Liquidity Hoarding and Interbank Market Spreads: The Role of Counterparty Risk

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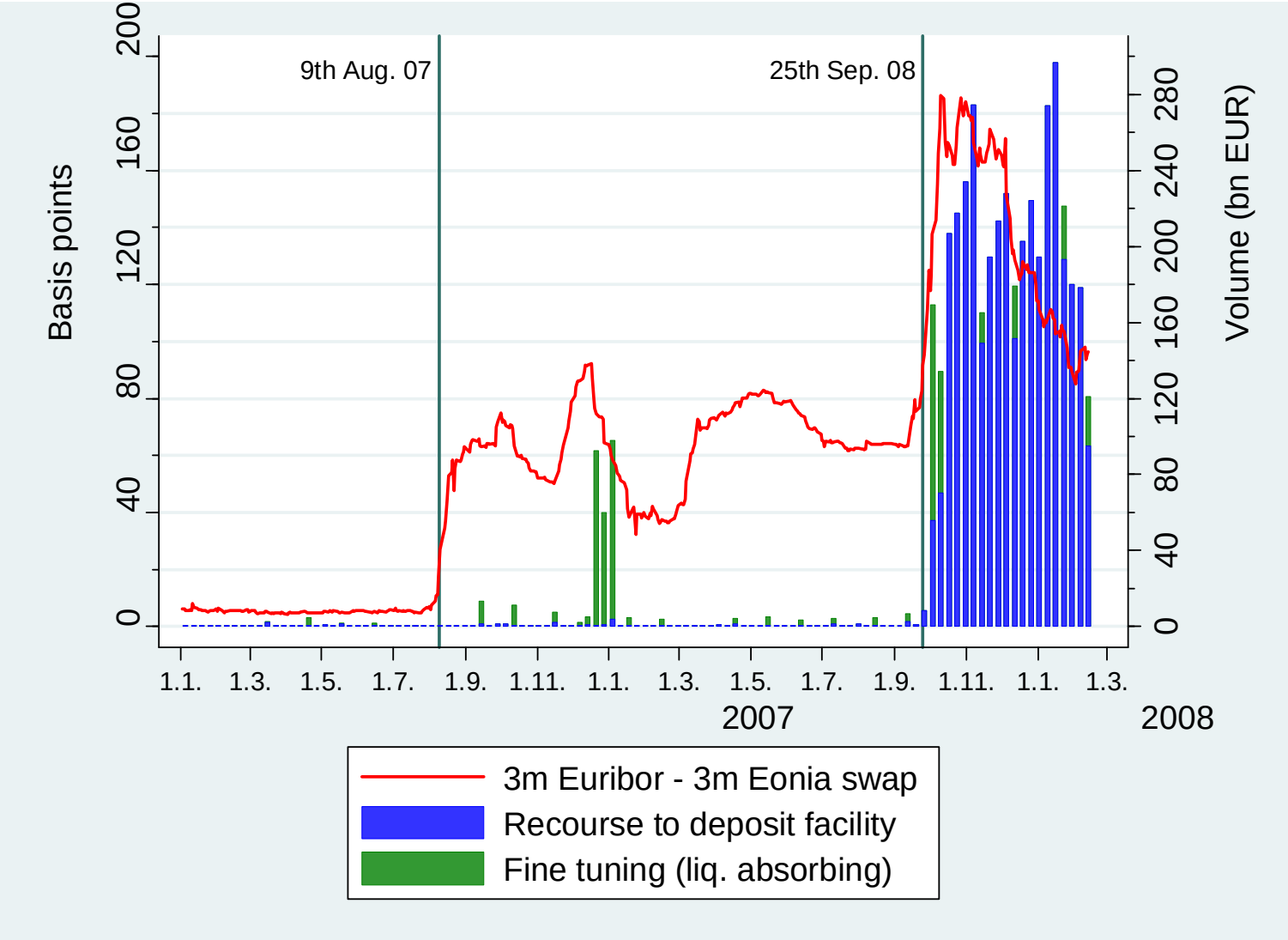
Conference on "Central Bank Liquidity Tools"
NY Fed, February 19, 2009

Interbank market: Some facts



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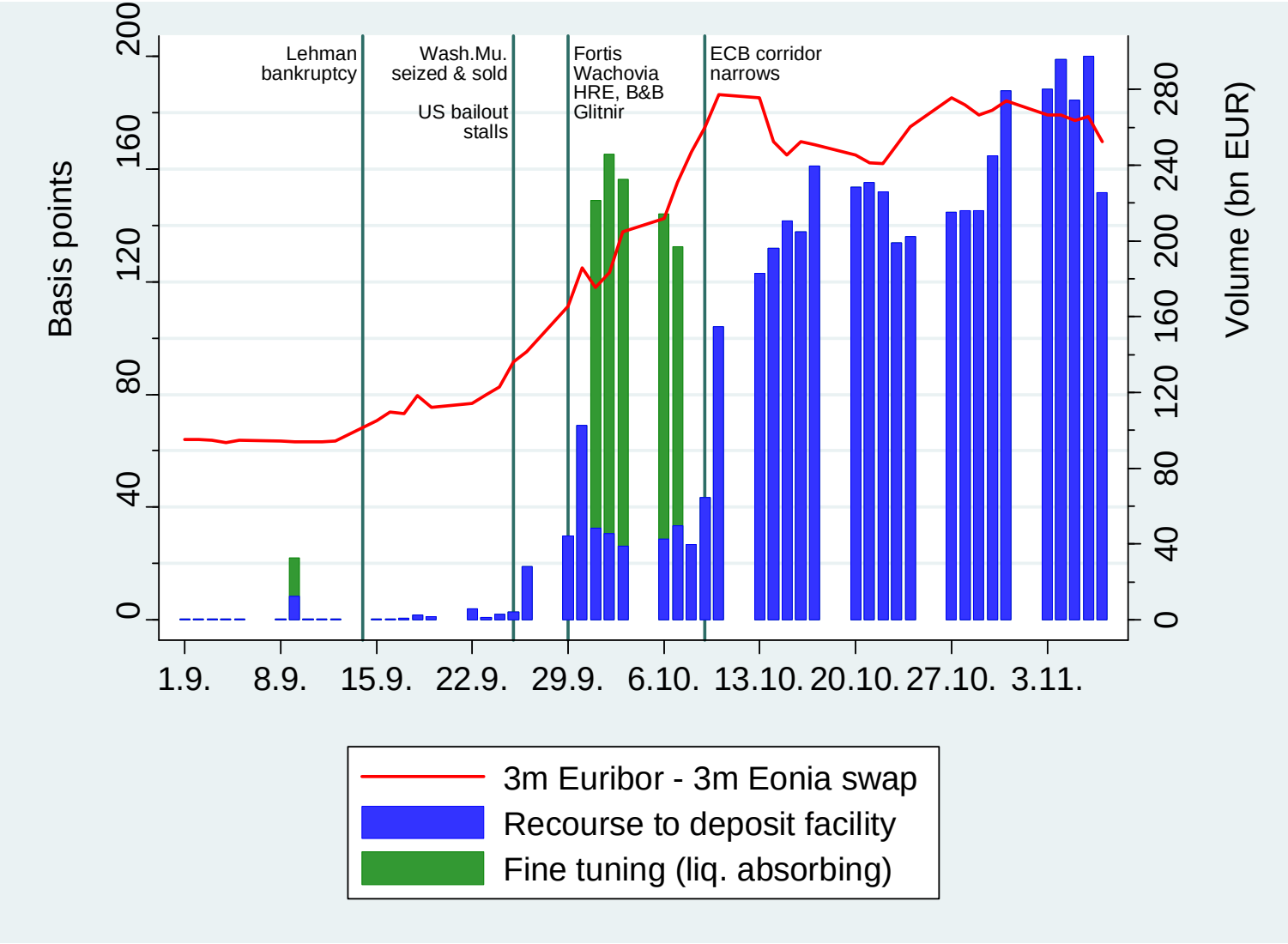

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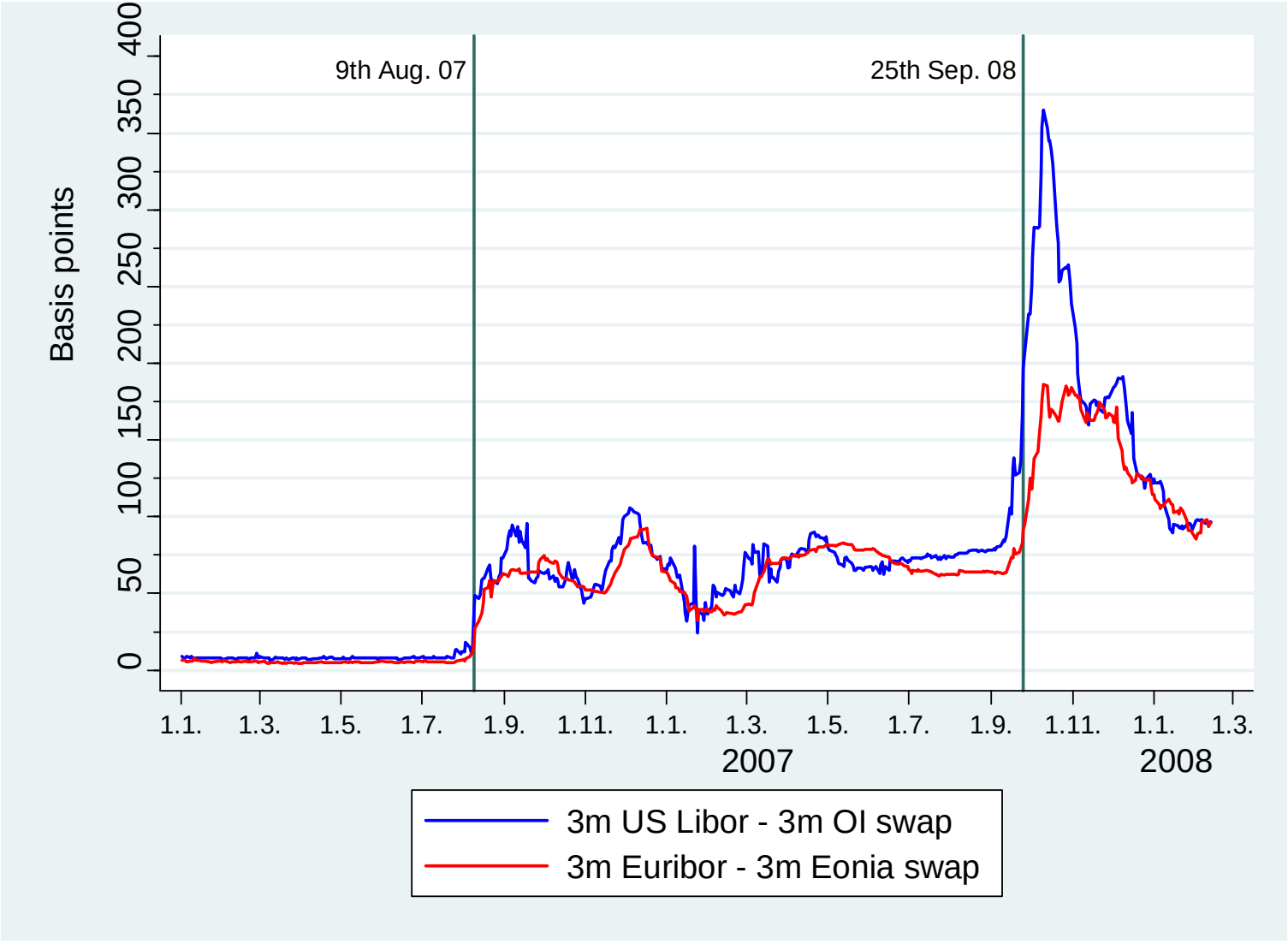

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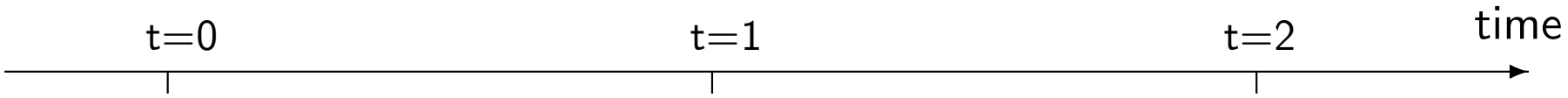

Banks offer deposit contracts.

Banks allocate deposits between liquid and illiquid assets.

Idiosyncratic liquidity shocks and shocks to illiquid asset's risk realized.

Banks borrow and lend on an interbank market at an interest rate r.

Additionally, they can liquidate some of their illiquid asset holdings and/or keep cash in reserves.

Impatient consumers withdraw deposits.

The return of the illiquid long-term asset realizes.

Interbank loans are repaid.

Patient consumers withdraw their deposits.

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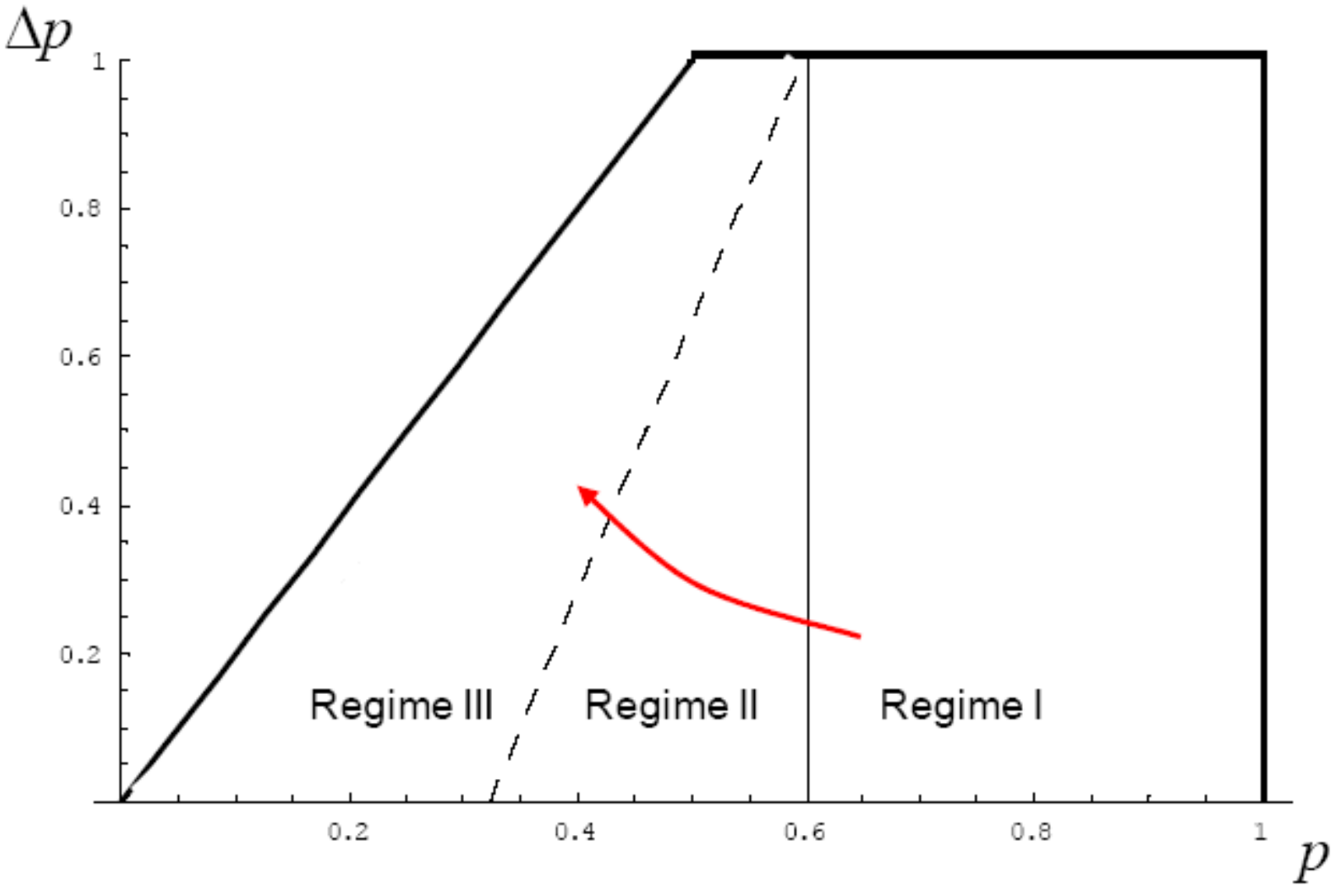

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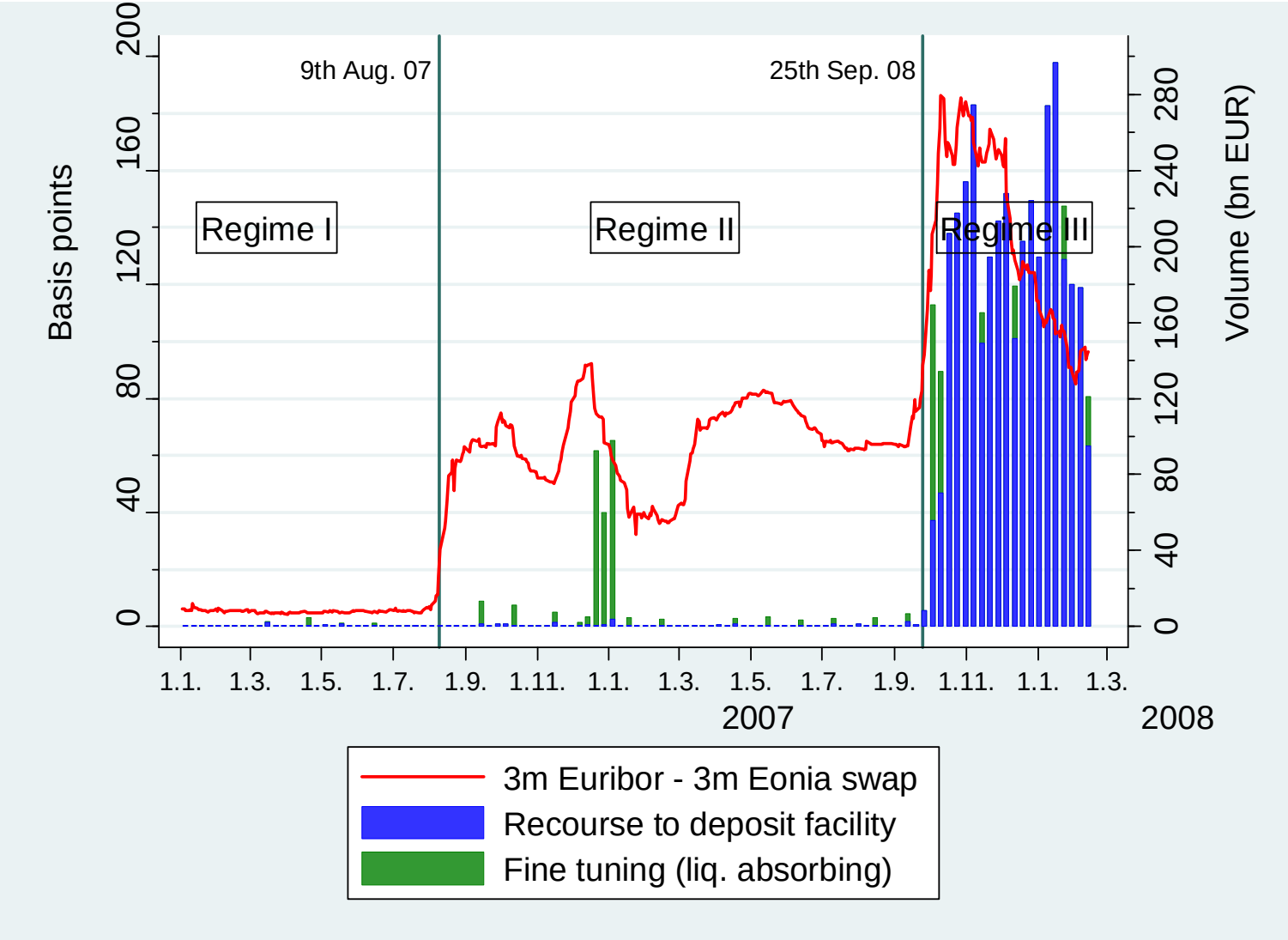
Basis points
Volume (bn EUR)
9th Aug. 07
25th Sep. 08
Regime I
Regime II
Regime III
0
40
80
120
160
200
240
280
1.1.
1.3.
1.5.
1.7.
1.9.
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2007
2008
3m Euribor - 3m Eonia swap
Recourse to deposit facility
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Thank you!

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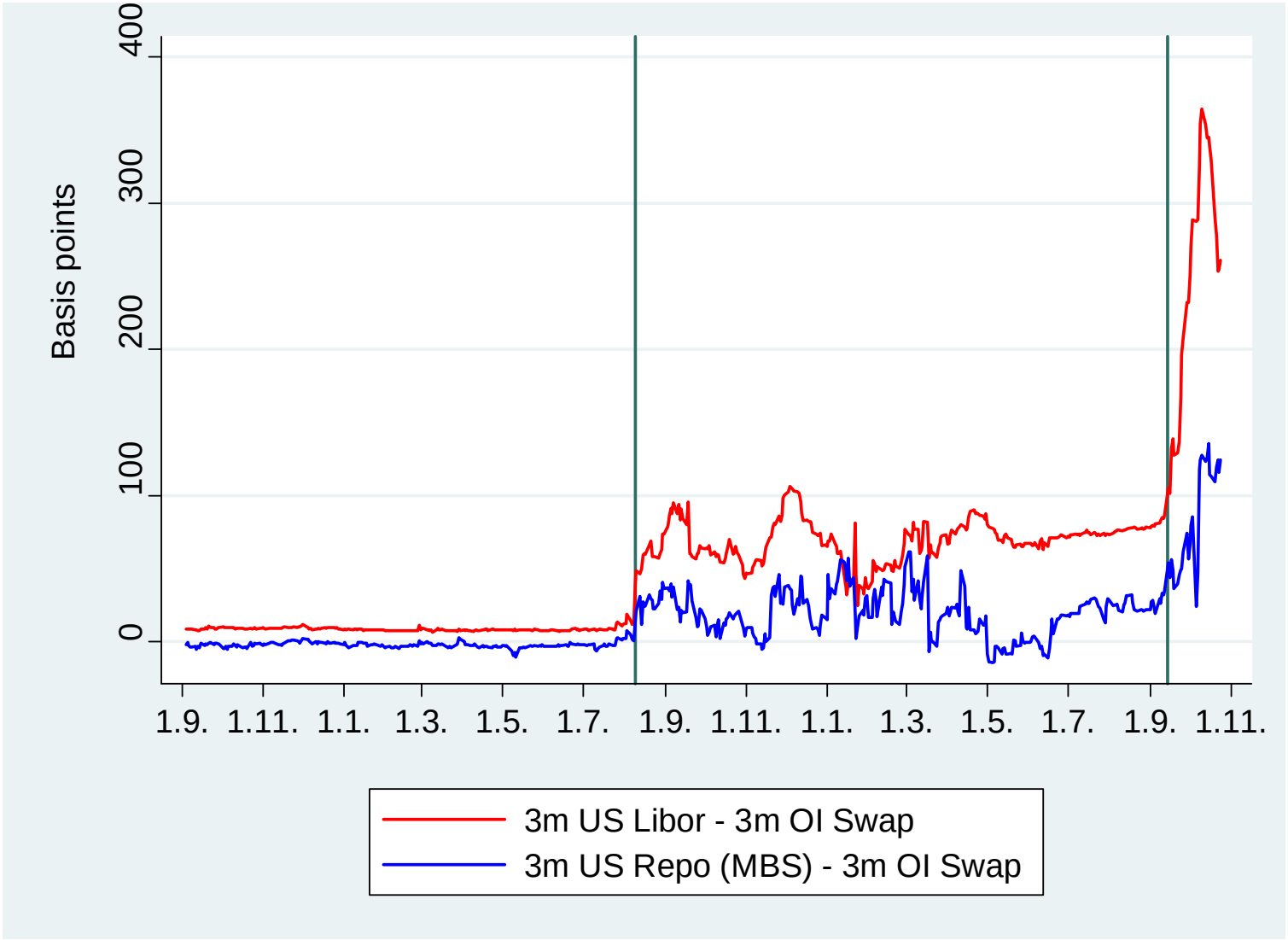

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