Universität Basel

Research Project

Exit Strategies and Trade Dynamics in Repo Markets

Project funded by own resources

Project title Exit Strategies and Trade Dynamics in Repo Markets
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Project start 01.01.2016
Probable end 01.01.2026
Status Active

How can a central bank control interest rates in an environment with large excess reserves? In this paper, we develop a dynamic general equilibrium model of a secured money market and calibrate it to the Swiss franc repo market to study this question. The theoretical model allows us to identify the factors that determine demand and supply of central bank reserves, the money market rate and trading activity in the money market. In addition, we simulate various instruments that a central bank can use to exit from unconventional monetary policy. These instruments are assessed with respect to the central bank's ability to control the money market rate, their impact on the trading activity and the operational costs of an exit. All exit instruments allow central banks to attain an interest rate target. However, the trading activity differs significantly among the instruments and central bank bills and reverse repos are the most cost-effective.

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393854	Berentsen, Aleksander	Kränzlin, Sébastien, Director	Swiss National Bank	01.01.2016	01.01.2026