Institutional Designs to Alleviate Liquidity Shortages in a Two-Country Model

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Abstract

Fujiki (2003, 2006) extended the Freeman (1996) model to a two-country model, demonstrating that elastic money supplies in foreign exchange markets and the domestic credit market yield efficiency gains in monetary equilibrium, and that several institutional designs equally achieve the desired elastic money supplies. The present paper considers four institutional designs using a model similar to Fujiki (2003): a combination of central bank discount window policy and the CLS Bank; a central bank intervention both in the domestic credit market and the foreign exchange market; cross-border collateral arrangements; and foreign currency liquidity swap lines. These institutional designs yield the same efficiency gains in our model.

Keywords: Foreign exchange market, CLS, Cross-border collateral arrangements, Liquidity swap lines

JEL Classification: E58, F31, F33

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