

# Interbank Money Markets and Payment Systems: a two-way relationship

Western Hemisphere Payments Week, 2009  
Punta del Este, November 17, 2009

*Massimo Cirasino*  
Head

PAYMENT SYSTEMS DEVELOPMENT GROUP  
THE WORLD BANK

***Interbank Money Markets and Payment Systems:  
Purpose of this session***

- To discuss, based on evidence from developed as well as emerging economies, if, and how, “safe and efficient collateralized money markets” can become a key mechanism to support the adequate distribution of liquidity in periods of market stress
- Present some related developments currently being analyzed by the PSDG

PAYMENT SYSTEMS DEVELOPMENT GROUP • THE WORLD BANK

2

## ***Interbank Money Markets and Payment Systems: Introduction***

- In mid-2007, as one of the outcomes of the meltdown of the subprime crisis in the US, money markets in developed economies began showing signs of stress, mainly a severe reduction of trading activity and increased volatility of associated interest rates

## ***Interbank Money Markets and Payment Systems: Introduction (ctd.)***

- As stated by José Manuel González-Páramo, Member of the Executive Board of the European Central Bank (Sept 2008):  
  
*“...market participants continue to report limited trading activity and high spreads, particularly in unsecured inter-bank term markets. Banks seem to be particularly reluctant to lend money in the unsecured inter-bank market due to uncertainty about their own funding needs, especially in USD, and lack of confidence in the soundness of their counterparties”*

## ***Interbank Money Markets and Payment Systems: Conceptual framework***

- The sound and efficient operation of financial markets, including the interbank money market, is strongly linked to the design of payment and settlement arrangements
  - ✓ In particular, the interbank money market as the “distributor” of liquidity throughout the financial sector relies heavily on the ability to transmit funds across the financial system rapidly and safely
  - ✓ At the same time, the interbank money market is one of the key sources of liquidity for the operation of a real time gross settlement (RTGS) system. The latter is one major reason why financial markets are likely to show their first signs of stress in the payments system

## ***Interbank Money Markets and Payment Systems: Conceptual framework***

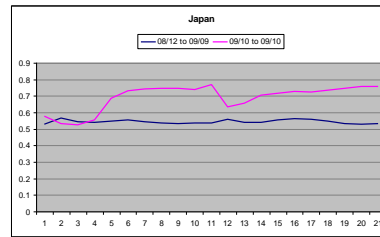
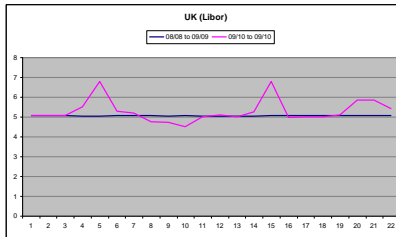
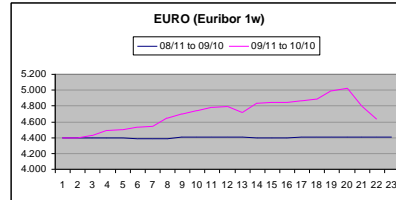
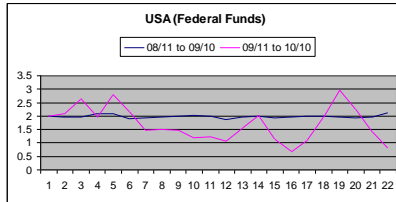
- In periods of market stress and distrust among market participants, overall liquidity in money markets tends to dry-up
  - ✓ This, combined with the tightening of credit policies, usually has a stronger effect on the uncollateralized or unsecured segment of the money market
  - ✓ In these circumstances, market players are generally only willing to lend any excess liquidity against high quality, readily enforceable collateral
  - ✓ Moreover, lenders need assurance that the transaction can be performed efficiently (real-time gross settlement, low transaction costs, flexibility to adjust haircuts to pledged collateral one or more times during the day) and that it be exempt of counterparty risk (i.e. under true DvP conditions)

## ***Interbank Money Markets and Payment Systems: Conceptual framework***

- **Two key elements are necessary for this:**
  - ✓ a sound legal framework that ensures finality of funds and securities transfers as well as the legal protection to pledged collateral from third-party claims and the possibility to seize the pledged collateral efficiently in case of a default by the debtor
  - ✓ the existence of an RTGS systems fully integrated with an electronic book-entry securities system that enables the on-line recording of pledges on securities and/or changes in ownership of securities

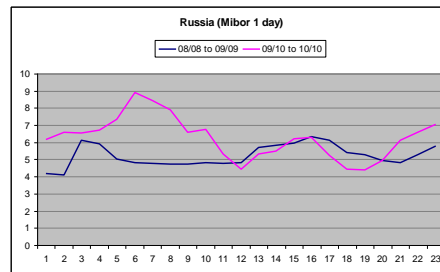
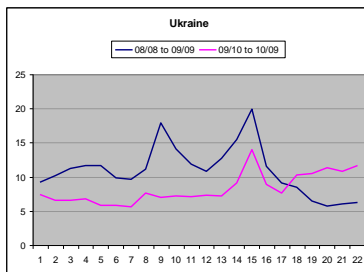
## ***Some Empirical Evidence from the recent financial turmoil***

## Money market rates in some developed countries (late 2008)



Sources: Federal Reserve Bank of New York, European Central Bank, Bank of England, Bank of Japan.

## Money market rates in Russia and Ukraine (late 2008)



Sources: National Bank of Ukraine, Bank of Russia.

## Decrease in volumes traded in interbank money market (proxy)

### Amounts outstanding of central bank standing deposit facilities (late 2008)

	Euro Area	US (1)	UK
<b>Average 08/11 to 09/10</b>	Euro 0.695 Bn.	\$1.988 Bn. (2)	£ 0
<b>Average 09/11 to 10/20</b>	Euro 69.361 Bn.	\$60.061 Bn. (3)	£ 1.915 Bn. (4)
<b>Peak</b>	Euro 239.576 Bn. (5)	\$136.033 Bn. (6)	£ 4.403 Bn. (7)

Sources: ECB, Board of Governors of the Federal Reserve System, Bank of England.

1. Excess reserves of depository institutions at the Federal Reserve System.

2. Average for August.

3. Average for September.

4. Average from September 18<sup>th</sup> to October 15<sup>th</sup>.

5. On October 17<sup>th</sup>.

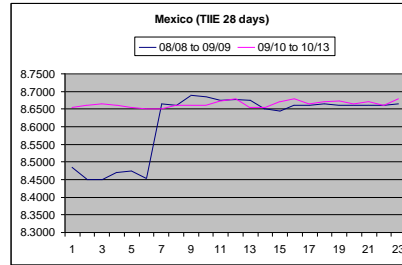
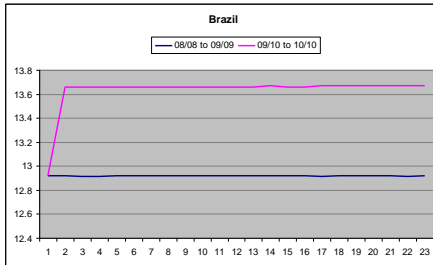
6. Average for the two-week holding period ending on October 8<sup>th</sup>.

7. Average for the weekly period ending on October 8<sup>th</sup>.

## Preliminary Observations

- In the countries shown so far, interbank money markets are mainly or exclusively of an unsecured type
- For other countries in which money markets operate mainly or exclusively on a collateralized basis via repos or other instruments, volatility has been much less dramatic
- Some countries have fostered the implementation of collateralized money markets (e.g. Italy)

## Money market rates in Brazil and Mexico (late 2008)



Sources: Banco Central do Brasil, Banco de Mexico.

### Notes:

1. Banco Central do Brasil increased its target interest rate in 75 basis points on September 12th
2. Banco de Mexico increased its target interest rate on 25 basis points on August 15th.

## Interbank Money Markets and Payment Systems: Policy Implications

- **Deep, transparent and collateralized interbank markets are key to liquidity management, even more so under financial stress**
  - Authorities' responses so far have included:
    - ✓ Access of a much broader range of counterparties to central bank liquidity to mitigate funding liquidity risk for a broad range of participants when short-term interbank markets stop functioning properly
    - ✓ Acceptance of a broad range of collateral in all classes of lending operations so that sufficient collateral is not a constraint, and provide additional channels for the transmission channels of authorities responses
  - ✓ **Maintaining the integrity and smooth functioning of the payments system, the arterial system of the financial market and the economy is a stand-alone objective of authorities, which becomes even more important during financial crisis**

Thank you!

Massimo Cirasino  
[mcirasino@worldbank.org](mailto:mcirasino@worldbank.org)

Payment Systems Development Group  
The World Bank

[www.worldbank.org/paymentsystems](http://www.worldbank.org/paymentsystems)