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A System with Zero Reserves and with Clearing Outside of the Central Bank: The Canadian Case

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ABSTRACT

In a number of ways, implementing monetary policy in Canada stands apart from monetary policy in most other industrial countries. Commercial banks and other participants to the main clearinghouse – the large-value transfer system (LVTS) – hold no reserves at the central bank. Clearing and settlement is both in real time and net, while only settlement occurs on the books of the central bank. The Bank of Canada does not conduct open-market operations and rarely intervenes in the repo market; and despite this, the collateralized overnight rate always remains within 2 or 3 basis points of the target interest rate. The paper explains why this is so by describing the setup of the Canadian clearing and settlement system, including the rules that have been put forward in case a bank defaults on its due payments before settlement occurs. Some puzzles that arose through the years are also discussed, as well as the unlikely prospect of introducing blockchain technology in the Canadian clearing and settlement system.

KEYWORDS:

Clearing and settlement | overnight interest rate | systemic risk | government deposits

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Notes

1 Some of the issues discussed here were also tackled in Lavoie (2005) and Lavoie and Seccareccia (2006).

2 Nobody ever claimed that this was inflationary or that it promoted excessive public deficits.

3 A similar point is made by Fullwiler (2013, p. 178): ‘When analysing monetary policy, the better starting place is the modern central bank’s role in the national payment system’.

4 The CPA provides an excellent pedagogical website. See https://www.payments.ca/resources/learning-exchange

5 https://www.payments.ca/sites/default/files/10-Sep-18/2018_lvts_volume_and_value_summary_-_july_1.pdf

6 https://www.payments.ca/about-us/our-systems-and-rules/retail-system/statistics

7 See Payments Canada at : https://www.payments.ca/our-directories/high-value-system-lvts-participants There are only 12 direct clearers in the ACSS.

8 For instance, in the USA, payments can clear through Fedwire Funds Service, which is operated by the Fed and is a real-time gross settlement system (RTGS), while the Clearing House Interbank Payment Systems (CHIPS) is privately owned and nets payments, which are thus not irrevocable until the end of the day, when net final payments must be made through Fedwire.

9 https://www.payments.ca/sites/default/files/10-Sep-18/2018_lvts_volume_and_value_summary_-_july_1.pdf

10 More on this below.

11 The Bank of Canada has not performed any outright open market operation since 1995 (Lundrigan and Toll 1997-98, p. 36).

12 For a long time these liquidity operations were offered in fixed amounts at the target interest rate and carried out through the so-called special purchase and resale agreements (SPRA, to increase intraday liquidity) and sale and repurchase agreements (SRA, to remove intraday liquidity). When the Bank abandoned this way of proceeding and moved to competitive auction procedures at market-determined interest rates, the names changed to those indicated here. The Bank claims that this change sends funds to those that most need it.

13 Note that these ‘reserves’ represent only 0.03 per cent of the value of chequable deposits held at Canadian chartered banks, which was $810 billion at the end of

September 2018. See https://www.bankofcanada.ca/rates/banking-and-financial-statistics/chartered-bank-selected-liabilities-monthly-average-formerly-c2/

14 When good collateral is scarce, its repo rate tends to fall relative to other repo rates because lenders will tend to accept lower rates of return if they have a hard time to find borrowers who can provide good collateral. On one occasion, the Bank argued that the actual overnight rate was systematically below target because money markets got confused as they thought that the target rate was the uncollateralized rate, as in the USA, whereas in Canada the target is the collateralized rate.

15 Bindseil (2004, 2014), a central banker, also provides an institutional analysis of the defensive nature of central banking, in the U.S. and within the Euro zone.

16 How this can be reinterpreted within the post-Keynesian theory of endogenous money is explained in greater detail in Lavoie (2010b) and Fullwiler (2013).