Repos, Postponing Settlement

- Repo: repurchase agreement
- What is a repo?
    - A collateralized overnight loan
    - Organized as sale + repurchase of a security
        - Person who needs money sells a security (for cash) and promises to buy it back
        - The security is the collateral (if you don't repay, the other person still has your security)
            - The value of the collateral is generally higher than the value of the loan, so there is an incentive to pay back the loan and repurchase the security
- The repo market is for everyone, unlike the Fed Funds market
- Sometimes, the borrower has an incentive to default and not return the money
    - Generally, you can borrow 2% less than the value of the bond
        - The borrower has to put up margin
    - If the price of the bond goes down by more than 2%, the money borrowed is worth more than the collateral

Eurodollars, Parallel Settlement

- The last of the three wholesale money markets (other two are the Fed Funds and Repo markets)
- The LIBOR rate and the Fed Funds rate are generally the same because banks arbitrage away the difference
    - This is not true during a crisis: banks that need money but don't have access to the Fed Funds market can't get any other bank to lend to them
        - The LIBOR rate is higher than the Fed Funds rate so that banks are incentivized to borrow in the Fed Funds market and lend in the LIBOR market
- When a corporation in the United States holds a deposit in another country's bank, that bank holds a deposit in a US bank (because the US bank can't transfer Fed reserves out of the country)
    - The deposit held by the other country's bank are Eurodollars
- Eurodollar market is a credit extension of the Fed Funds market (doesn't behave the same in a crisis)
    - Banks in other countries could make loans to each other in the Eurodollar market
- Banks need to manage their liquidity by ensuring that at any given time, their cash outflow isn't higher than their cash inflow
    - They do this with Forward Rate Agreements (FRA)

- Forward Rate Agreements are an agreement to pay the difference between F% and the LIBOR rate
    - F% is the rate at which a bank borrows from another bank
    - Instead of actually borrowing from that bank, they borrow in the Eurodollars market and sell an FRA to the bank they are "borrowing from"
        - This essentially acts like borrowing from the back directly
        - This is simpler than an "on balance sheet" swap of IOUs