# Policy Coordination

## Debt and Cash Management and the Central Bank

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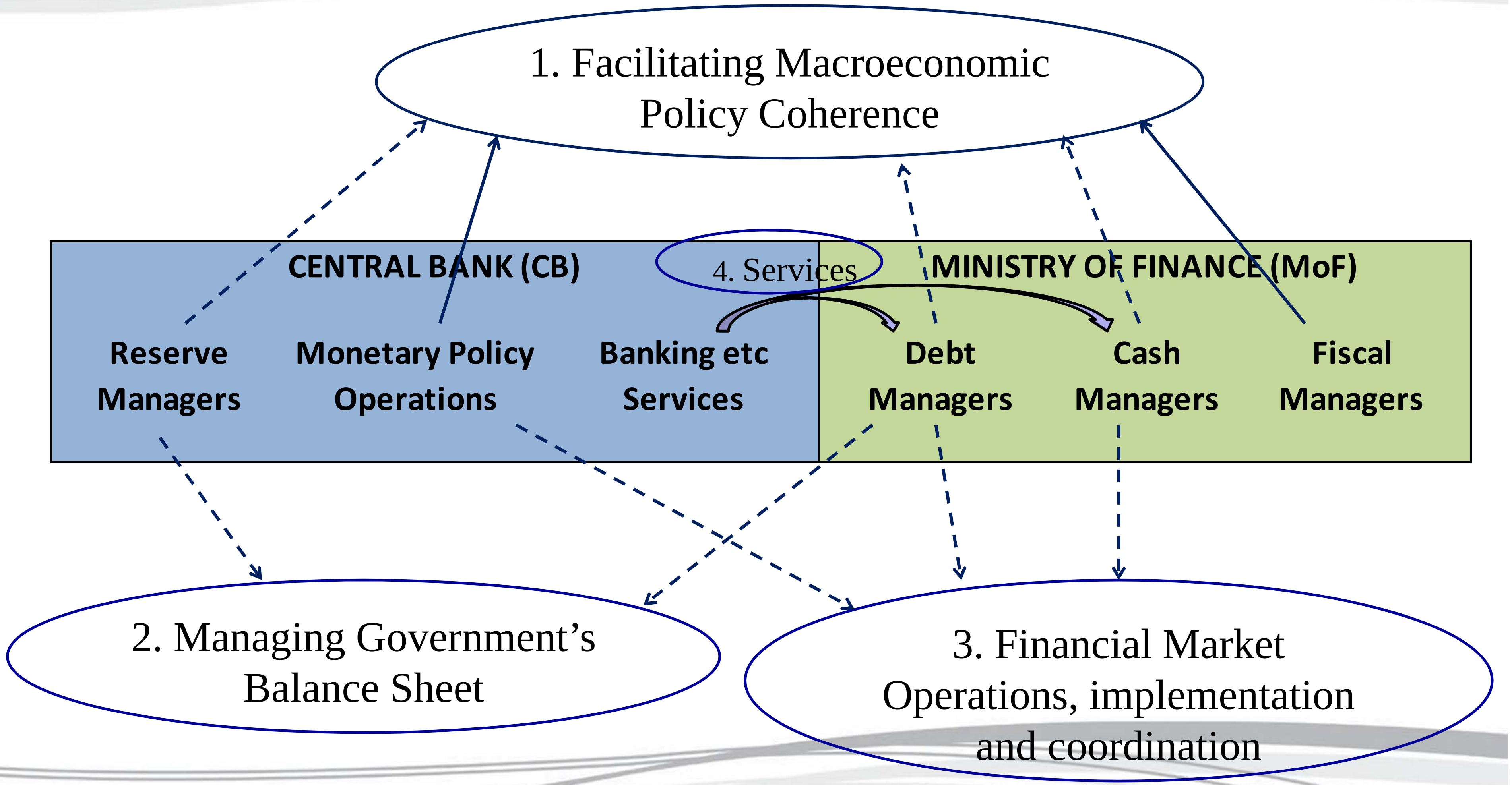
# The Challenge

- Central banks (CBs) and DMOs/treasuries have different policy objectives and operational requirements
  - Potential strains between fiscal and monetary policies
  - Inconsistent objectives for different parts of government balance sheet
  - Operational conflicts or clashes
- But they have common interests
  - Efficient debt, cash and monetary policy operations
  - Development of the money market
  - Well-managed flow of services
- Requires
  - Understandings about responsibilities and objectives
  - Effective governance and coordination arrangements

# An Overview – Policy and Operational Interaction




Focus today on 3 and 4; but first some brief comment on 1 and 2

# High-level Policy Coordination

- Model of last 30 years - separating monetary policy from fiscal and debt/cash management policies under some strain
  - Assumes highly liquid markets, and independence of policy instruments – even in developed markets compromised by QE
  - In less developed markets always the case that cash and debt operations may affect monetary policy operations & vice versa
- Still a case for operational separation; but that requires mechanisms to facilitate
  - High-level policy coherence
  - Coordination at operational level
- Different mechanisms
  - Potential use of Public Debt Committee (PDC) or similar to facilitate coordination
  - Brings together representatives of main macroeconomic policy functions to ensure that cash and debt management decisions are properly embedded in wider macroeconomic policies

# Changing Roles of CB and Treasury

| Traditional Roles → | Problems |
|---|---|

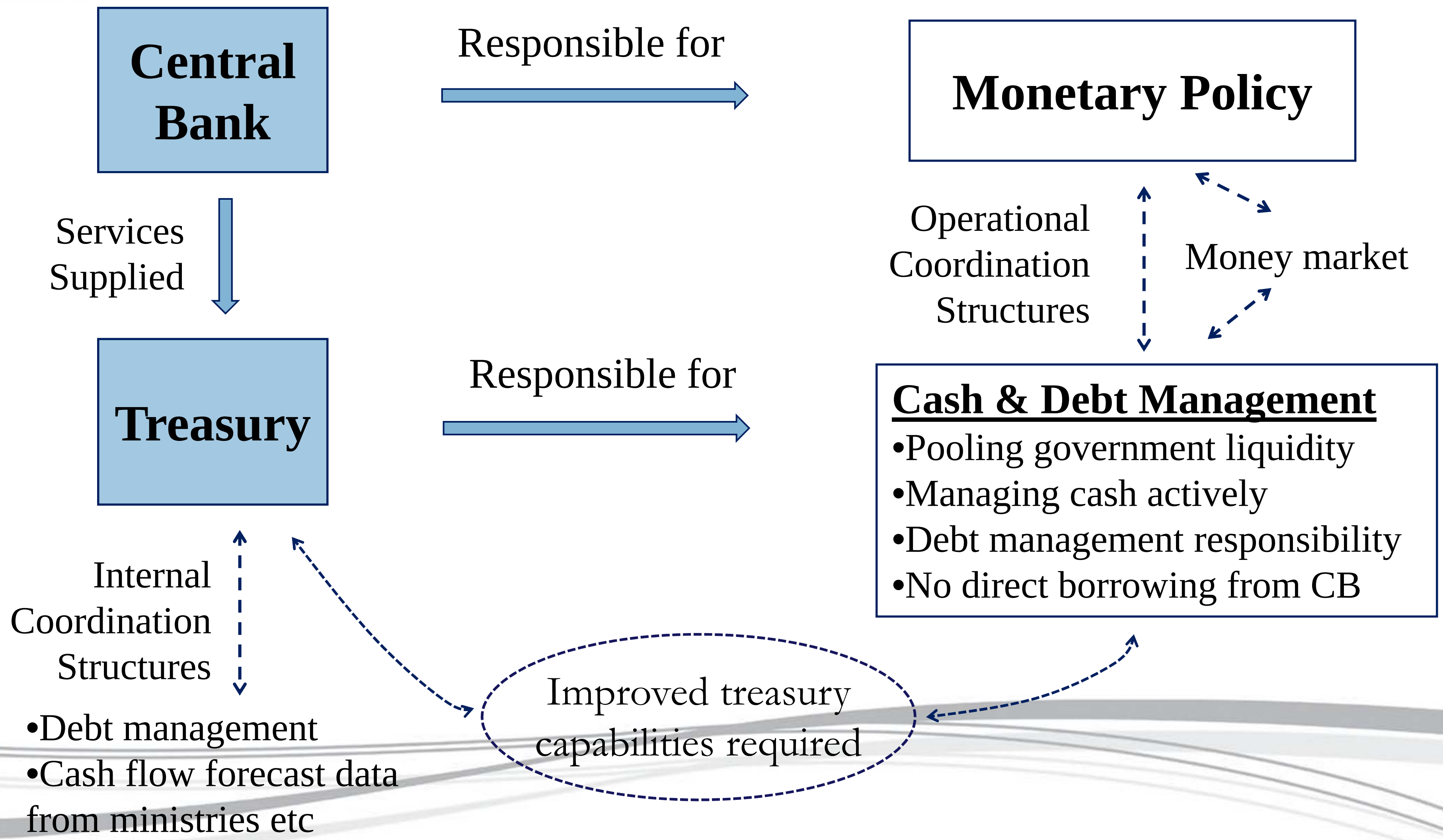
**Traditional Roles**

- **Treasury:** Treasury primarily a gov't payment office; TSA incomplete; limited cash management
- **CB:** managing domestic monetary conditions, including impact of gov't cash flows; directly influencing cash and debt management policies through its role as fiscal agent; range of services supplied to treasury

**Problems**

- Excess government liquidity; lack of interest on balances => a subsidy to banks
- Volatile government cash flows complicate monetary policy operations
- CB's implementation of debt and cash management policy potentially conflicting with monetary policy goals
- CB lending to government risking adding to inflation

# The New Framework



# Implications for Central Bank

- Less influence on choice of debt management instrument
- Movement of liquidity away from the banking system as TSA develops
- But as cash management develops:
  - Treasury will reduce cash balances
  - Reduced volatility of cash balances will benefit central bank – the counterpart is reduced volatility in banking sector liquidity
  - Bank may remain as fiscal agent – but clarity important
- Coordination and cooperation
  - Clarity on responsibilities and information flows
  - Operational interactions – eg auction timings
  - Mutual development of money market

# Some Policy Challenges - 1

### Tbills or CBBills

- Use of CBBills to drain domestic liquidity potentially fragments money market
  - Preferable for the treasury to sell additional TBills at the request of the CB, as an add-on to the normal auction
  - Must sterilize the proceeds by holding them in a separate account at the CB
  - Remunerate at discount rate set in the bill auction

### TSA in CB or Commercial Bank

- Intermediate bank may protect CB from cash volatility, but
  - Potentially weakens treasury's policy leverage over management of its cash flows
  - Adds a layer of complexity to coordination; information sharing more cumbersome
  - Exposes the government to moral hazard and credit risk
  - Lack of transparency and cross-subsidy may affect development of banking sector

# Some Policy Challenges - 2

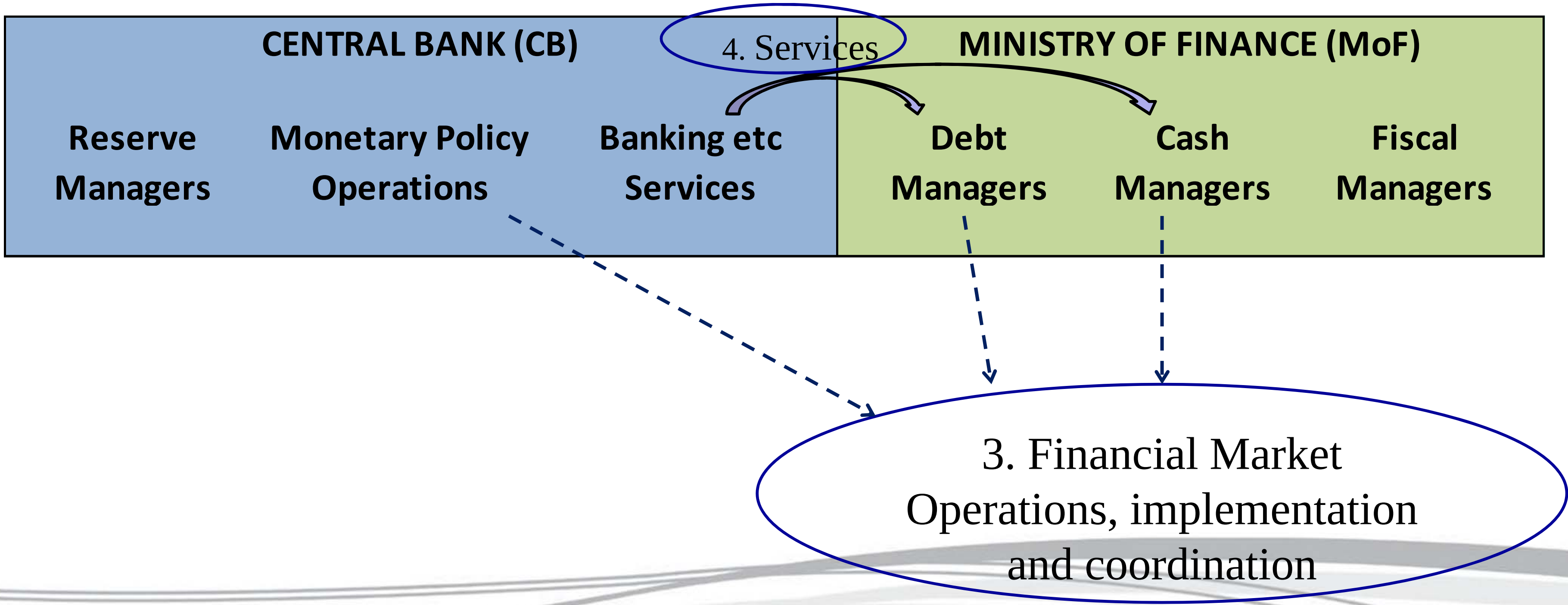
### Remuneration of Treasury Deposits at CB

- Good practice to pay interest on treasury deposits at market rate
  - Usually interbank rate or CB's policy rate
  - Improves transparency, avoids cross-subsidy
  - Removes incentive on treasury to take wrong choices on investment of surplus cash
- But treasury should pay transactions-related fees

### Other Issues

- Must define any use of overdraft
  - Term, rate, speed of repayment
- Structural surpluses – wealth funds, fiscal reserve funds etc
  - May be managed separately on or off CB's balance sheet
  - In all cases need transparent governance, agreement on objectives, asset allocation, reporting etc
- Who bears monetary policy cost ?
- CB views on debt instruments – eg preference for indexed or FX linked debt?

# Coordination Structures: Operations and Services



# Coordination Structures

- Must cover both policy and operations
- At different levels
  - Minister/Governor
    - Shadowed by regular meetings between senior ministry and central bank officials
    - Handle high level policy issues, firefighting
    - Identify areas for cooperation
  - Formal committee structures, e.g.
    - Public Debt Committee for high level policy coherence
    - Cash Coordination Committee for daily or weekly cash management operations
  - Technical working groups
  - Day to day operational interaction

# Coordination Mechanisms

- Formalize objectives and understandings
  - Legislation, Decrees, Regulations where needed
  - Terms of reference of committees and working groups
  - Memorandums of Understanding or Protocols on operations
  - Service level agreements (SLAs)
- Treasury "ownership" functions logically separate
  - Financial performance of CB, rules applying to dividend, capitalization, etc
  - Best managed separately from operational interactions

# Some Issues for the MoU(s)

- The joint program for the development of the money market
  - Including policies and operations for bill issuance and the respective roles of CBbills and Tbills
- How the CB reports its and the market's views about the debt and cash management program and operations (might be covered by the PDC)
- Choice of primary dealers or auction counterparties
  - Shared or independent
- The payment of interest on government balances at the central bank
  - Has be agreed at the policy level, but the basis of interest – maturity, relevant market analogues, etc – should also be identified (or in SLA)
- Information exchanges – respective responsibilities
  - Mechanism of communication and issues covered (e.g. the prospective auction schedule, cash flow forecasts, banking information)
- Determinants of e.g. the timing of respective auctions and the associated market announcements and any prior warning
- [Where the treasury is able to borrow from the CB], understandings of the limits (sums, maturities, ability to roll over etc.) of such borrowing

# Service Level Agreements (SLAs)

- Note the range of services supplied is potentially wide
  - Banker, fiscal agent, settlement agent, registrar…
- Some examples of issues covered
  - The notice that both sides would give of any impending change in the auction pattern or timetable
  - The turnaround times by the central bank in handling any relevant transactions, e.g. as fiscal or settlement agent.
  - Details of information flows in either direction, with intended timing, e.g. of cash flow forecasts or transactions across the TSA.
  - The basis of calculation of fees paid for the services (potentially covering compensation for any failure to meet the specified service)
  - Details of the rate of interest to be paid on government accounts
  - Exchange of risk-related information (including audit information)
  - The handling of any business continuity problem
  - The arrangements for handling disputes and for review of the SLA
- SLA normally reviewed regularly , e.g. every year, fees reassessed

# Conclusion

- The development of a modern debt and cash management function potentially affects the operations, finances and balance sheets of government and CB (and commercial banks)
  - CB may still control important segment of government balance sheet (FX reserves)
  - Movements of liquidity: but in time reduced fluctuation in cash balances benefits monetary policy
  - Interest payments and transactions fees improve transparency and remove cross subsidy
  - Transitional issues to address
- Importance of structuring at different levels
  - Areas of contention – but scope for cooperation, especially in money market development
  - MoUs and SLAs bring clarity and remove misunderstanding

**Thank You!**