capital IQ; BIS.

From the point of view of investors, higher rates translate to losses; interest rate risk on the banking book is one example



Source: FDIC.
Note: Insured Call Report filers only.

When assets are marked-to-market, impact of higher rates show up as duration risk with gilt stress episode of September 2022 an example; it lies on a broad continuum with March 2023 stress



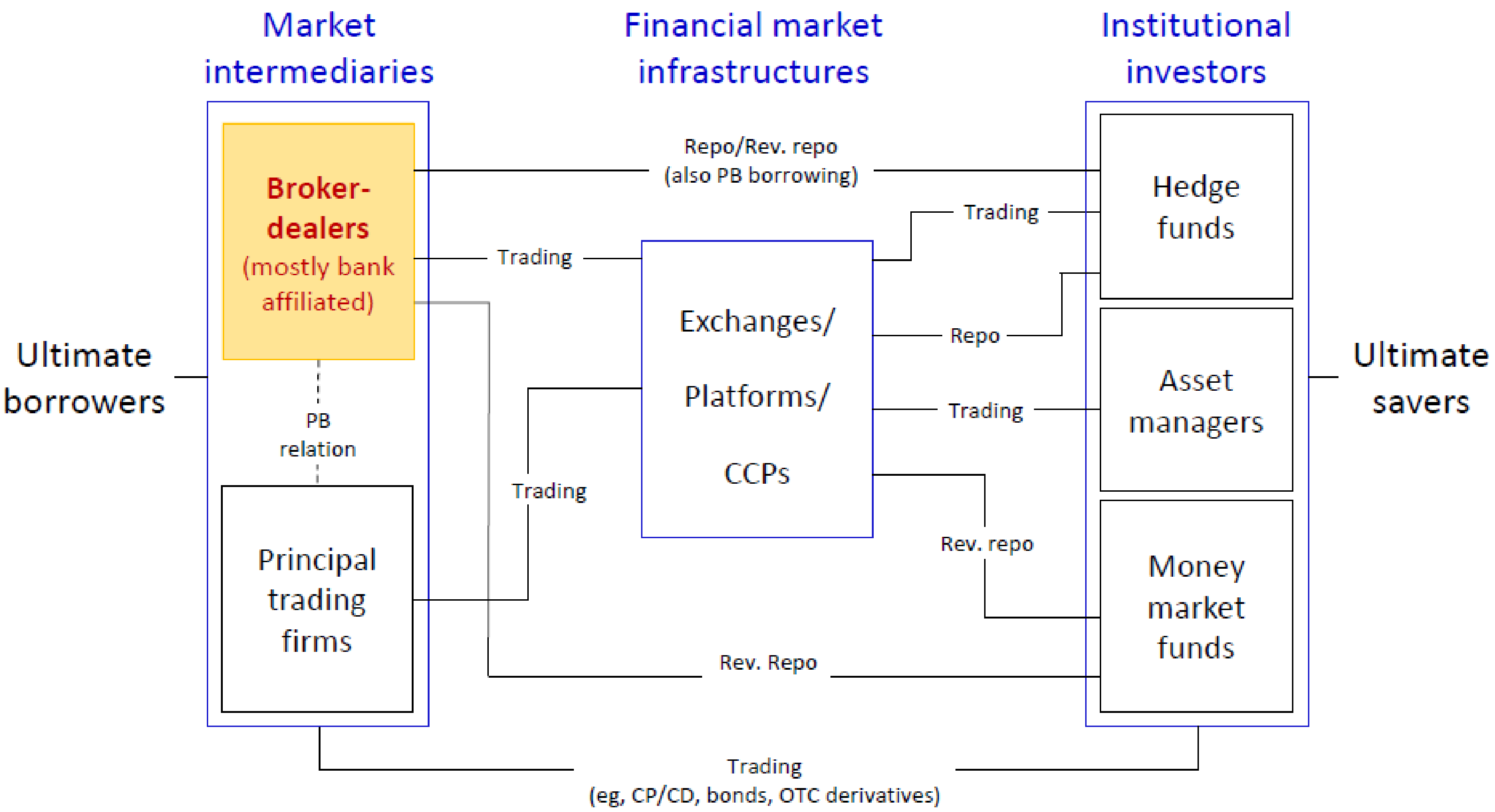
Source: Bank of England.

Do policy objectives in liquidity provision and monetary policy point in the same direction or opposite directions?

- March 2020 was an episode when the monetary policy imperative and financial stability objectives were aligned
  - Loosening of monetary policy through central bank asset purchases
  - Central bank market intervention for financial stability objectives

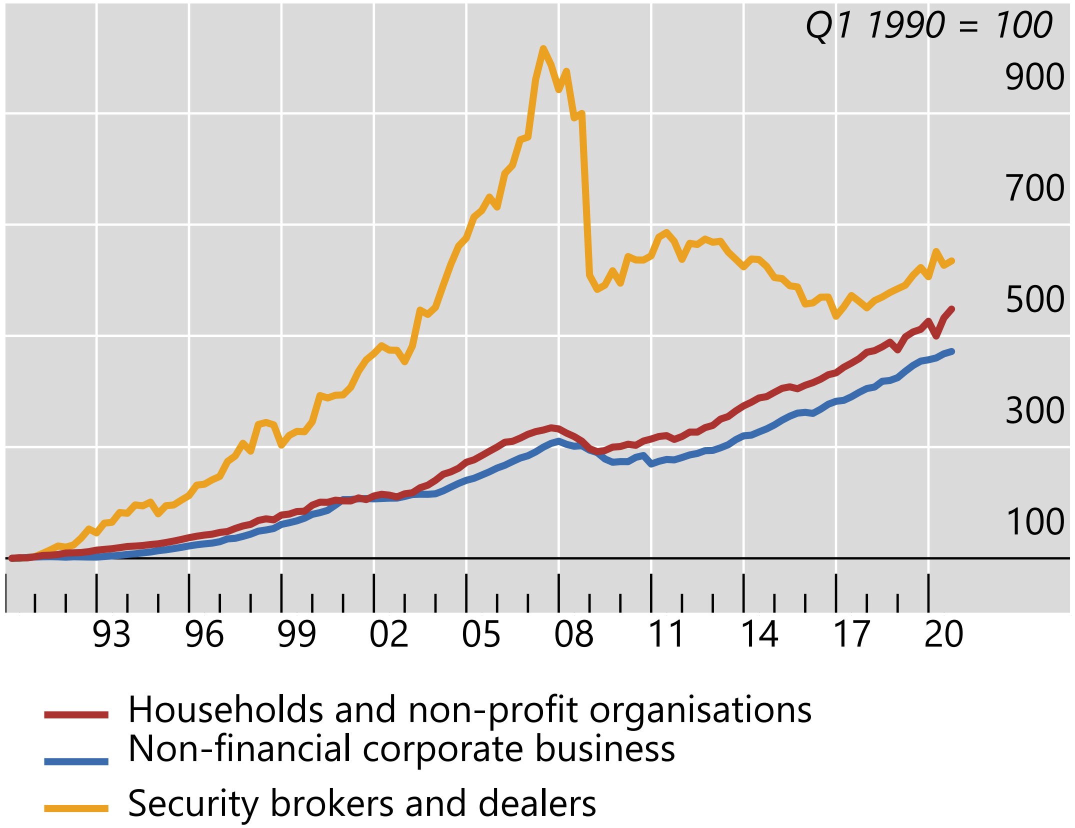
- Policy objectives may not be aligned when inflation is high
  - Tighter monetary policy to deal with inflation
  - Liquidity provision for financial stability objectives

Shifting structure of financial intermediation is relevant consideration in the tradeoffs

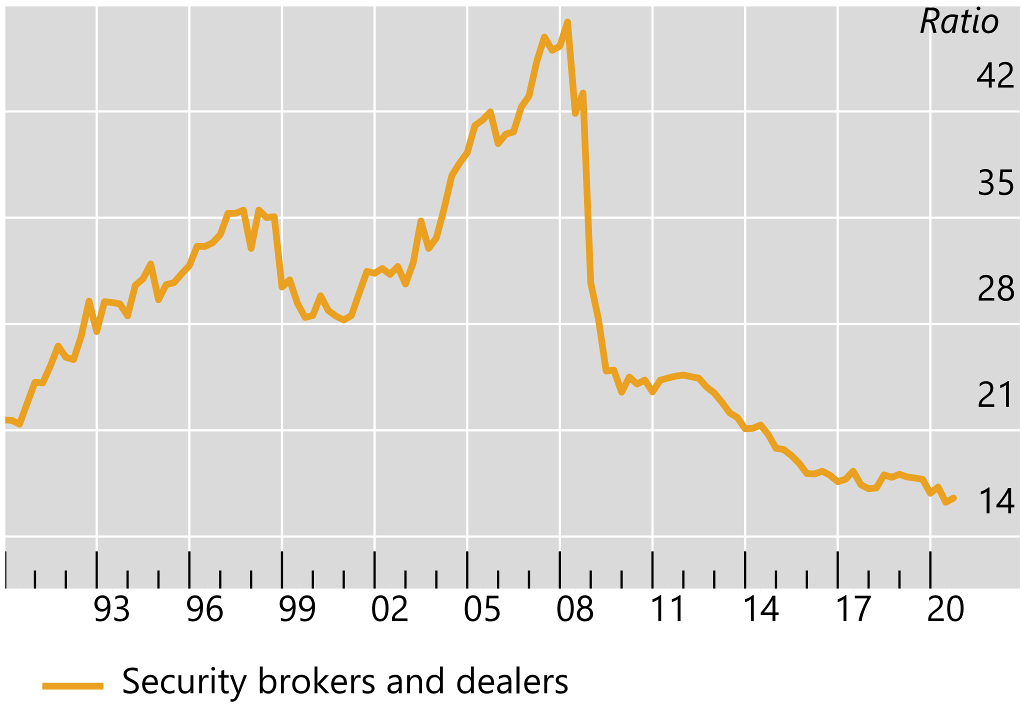


Broker-dealer balance sheets have smaller heft in the financial system post-crisis, as market-based intermediation has migrated elsewhere

Total assets (1990Q1 = 100)

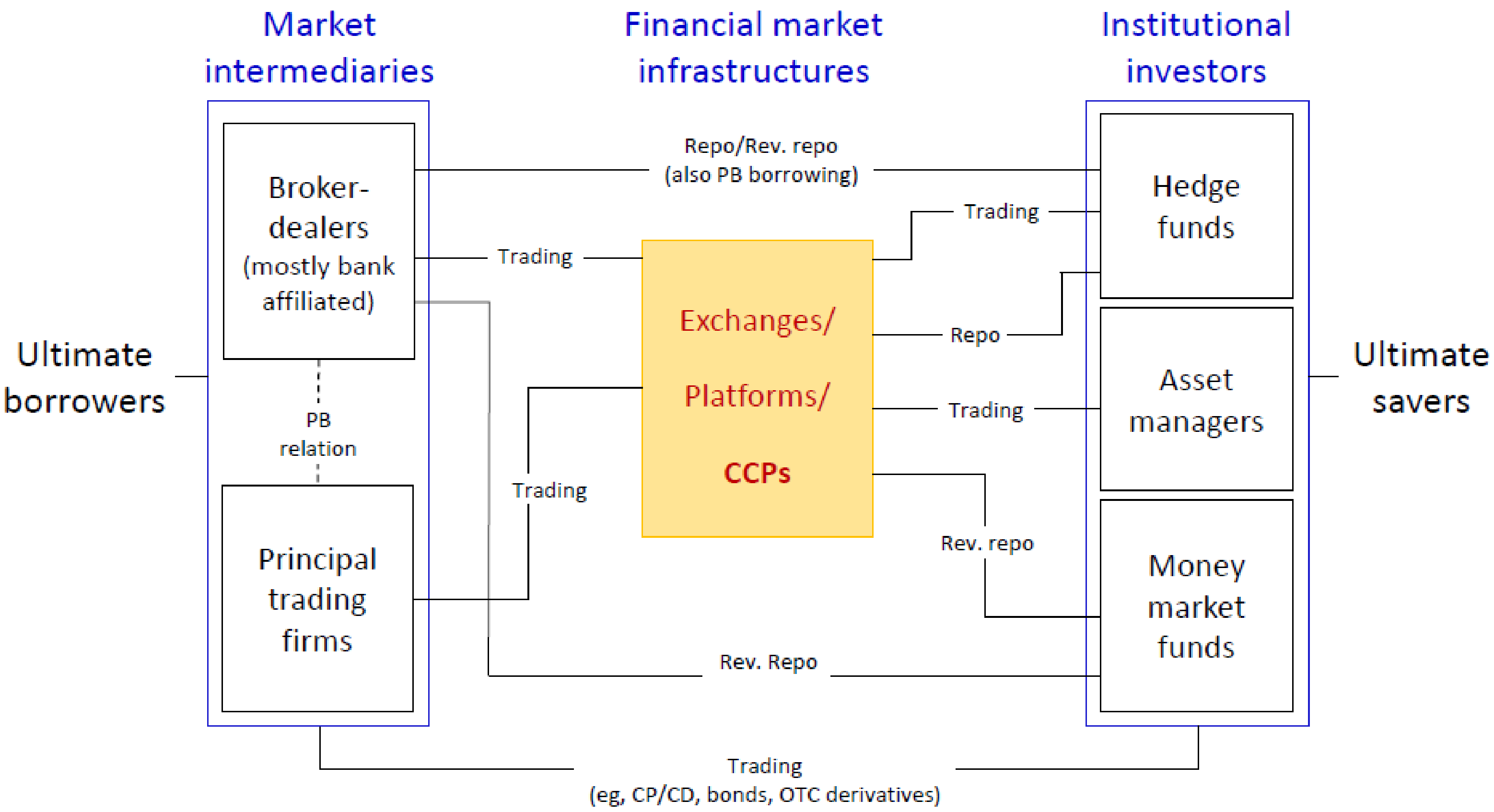


Leverage (=assets/equity)

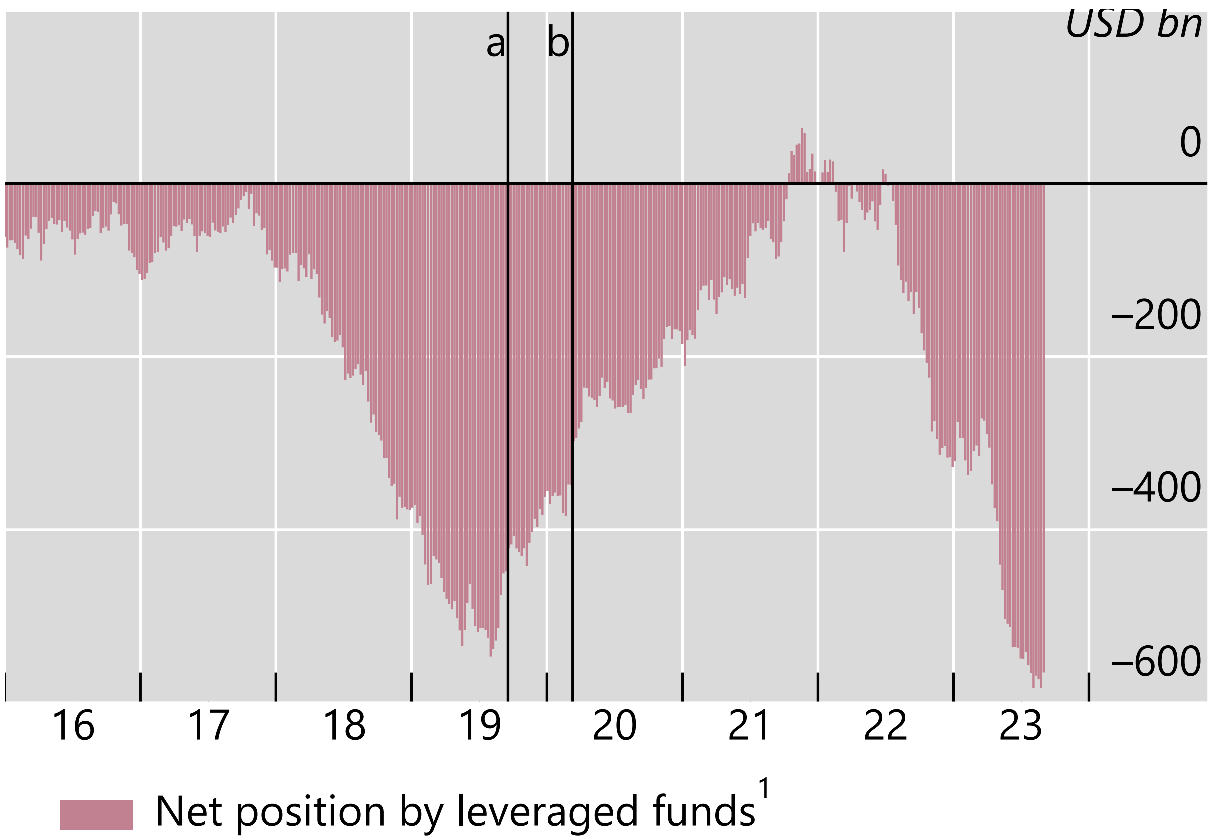


Source: Federal Reserve, *Flow of Funds*

Financial intermediation has shifted from traditional banks and dealers to non-bank financial intermediaries and exchanges/CCPs



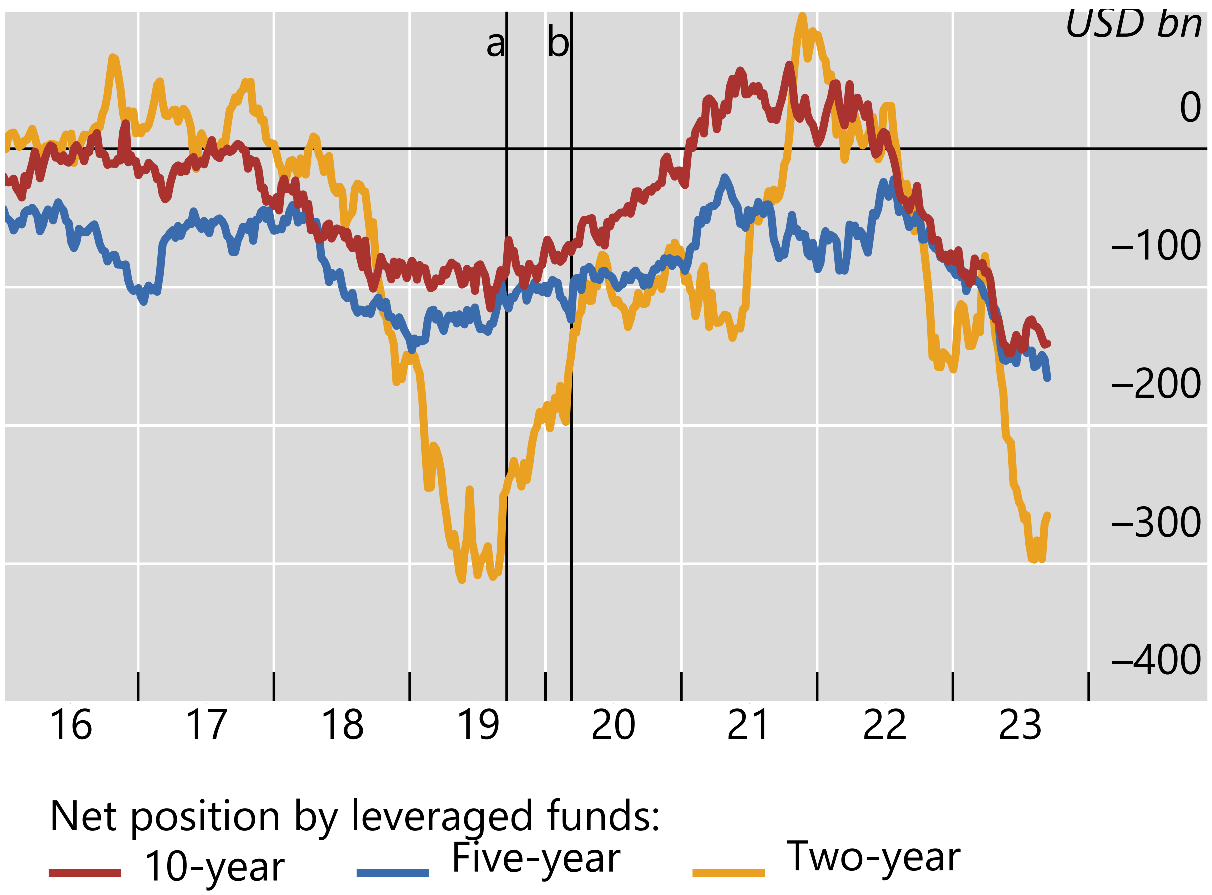
Relative value trades in government bond markets have returned in recent months, as seen in the net short position in US treasury futures of leverage funds



[a] Repo market stress (17 Sep 2019). [b] "Dash-for-cash" (9 Mar 2020).
[1] The sum of net positions in two-, five- and 10-year US Treasury futures.

Sources: Commodity Futures Trading Commission; Bloomberg; Chicago Mercantile Exchange, BIS.

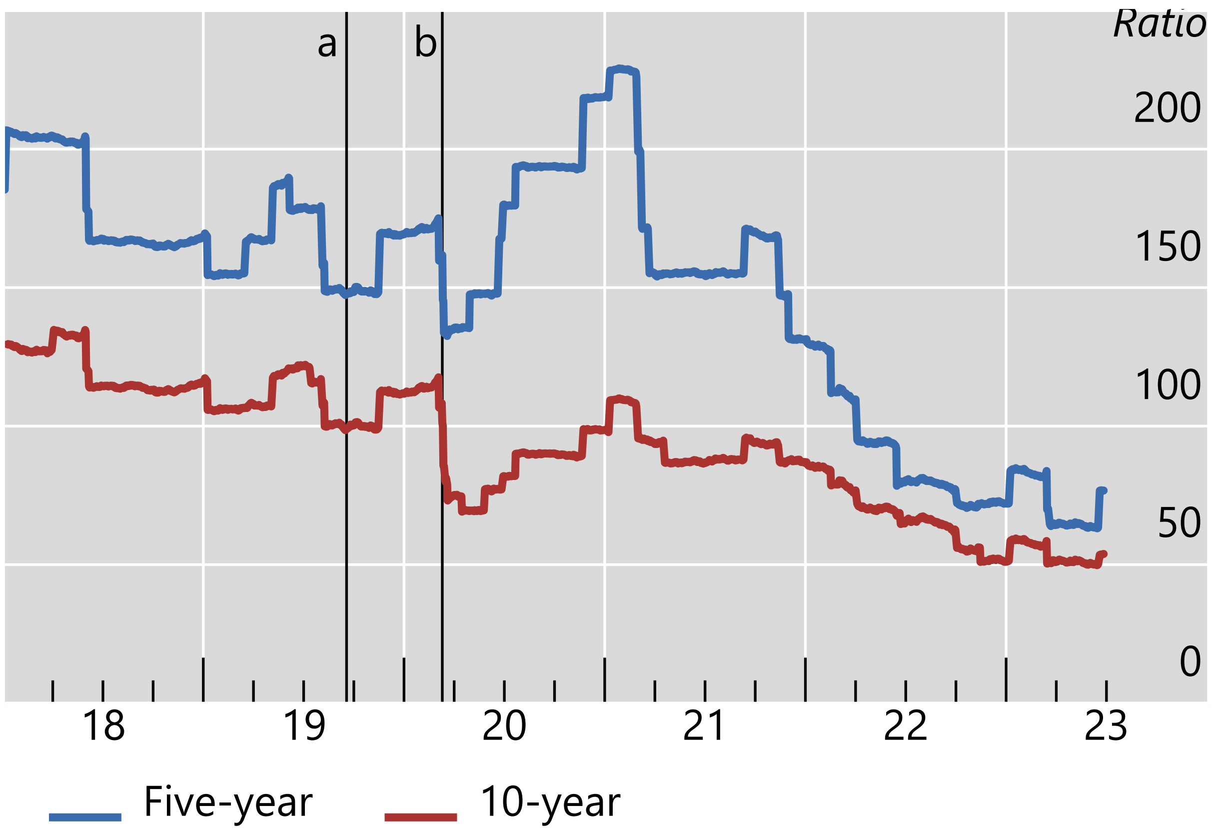
Positioning has exceeded the run-up to the March 2020 episode on some measures



[a] Repo market stress (17 Sep 2019). [b] "Dash-for-cash" (9 Mar 2020).

Sources: Commodity Futures Trading Commission; Bloomberg; Chicago Mercantile Exchange, BIS.

Leverage (as measured by contract price over initial margin) was cut sharply in earlier stress events in 2019 and 2020; leverage is lower currently



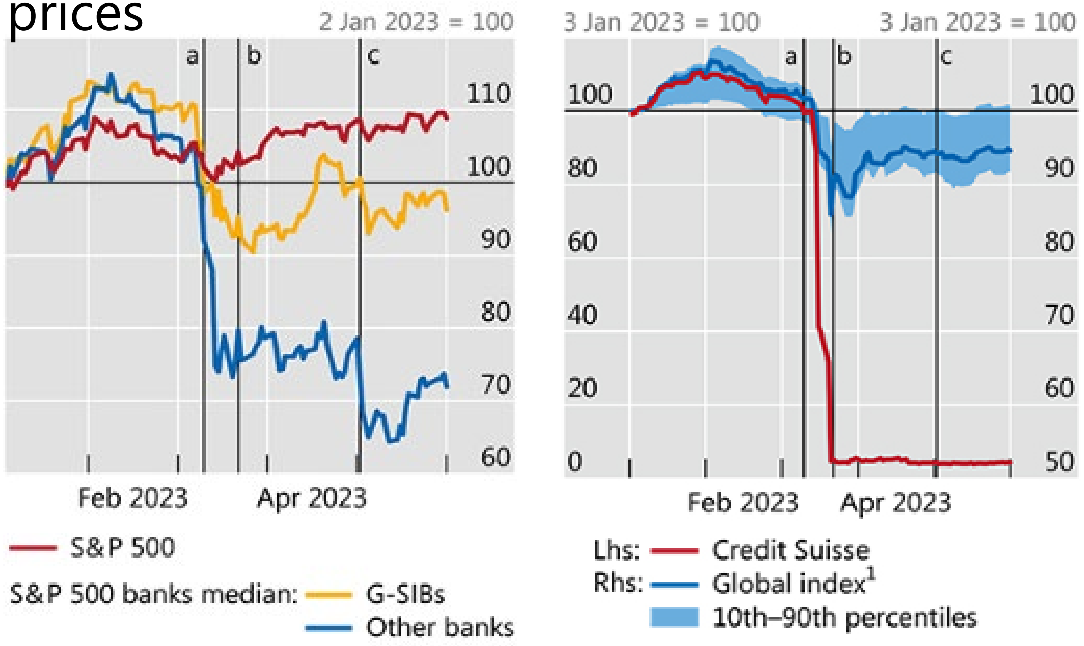
[a] Repo market stress (17 Sep 2019). [b] "Dash-for-cash" (9 Mar 2020).

[1] Contract price over initial margin.

Sources: Commodity Futures Trading Commission; Bloomberg; Chicago Mercantile Exchange, BIS.

March 2023 banking stress has raised question of how market prices should be taken into account in monitoring banking sector

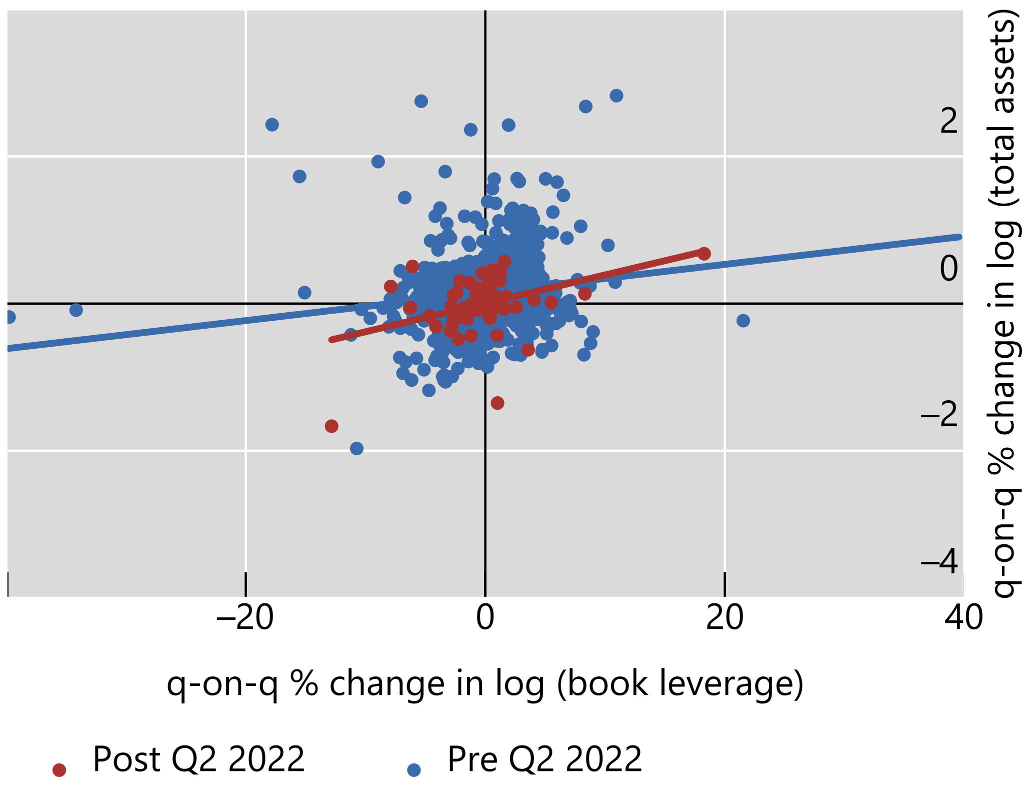
Graph 1: Equity and Additional Tier 1 (AT1) prices



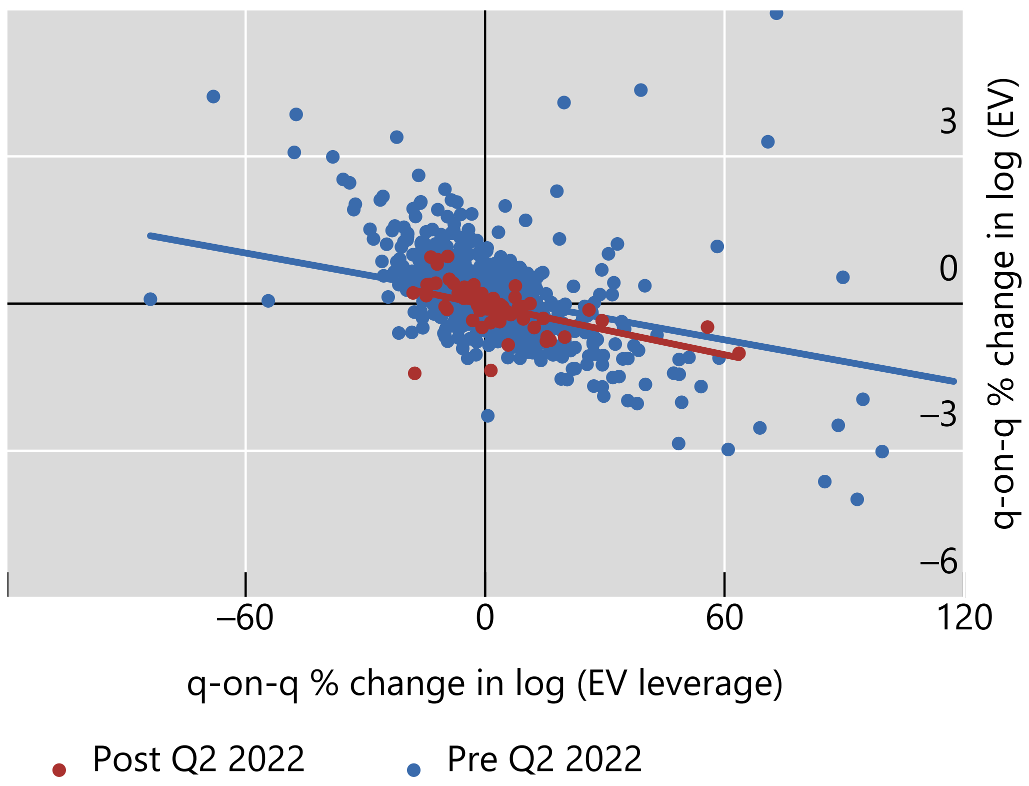
Source: BIS (2023). (a) Silicon Valley Bank failure. (b) Credit Suisse failure. (c) First Republic failure

Book leverage is procyclical; enterprise value leverage is countercyclical

Book leverage vs assets



Enterprise value leverage and enterprise value



Based on data for 18 global and US regional banks for the period 1998-latest.

Sources: Datastream; Fitch; BIS.