BANQUE DE FRANCE
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BANKS' LIQUIDITY IN VOLATILE MACROECONOMIC AND MARKET ENVIRONMENTS

AGNÈS BÉNASSY-QUÉRÉ
DEPUTY GOVERNOR, BANQUE DE FRANCE
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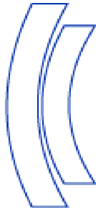
INTRODUCTION

“With capital regulation, there is a huge literature but little agreement on the optimal level of requirements. With liquidity regulation, we do not even know what to argue about.” (Allen and Gale, 2017)

OUTLINE

1. The case for a macroprudential approach to liquidity
2. Banks’ excess reserves at the central bank
3. Implications of retail central bank digital currencies



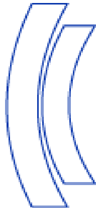
1. The case for a macroprudential approach to liquidity

1. Reluctance of banks to drawdown liquidity buffers during crises
2. Liquidity **ringfencing**
3. Spillovers from **NBFIs**
4. **Trade-off** between deleveraging and liquidity provision in stress periods
5. Liquidity risk with the central clearing **margin calls**

1. **Less procyclicality** in margins and haircuts
2. **Investment funds**: ability of macroprudential authorities to activate liquidity management tools (LMTs) to groups of funds

Usual objection of **moral hazard** to be balanced against the need for central bank intervention ex post.

Needed: further research in this area.



2- Banks' excess reserves at the central bank

EXCESS RESERVES FILLING LIQUIDITY REQUIREMENTS

- **Euro area**: excess reserves ≈ 65% of LCR HQLA at 31/12/2023 (Sovereign bonds: 30%).
- Especially for banks with lower LCRs relative to their peers (Kedan and Ventula Veghazy, 2021)
- **CB balance sheets** may need to remain larger than they were prior to the financial crisis

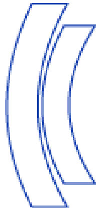
THE SUPPLY OF RESERVES

- ECB, Fed, BoE have decided to keep ample reserves and a **floor** rather than a corridor system

- Which **composition of HQLA**?
  - ECB: broad collateral framework to avoid situations of impairment of market functioning, and situations in which collateral would become too scarce due to the central bank’s market footprint.

NBFI RESERVES IN TIMES OF STRESS

- **Ex ante**: macroprudential liquidity buffers.
- **Ex post**: provision of liquidity in times of stress:
  - **Bank of Canada**: NBFI temporary access to CB liquidity during Covid
  - **Bank of England**: possible, contingent and non-permanent access of insurance companies and pension funds
- A **quid-pro-quo** approach?



3. Implications of CBDCs

WHY RETAIL CBDCs?

1. Monetary anchor
2. Secured and anonymous means of payments
3. (Financial inclusion)

MONETARY ANCHOR

"The idea of a disembodied fiat unit of account, with embodiments of it freely and competitively supplied by private agents, seems to me to be a fairy tale" (James Tobin, 1985, p. 22).

POSSIBLE IMPLICATIONS FOR BANKS' DEPOSITS

Lower deposits? (Fernandez-Villaverde et al 2021; Tenner et al. 2023)	**Volatile deposits?** (Kumhof and Noone 2018, EBF 2021, Angeloni 2023)
a) Holding limits, zero remuneration b) Waterfalls, reverse waterfalls → Retail CBDC as a means of payment rather than a store of value → No holding limits for banknotes → **Will households hold more CBDC than banknotes?**	a) Holding limits b) Risk is elsewhere: (i) large, unsecured depositors (ii) runs, wholesale market (iii) money market funds c) Retail customers can already transfer deposits → **Will CBDCs really change deposit stability?**

- **Counterfactual:** stablecoins, e-money institutions, narrow banking constructs, some sponsored by BigTechs.
- **Retaining deposits through offering new services**.
- **Financial inclusion**.

CONCLUSION

- **Three structural changes**: NBFI, excess reserves, CBDCs
- Public and private institutions need **to adjust**
- **Further research** welcome: new liquidity requires… new plumbing.