

Hunting for Dollars

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Contribution

- Novel empirical evidence on
 - How regulation matters for financial intermediaries/institutions through the **balance sheet** channel.
 - Dollar is special – intermediaries/institutions have **inelastic demand for USD**.
- Main exercise similar to the quarter-end window-dressing exercise of Du, Tepper Verdelhan (2018)
- DTV2018: CIP deviations large at quarter ends.
- KMR2024: Spikes in FX swap volume at quarter ends – non-US banks satisfy inelastic dollar demand through FX swaps given regulatory constraints.

Motivation

- Basel III: capital adequacy regulations impose constraints and opportunity costs on balance sheet size/space.
- Two ways non-US banks access USD:
 - **Wholesale (repo)**: on balance sheet (regulated) but inexpensive.
 - **Synthetic (FX swap)**: off balance sheet (no regulatory pressures) but expensive measured by basis (deviation from CIP).
- At quarter-end, the regulator shows up. Window-dressing: banks switch from wholesale to synthetic albeit more expensive.
- Why not give up USD funding business? Inelastic demand for USD.

Data

- Bespoke CLS dataset with quantities, prices, and counterparties.
- Counterparties manually classified into 3 categories: global systemically important banks (G-SIB), regular banks, and non-banks.
- Nationality classification: JP Morgan's London branch considered US.
 - Justification: balance sheets are reported in USD, and the deposit base is in USD.
- Captures at least 30% of FX market according to BIS.
- [Bank Positions in FX Swaps: Insights from CLS.](#)

What do the data tell us?

- Lending behavior in the FX market:
 - Market **dominated by G-SIBs (big banks really)**.
 - G-SIBs are lenders, with US G-SIBs being largest.
 - US G-SIBs lend to non-US G-SIBs, and non-US G-SIBs lend to end customers.
 - Customers (regular banks and **non-banks**) are **net borrowers**.
 - Figure 2 shows a neat network visualization.
- On FX swaps trading volume
 - FX swap trading volume **spikes at quarter-end** (Figure 4).

Key Result: Repo-FX Swap Substitution

Frictions in wholesale funding spill over into FX markets.

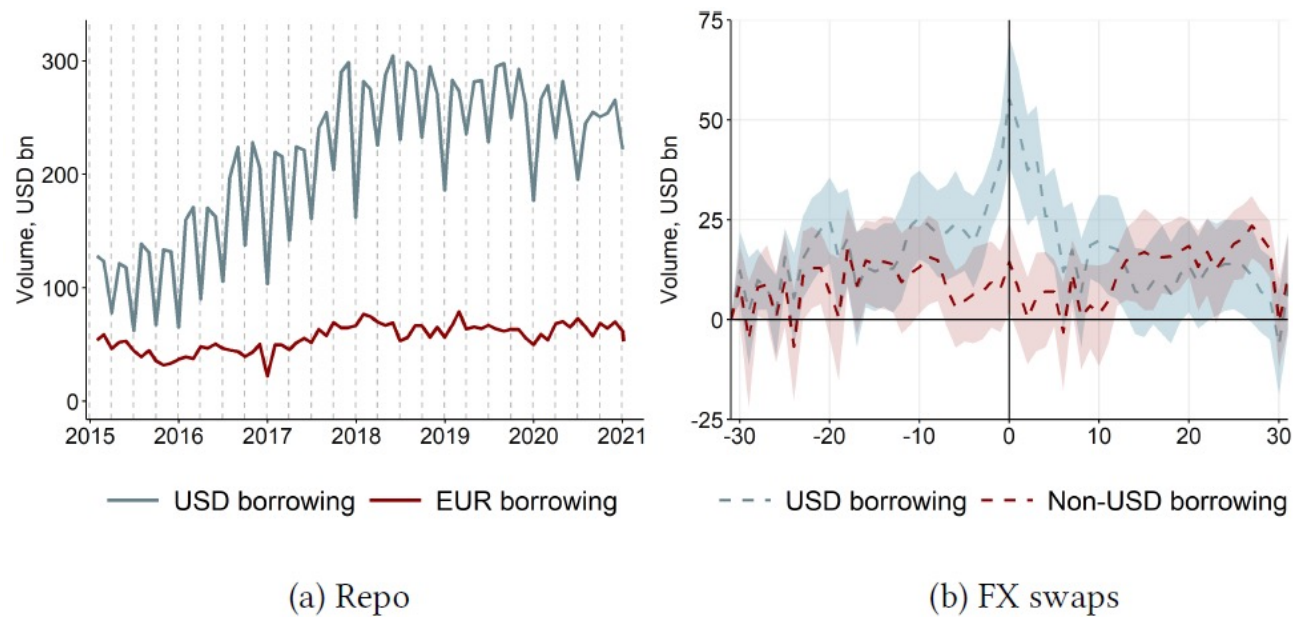


Figure 5

Identification via Heterogenous Regulations

- To establish substitution across dollar funding sources, authors utilize heterogenous regulation patterns to conduct a DiD analysis.
- The regulatory incentive differs across banks in different regions:
 - **US** and **UK** banks regulated using **average ratio over quarter**.
 - **Eurozone** banks regulated using **quarter end ratios**.
- Thus, **UK banks** do not have an imperative to window-dress at quarter end. Use **as control group** and conduct DiD.
 - Indeed, no window-dressing behavior for UK banks.
 - So, the pattern in Fig 5 is more likely not a coincidence.
 - Fig 6 and Table 2.

Implications for Financial Stability?

- Paper suggests that quarter-end window dressing is **efficient from the banks' perspective**: substantial net savings for Eurozone banks due to repo-FX swap substitution.
- What about **welfare implications**? Of substitution? Of pricing distortions?
 - Excessive risk taking (circumventing regulation via swaps) relative to their US, UK counterparts?

Summary

- Really enjoyed reading paper.
- A clever and neat empirical setting to cleanly identify substitution across dollar funding sources.
- An impressive new dataset.
- Look forward to seeing it in print!