Working Papers on Economics - Uncertainty in the money supply mechanism and interbank markets in Colombia

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AUTHORS AND/OR EDITORS González-Sabogal, Juan Camilo Silva-Escobar, Luisa Fernanda Vargas-Riaño, Carmiña Ofelia Velasco-Martínez, Andrés Mauricio Publication Date: Friday, 15 of November 2013
We set a dynamic stochastic model for the interbank daily market forfunds in Colombia. The framework features exogenous reserve requirements and requirement period, competitive trading among heterogeneouscommercial banks, daily open market operations held by the Central Bank(auctions and window facilities), and idiosyncratic demand shocks anduncertainty in the daily auction. Analytical derivations of their decisionmaking process show that banks involvement in the interbank market andopen market operations depend on their individualrequirement constraintand daily liquid assets. Our results do not show a linkage between theuncertainty in the money supply mechanism and activity in the interbankmarket. Equilibrium interest rate for the interbank market is derived,and is shown that it is distorted by uncertainty at the daily auction heldby the monetary authority. Using data for Colombia, we test the mainresults of the model and corroborate the Martingale hypothesis for theinterbank interest rate.

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