

# Segmented Money Market and Covered Interest Rate Parity

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Sustainable  
Architecture for  
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## Objectives:

Document the violation of Covered Interest Rate Parity

Why do we observe this violation?

- a. Segmentation of the money market
- b. Heterogeneity in marginal costs
- c. Term funding liquidity premium
- d. Intermediaries order flows imbalance
- e. Arbitrage capital is difficult to deploy on a large scale

Why this violation is so persistent?

# Key findings and policy implications

- The CIP we observe could be exploited only by a limited number of banks, those that have access to cheap funding in US dollars
- The CIP is violated persistently because:
  - (i) Arbitrage capital is difficult to deploy on a large scale
  - (ii) CB QE affects marginal funding costs persistently
  - (iii) Intermediaries have to set an equilibrium price that allows to balance inventories

# Comment

- Very detailed analysis
- Very rich (maybe too much)
- Very interesting

# Comment

Given the different elements

- a. Segmentation of the money market
- b. Heterogeneity in marginal costs
- c. Term funding liquidity premium
- d. Intermediaries order flows imbalance
- e. Arbitrage capital is difficult to deploy on a large scale
- f. QE implementazion and CB deposit facility

Is there any way to disentangle among all of them?

Which one is the most relevant?

# Questions

Which one of these elements is the most relevant?

What are the policy implication?

How this issue could be solved?

- Is it enough to stop QE?
- Do we need a functioning interbank mkt to eliminate this CIP violation?
- Is it a regulatory capital issue?

# Questions

## Role of imbalance flows:

- I am sympathetic with this story..
- However, the empirical analysis is not convincing me:
- (i) provide some statistics of the variables you are using in terms of autocorrelation and other statistical proprieties, integration, cointegration etc.
- (ii) perform a proper Vector Error-Correction model as in several papers on the basis, see for example CDS-bond basis Fontana (2011) used by John Cochraine in his course.



# Questions

- Is the CIP violated only against the US dollar because of:
  - cheap funding in US dollar
  - large demand of US dollar around the world
- or is relevant for other cross currencies as well?
- Differences on marginal costs should be reflected in several „arbitrage opportunities“ and differences in funding (law of one price) i.e. Basis between spot and derivatives markets not only for exchange rates, do you know any evidence of this?



# Questions

- Terminology:
  - a. Term funding liquidity premia
  - b. Funding liquidity premia
  - c. Liquidity premia

Very interesting paper!

Enjoy reading it!



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