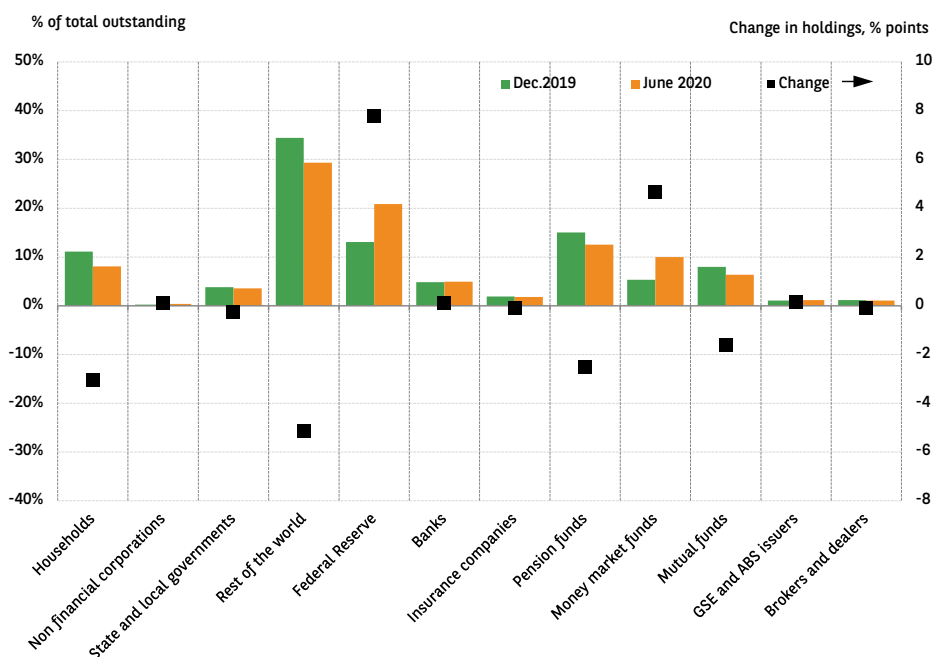


28 October 2020

TREASURIES HAVE PRETTY MUCH BECOME PROXIES FOR CENTRAL BANK RESERVES FROM A REGULATORY POINT OF VIEW

Céline Choulet

Breakdown of Treasuries by holder sector



Source: Federal Reserve

On 20 October banking regulators finalised the transposition into American law of the Basel Net Stable Funding Ratio (NSFR)* liquidity requirement. This requires banks to maintain a stable funding profile with regard to the theoretical liquidity of their exposure over a one-year period (in order to protect their capacity to maintain exposure in the event of a liquidity crisis).

The final rule differs from the Basel standard, by allocating a nil stable funding requirement to high-quality liquid assets (such as Treasuries) and short-term loans guaranteed by such assets (reverse repos)**. Although it does not eliminate the risk of renewed market dysfunction, this provision should help prevent the NSFR requirement from exacerbating the stress that is caused during episodes such as those in the repo markets in September 2019 (due to a lack of central bank money) or the Treasuries markets in March 2020 (due to the emergency sell-off of securities by a broad range of investors). By giving Treasuries the status of near-substitutes for cash and central bank reserves, it effectively serves, in periods of abundant reserves, to encourage banks to circulate central bank money (by lending on repo markets or investing in Treasuries) and maintain their market-maker role. At the end of June, banks held 5% of outstanding Treasuries.

* Nine banks will be subject to the full requirement from 1 July 2021, with eleven others covered by a looser standard.
 ** European regulation 2019/876 makes the same adjustment but for a transitional period of 4 years from its application on 28 June 2021.

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