Money Market Funds and the Pricing of Near Money Assets

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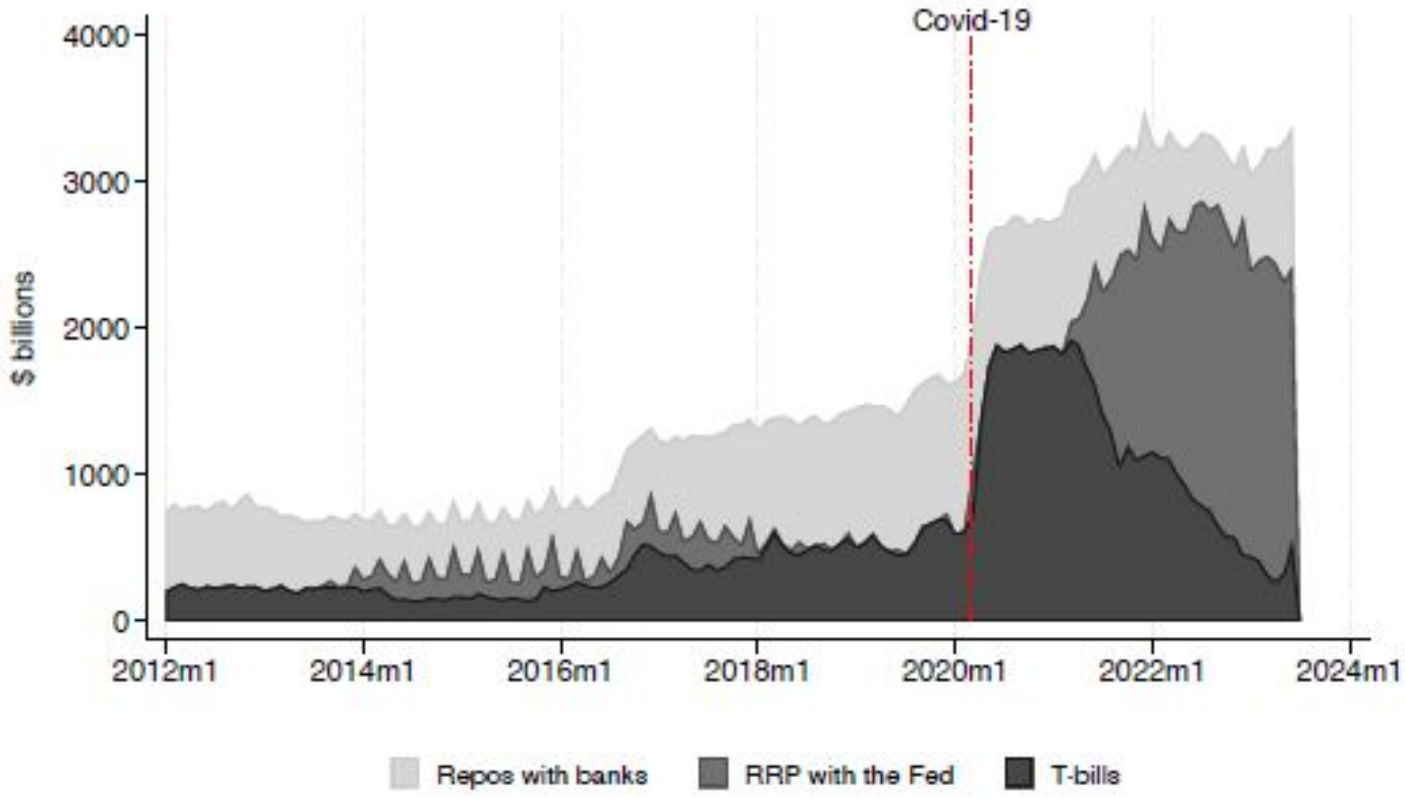
(US) Money Market Funds

- deposits from retail, firms and investment funds
- 6 Tr. AUM
- customers want VERY liquid investment
- regulation & sense $\rightarrow$ MM buy VERY liquid assets:
  (short-term treasuries, Repo with banks, Repos with the fed)

Interesting touch stones:

- Repo with US MMF is a key source of dollar funding for EU banks
- RP and RRP is a key monetary policy tool for the FED

Money Market Funds



(b) MMF portfolio allocation between T-bills, repo, and RRP varies over time

The Price of Near-Money Assets

- Assets that have money-like function: super save & super liquid
- Tend to be more expensie than assets that are only super save

For example:

- On-the-run treasuries are more expensive than off-the-run treasuries

Large literature:

- Krishnamurthy and Vissing-Jorgensen (2012)
- Greenwood, Hanson and Stein (2015)
- Nagel (2016)

This Paper: MMFs contribute to the high price of near-money assets.

How?

- MMF sector is huge (yes)
  $\Rightarrow$ they have price impact in the t-bill market (table 2, but questions)
- MMF sector is concentrated (yes, cool holdings data!)
  $\Rightarrow$ they internalize their price impact in treasuries
  (MMF with more market share in treasuries charge lower repo rates)
  $\Rightarrow$ they have pricing power in the bank repo market
  (MMF with more market power in bank repos charge higher repo rates)

Thus: MFFs integrate Bank Repo market with US treasury market.

- Repos more attractive for MMFs $\Rightarrow$ T-bill prices down
- T-bills more attractive for MMFs (e.g. more liquid) $\Rightarrow$ T-bill prices up

Why is this interesting?

- Not just another source of money demand:
  instead: intermediation friction.
- however: argument still requires money demand

What I do not understand: Identifcation of Price Impact

$$RP_t^{yield} - Tbill_t^{yield} = \beta\ residual\ cash\ share_t + controls_t + \epsilon_t \qquad (1)$$

problem: regress price on quantity $\Rightarrow$ endogeneity

solution: 2SLS, regress rcs on change of EU bank repo use into quarter end months

however: concern that *monthly* repo use reflects more than window dressing.

Very Happy I Read this Paper!

Further Comments

Is the volume of EU window dressing sufficiently large to plausibly impact MMFs residual cash holdings?

"Institutional Details" currently is 1 page.
I think it could be very helpful if you were to explain some of the things that are obvious to you: What kind of assets are the subject of Repos? What kind of repos with banks: Bilateral / Trilateral / Cleared? etc.