

Bond Market Versus Banks. Financial Plumbing, Policy and Regulation

The banking system is the plumbing of the economy. The past 7 years have seen this plumbing system undergo extensive repair works. While repair and upgrading works are ongoing, capacity has to be turned down and alternative infrastructure employed. Regulators like the Fed have to ensure that such alternative infrastructure is created or supported. The bond market is the back up infrastructure and has done an excellent job. Successive rounds of QE have kept base rates low and total debt costs manageable.

For the banks, the upgrading works are almost over. It may be time to review or upgrade the bond market, hence the talk of normalizing the Fed balance sheet. For the banks, it will soon be business as usual.