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Near-Money Premiums, Monetary Policy, and the Integration of Money Markets: Lessons from Deregulation

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The 1960s and 1970s witnessed rapid growth in the markets for new money market instruments, such as negotiable certificates of deposit (CDs) and Eurodollar deposits, as banks and investors sought ways around various regulations affecting funding markets. In this paper, we investigate the impacts of the deregulation and integration of the money markets. We find that the pricing and volume of negotiable CDs and Eurodollars issued were influenced by the availability of other short-term safe assets, especially Treasury bills. Banks appear to have issued these money market instruments as substitutes for other types of funding. The integration of money markets and ability of banks to raise funds using a greater variety of substitutable instruments has implications for monetary policy. We find that, when deregulation reduced money market segmentation, larger open market operations were required to produce a given change in the federal funds rate, but that the pass through of changes in the funds rate to other market rates was also greater.

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Keywords: money markets; deregulation; market integration; monetary policy; Eurodollars; Regulation Q

JEL classifications: E50, G18, N22

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