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Opening Remarks

by

Philip N. Jefferson

Vice Chair

Board of Governors of the Federal Reserve System

at the

18th Central Bank Conference on the Microstructure of Financial Markets
Board of Governors of the Federal Reserve System

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It is my pleasure to welcome you to the 18th Central Bank Conference on the Microstructure of Financial Markets. This is the first time that this event has been held at the Federal Reserve Board, and we are very pleased to host the conference.

Before I begin, let me remind you that the views I will express today are my own and are not necessarily those of my colleagues in the Federal Reserve System.

Our guests include academics from a number of institutions, both in the U.S. and abroad; fellow central bankers, including colleagues from the Bank of England, the Bank of Japan, and the Bank for International Settlements; and friends from across the Federal Reserve System and from several U.S. government agencies, such as the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC), and the U.S. Treasury, including the Office of Financial Research (OFR).

Now, since this is what you have gathered here to discuss, I do not have to convince this group of the critical importance of well-functioning financial markets for the economy. In my case, coming as a macroeconomist from the academic world to the Federal Reserve has only reinforced that conviction.

Market Microstructure Is Important

Central bankers, regulators, and market participants ask a lot of financial markets. We want financial markets to be effective and efficient, and to aggregate and reflect all pertinent information. We rely on these markets to help us gauge how the economy is performing, to help us measure market expectations of monetary policy, and even to help us predict how the economy might evolve in the future. We want financial markets to be deep and liquid in good times, but also to remain deep and resilient when the economy is stressed. We want financial markets to be fair, so as not to favor certain participants. And central bankers, obviously, rely

critically on financial markets for the implementation and transmission of monetary policy. As we have broadened our arsenal of policy tools over the past two decades and as markets have become larger, more complex, and more diverse, I would argue that it has become even more critical for us to understand in detail how financial markets operate.

Effective and efficient financial markets do not happen automatically. The precise structure of each financial market, its trading rules, the mix of market participants and the constraints they face, how and how fast information is transmitted, all part of the microstructure of that market, do make an important difference. I think that fact has now become more widely recognized by economists. But it was not the case just a couple of decades ago, when most macroeconomists almost routinely assumed in their models that financial markets would function perfectly in the background. I believe that has changed—witness, for instance, the growth of macrofinance in recent years—and that change has certainly been an improvement.

A Few Words about the Program and Interagency Work

Now, let me say a few words about the first financial market this conference will focus on, the market for U.S. Treasury securities. The U.S. Treasury market clearly remains the largest and deepest government securities market in the world. But it has changed a lot. To quote a recent speech by our former Fed colleague Nellie Liang, who is now the Under Secretary for Domestic Finance at the Treasury, “The market has changed significantly over time, with changes in technology, participants, and regulations, and Treasury debt outstanding has grown substantially.”¹

Some episodes of stress in the Treasury market, including a flash event in 2014 and, more recently, the Treasury repo market disruptions of September 2019 and the so-called dash-for-

¹ See Nellie Liang (2022), “Remarks by Under Secretary for Domestic Finance Nellie Liang at the 2022 Treasury Market Conference,” remarks, November 16, <https://home.treasury.gov/news/press-releases/jy1110>.

cash episode in 2020, have focused the attention of researchers and U.S. government agencies on the plumbing of the market and on the composition and behavior of its participants. For example, an interagency working group, composed of staff from the U.S Treasury, the SEC, the CFTC, the New York Fed, and the Board of Governors—several members of the group are here—has been studying a broad range of ideas to enhance the resilience of the market. The U.S. Treasury has also spearheaded initiatives to enhance data transparency. And the SEC has sought comments on several proposals that could materially alter the structure of the market.

The Federal Reserve does not regulate markets, but we obviously have a special interest in the Treasury market, in part because some of our policy tools operate through that market and because of how important Treasury market functioning is to financial stability. And the recent discussions on the Treasury market have involved a lot on market microstructure and market design, including questions such as the following:

- Is the current intermediation capacity of dealers sufficient given the size of the market?
- Would an increase in the share of transactions that are centrally cleared help that intermediation capacity?
- Is a decentralized dealer-intermediated market optimal, or could an all-to-all market for Treasury securities be more resilient under stress?
- What are the respective roles of banks and nonbanks in this market?
- Are the incentives faced by market participants naturally leading the Treasury market to become more resilient over time? Or would some carefully crafted intervention be helpful?

As you can hear, this list of research questions contains a heavy dose of market microstructure content. Why am I sharing them with you? Just to make my final point: As

economists focused on market microstructure, what you do is important, and what you do is immediately relevant.

So, again, welcome to the Federal Reserve Board. I wish you an excellent conference.