The Workings of Liquidity Lines Between Central Bank

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What is a liquidity line?

- Collateralised loan at term between a source and recipient central bank.
  - Loan (typically) denominated in source currency.
  - Collateral can be recipient currency (swap line) or securities (repo line).
- Modern usage: fund source currency liquidity facility operated be recipient central bank for banks in its jurisdiction.
- Historically: also a tool for managing exchange rate pegs.

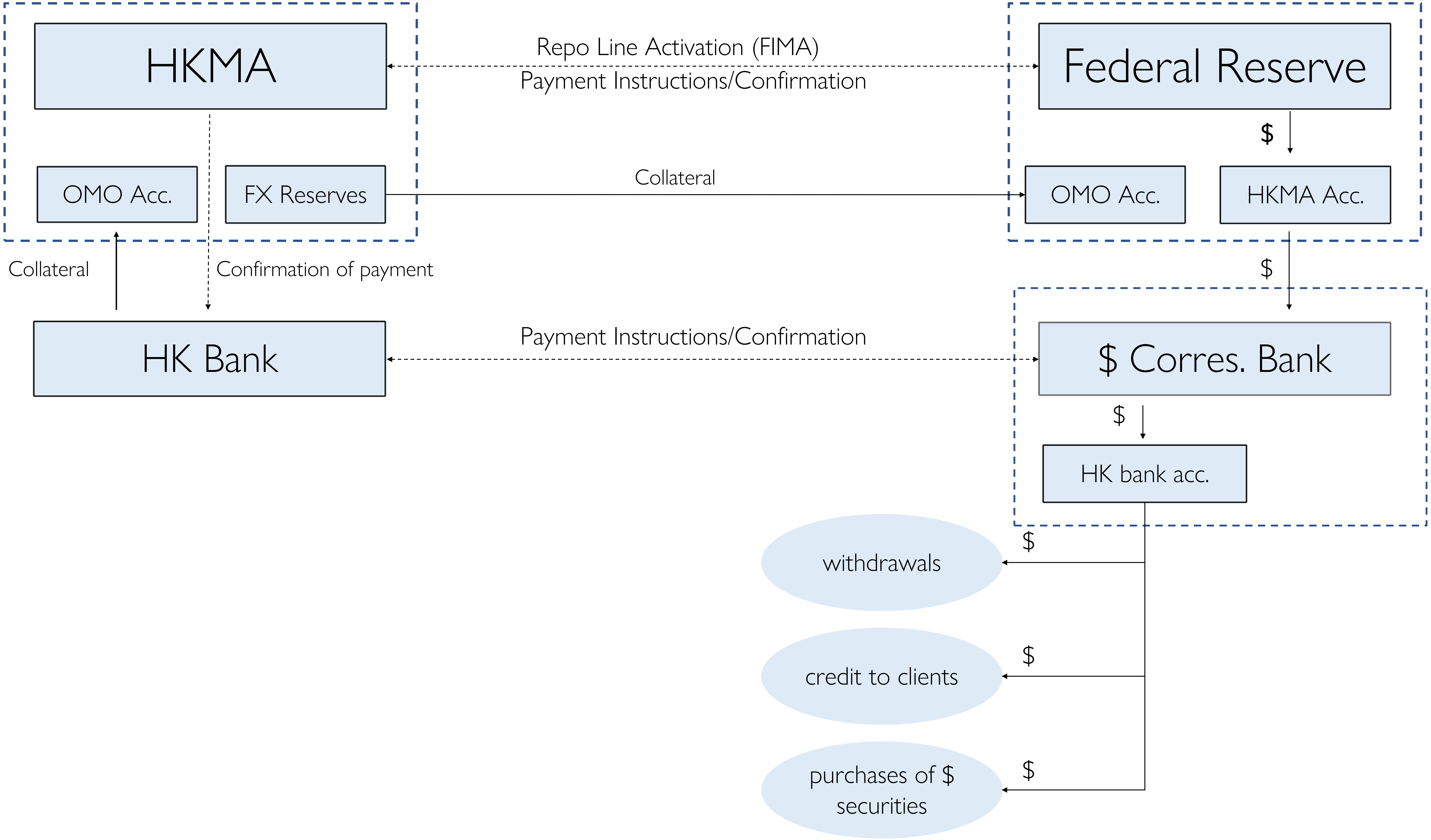
This talk:

(i) Conjuncture and motivations; (ii) Operational features; (iii) Lessons for policy.

The Modern Network - 2020

Source: Albrizio et al (2020), Perks et al (2021).

Liquidity Lines as a Financial Stability Tool



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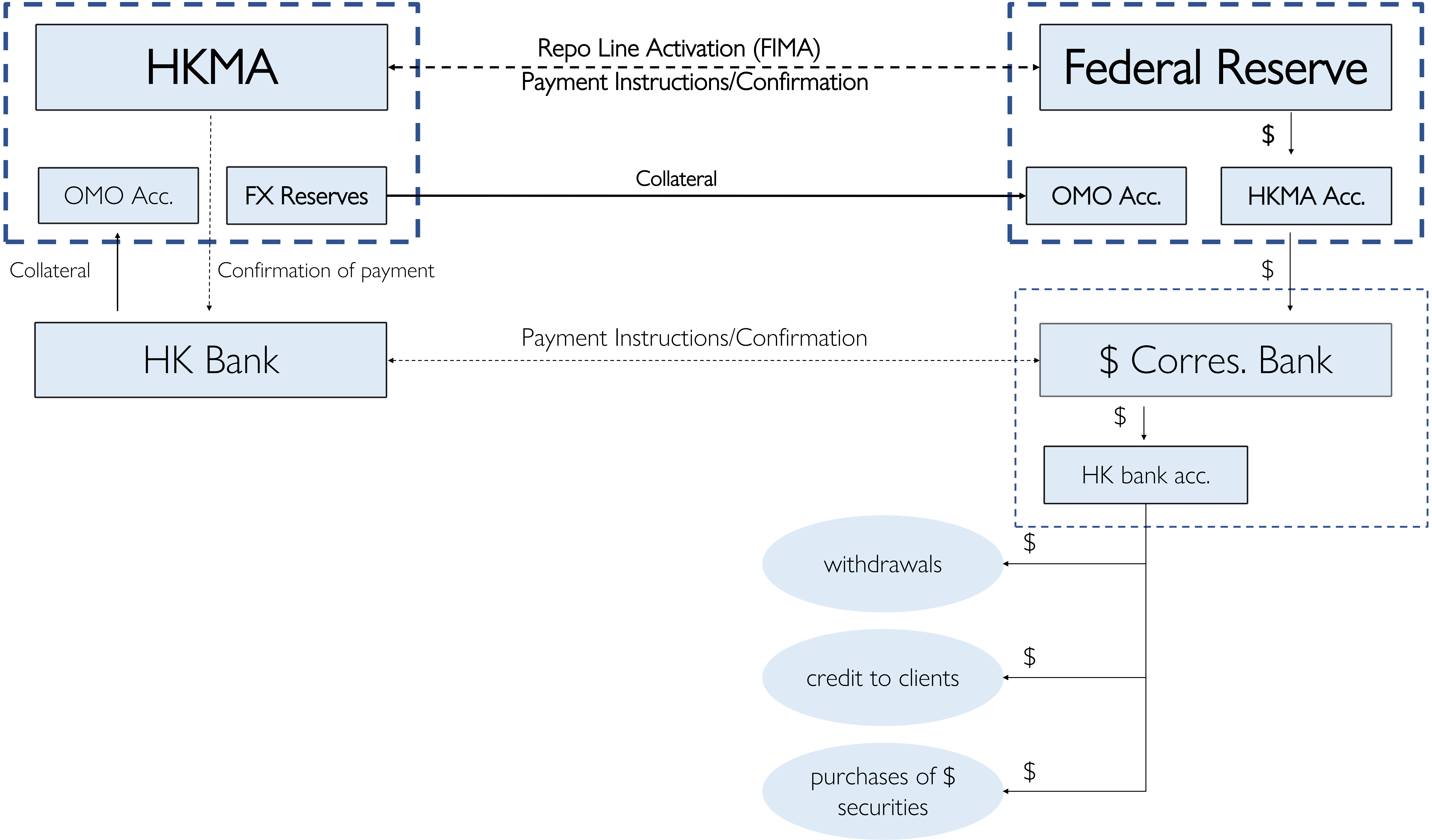

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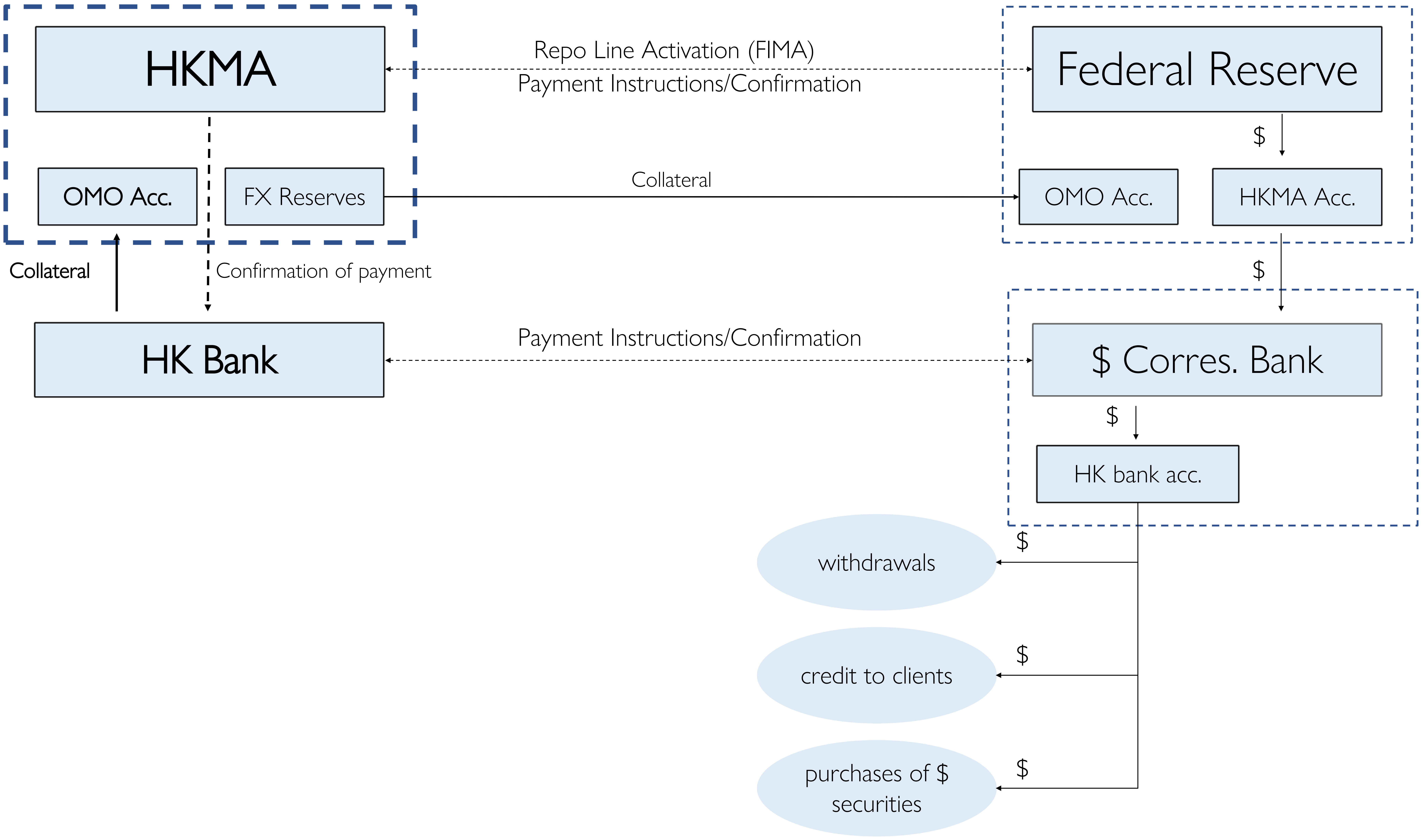

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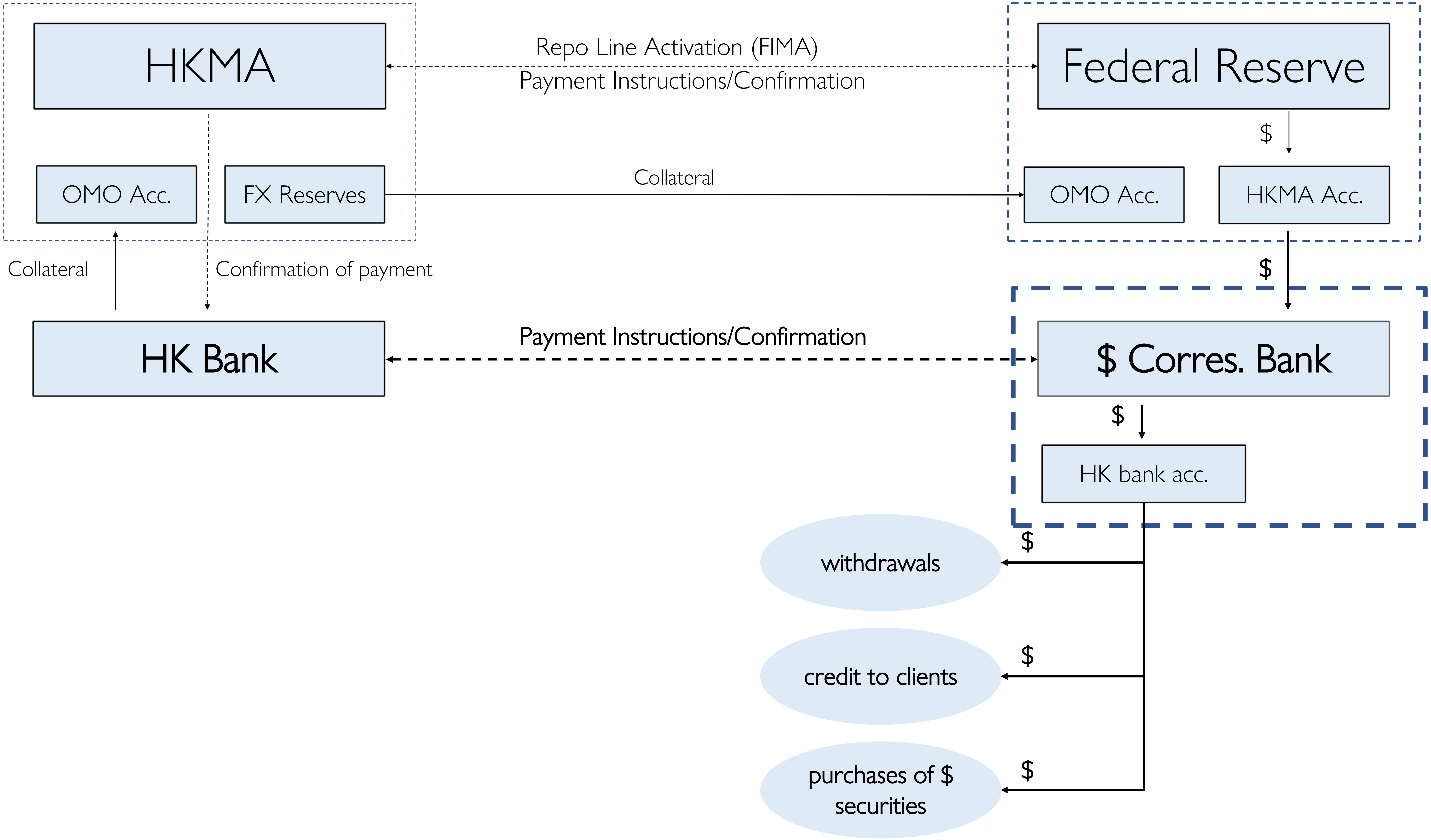
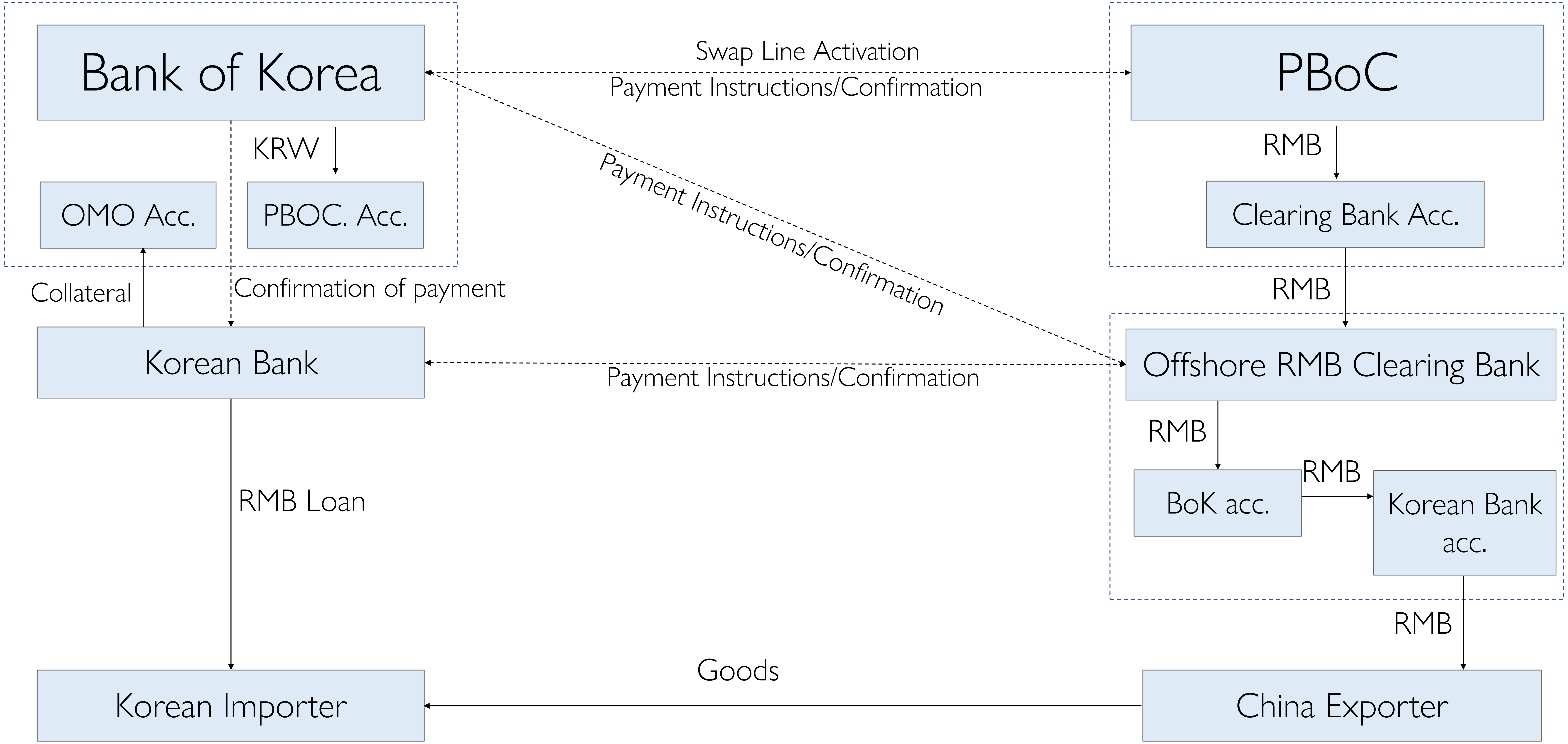


Liquidity Lines for Trade Finance



Properties

Liquidity assistance to foreign bank using foreign central bank to do the monitoring of the collateral and of the bank.

- Source monetary base expands not recipient monetary base. No FX or interest rate risk. Recipient CB bears private credit risk, source CB sovereign risk.
- Basic function of central banks:
  - Source CB: best suited to provide the liquidity.
  - Recipient CB: best suited to do the monitoring.

Economic Effects

Main economic effect: ceiling on offshore borrowing costs.

Also:

1. Encourages currency use.
2. Capital inflows into assets denominated in source-currency.
3. Raises profitability of foreign banks with source currency assets.

Some Lessons

For policymakers

1. Collateral (and disclosure) regimes are inconsistent across central banks.
2. Consider setting up standing facilities.
3. Specify the terms of the liquidity lines ahead of time.

For applied researchers

1. Drawings from the line are not a policy choice.
2. The liquidity lines are one piece of the international financial architecture.
3. Effects should be more noticeable during crises.