

# Monetary Policy Implications of Market Maker of Last Resort Operations

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- 1) Why have a market maker of last resort?
- 2) Two recent episodes
- 3) Some recommendations on setting up a MMOLR

# Two distinct rationales for MMOLR

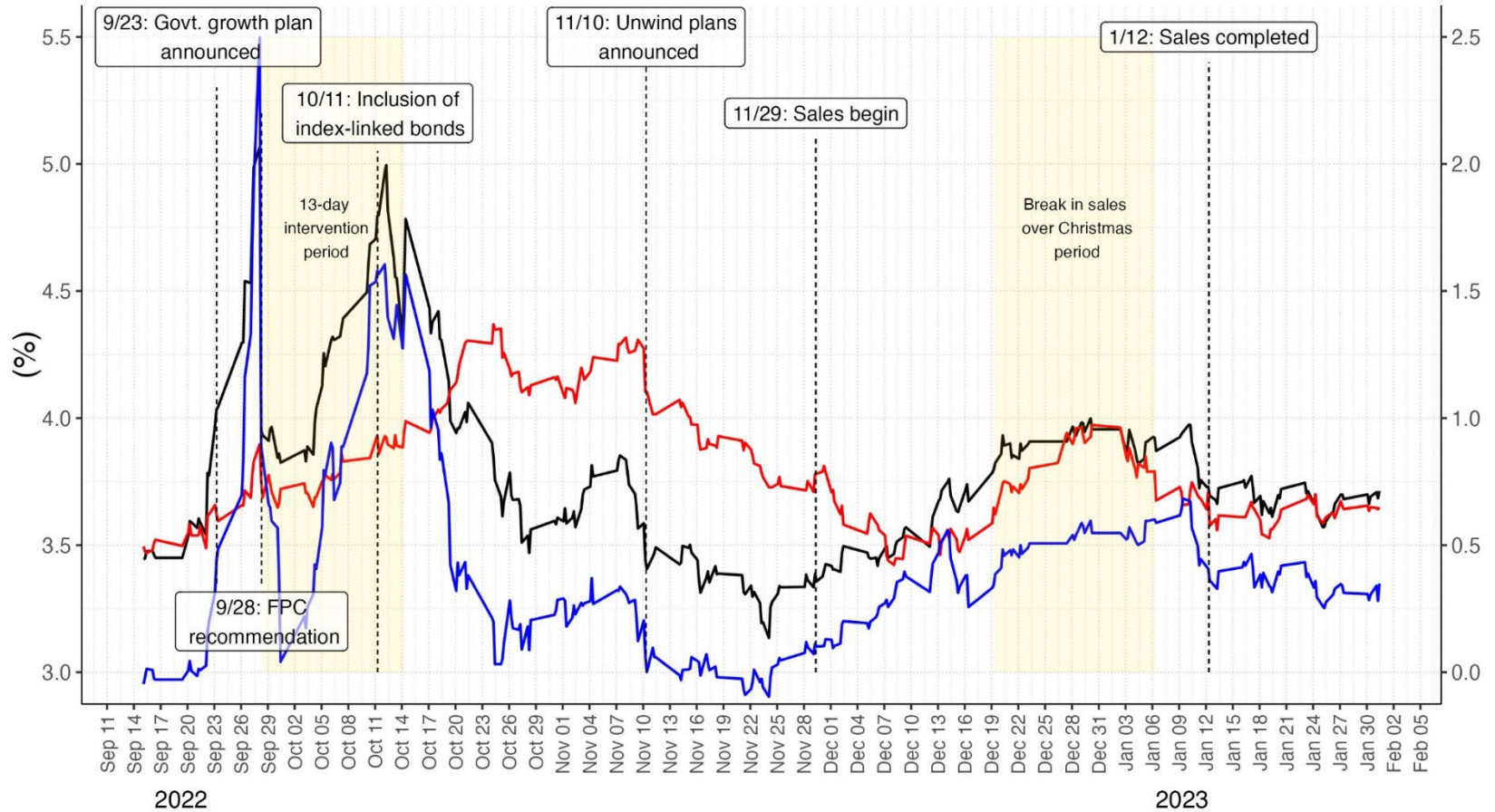
- The presumption that lending facilities will not be adequate (Hauser 2021)
- Stabilizing the safe yield curve
  - Limited moral hazard, favorable spillovers
- Ending a deep and persistent fire-sale of private securities
  - Aim to reactivate the primary issuance market
  - But moral hazard and other risks are present

# Market Maker of Last Resort

## Evolving FOMC rationale after the Dash for Cash

Date	Excerpts from FOMC Statements explaining purchase rationale
Unscheduled Meeting March 15, 2020	<i>To support the smooth functioning of markets</i> for Treasury securities and agency mortgage-backed securities <i>that are central to the flow of credit to households and businesses</i> , over coming months.....
Unscheduled Meeting March 23, 2020	The Federal Reserve will continue to purchase Treasury securities and agency mortgage-backed securities in the amounts <i>needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions</i> .
Regularly Scheduled Meeting April 29, 2020	... in the amounts needed to <i>support smooth market functioning, thereby fostering effective transmission of monetary policy to broader financial conditions</i> .
Regularly Scheduled Meeting September 16, 2020	In addition, over coming months the Federal Reserve will increase its holdings of Treasury securities and agency mortgage-backed securities <b>at least at the current pace</b> to <i>sustain smooth market functioning and help foster accommodative financial conditions</i> , thereby supporting the flow of credit to households and businesses.

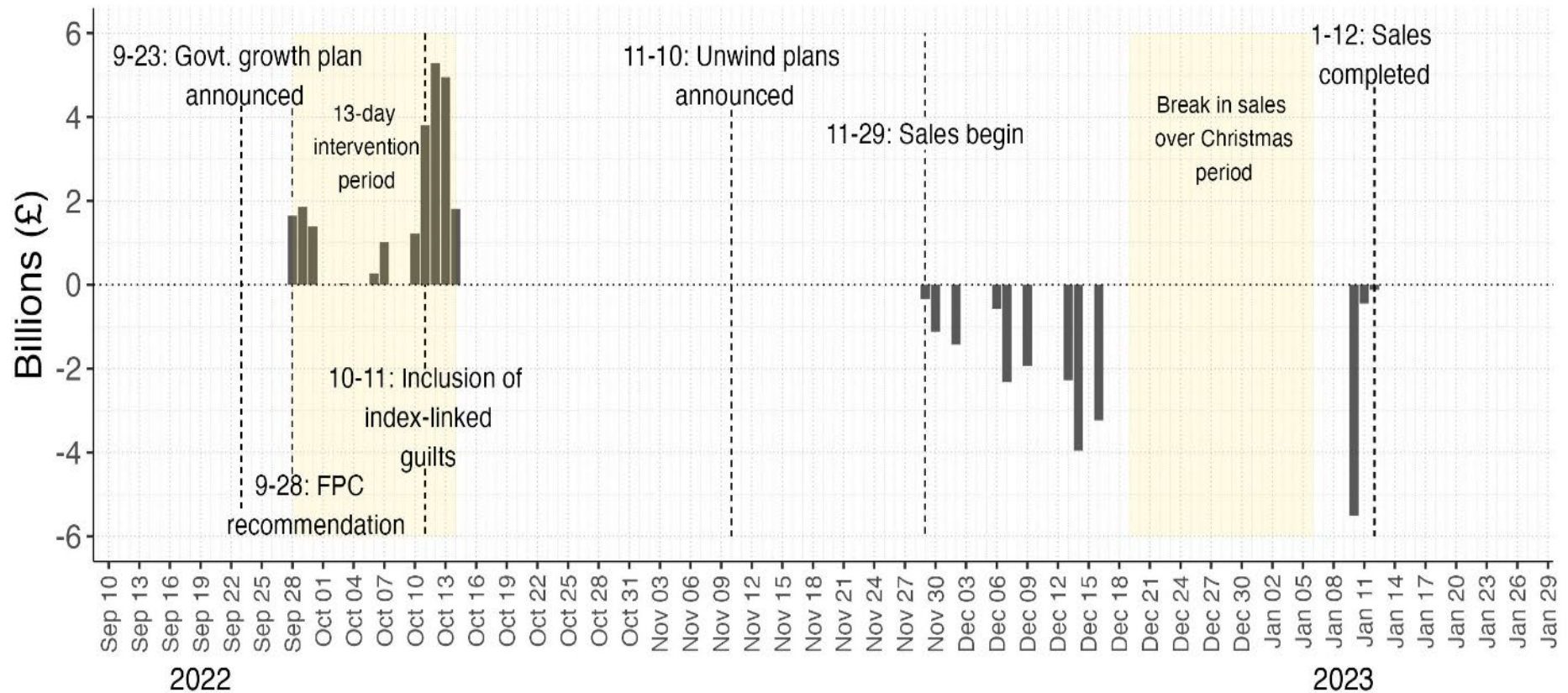
# Interest Rate Stress During the LDI Episode



- UK 30-year conventional yield (left axis)
- US 30-year conventional yield (left axis)
- UK 30-year real yield (right axis)

# Sharp Contrast with the UK LDI Episode

## Daily gilt purchases/sales



# The LDI Exit

- Commitment to exit in a timely and orderly fashion
- Demand-driven sales strategy
- Pressure from the FPC (or MPC) to follow through?
  - Should the CB care about making a profit?

# Form a Purchase Facility Committee (PFC)

- PFC Membership
  - Combination of monetary policymakers, **plus** at least head of the trading desk and financial stability division
- Logic for a separate body
  - Internal analytic clarity, plus benefits of specialist staff (including ceasing purchases)
  - External communications
  - Separating ex-post accountability and insulating monetary policy



# Start Consulting Now!

- Complex design issues
  - Eligible securities and counterparties, pricing, quantity limits, etc.
  - Governance of the balance sheet
  - Information that will be shared in advance?
- Reaction functions matter for financial stability