

Central Bank Asset Purchases and Lending: Impact on Search Frictions

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Abstract

Central banks implement a combination of two policies: asset purchases and asset lending. The primary purpose of asset purchases is to lower interest rates; however, this impairs bond market liquidity, so central banks supplement the function of market liquidity by lending purchased assets. We apply a search-theoretic model to explore the impact of the securities lending facility (SLF) of central banks by introducing a central bank as a lender. We test three model predictions using intraday data from a Japanese government bond electronic platform. First, we find large-scale asset purchases (LSAPs) increase order imbalance in the repo market. Threshold analysis reveals that asset purchase amounts exceeding ¥9 billion (equivalent to 1.4% of the outstanding) generate a significantly higher proportion of bid orders. Second, the SLF rate has a ceiling effect on the repo rate by affecting dealers' choice between the repo market and the SLF. Third, new concrete friction measures are tested, showing that LSAPs and the SLF have opposite influences on bargaining power in the repo market.

Keywords: Order imbalance, sovereign bonds, large-scale asset purchase, bargaining power, repo

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