Wholesale Funding Dry-Ups

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Summary

The Euro-denominated Certificate of Deposits (CD) had no market freeze but some individual dry-ups, associated with …

1. Worse ROA
2. Worse CDS
3. More impaired loans
4. Shortening of maturities
5. and larger issuance goes with larger ROA

Summary

The authors argue that …

1. Worse ROA suggesting some lenders are better informed
2. Worse CDS suggesting some lenders are better informed
3. More impaired loans
4. Maturity shortening
5. and larger issuance goes with larger ROA

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The authors argue that …

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2. Worse CDS suggesting some lenders are better informed
3. More impaired loans suggest no reverse causality
4. Maturity shortening
5. Also, larger issuance goes with larger ROA

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The authors argue that …

1. Worse ROA suggesting **some lenders are better informed**
2. Worse CDS suggesting **some lenders are better informed**
3. More impaired loans suggest **no reverse causality**
4. Maturity shortening suggest **information-sensitivity**
5. Also, larger issuance goes with larger ROA

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The authors argue that …

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2. Worse CDS suggesting some lenders are better informed
3. More impaired loans suggest no reverse causality
4. Maturity shortening suggest information-sensitivity
5. Also, larger issuance goes with larger ROA suggesting lender's reallocation ability

I think this paper …

- is **very interesting**
- addresses an **important and timely issue**, especially given the ongoing regulatory reform
- has potential for an original **contribution**, but …

- The (theoretical) explanations are limited
- The other main sources of liquidity are neglected
- Some statements and interpretations are stretched

Comment 1: Explanations

- Adverse selection (asymmetric information) theories postulate more "good" (bad") borrowers in times of risk because lenders are homogenously (heterogeneously) informed
- Only the **lender's** point of view! … and then test **borrowing**
- **Borrowers** matter! In addition to credit risk, heterogeneity in information, sophistication, market power, competition, rent extraction, …
- And about lenders, there is **more** …
  - Market power vis-à-vis banks needing liquidity (e.g. Acharya, Gromb, and Yorulmazer 2012)
  - Experience, learning (e.g. Arrow 1962; Grossman, Kihlstrom, Mirman, 1977)
  - …

Comment 1: Explanations

- Analyze the **borrower-lender relationships**, e.g.
  - Do a given lender reduce or stop lending to a given borrower with a deteriorated risk profile? Before or after?
- Analyze the **rates**, e.g.
  - Does quantity rationing go with higher rates? Before or after?

Comment 2: Other liquidity sources

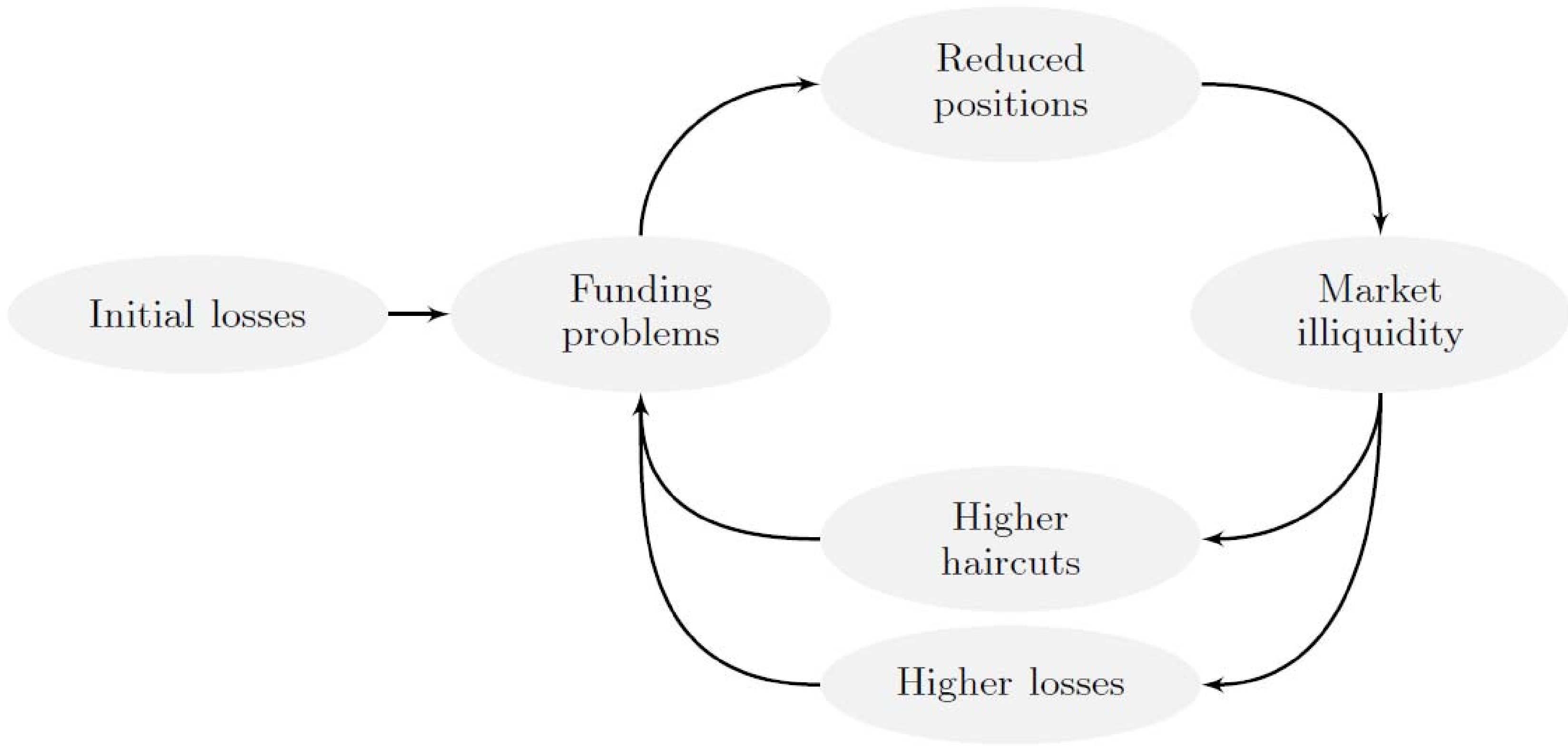
- This paper focuses **only on CD** as it would be the only source of short-term funding. But a bank can fund itself …
  - **Unsecured** liquidity, in various forms
  - **Secured** funding, in various forms
  - **Central bank liquidity**
  - **Asset markets**

Comment 2: Other liquidity sources

Liquidity sources	Related Theoretical Literature
Secured funding	E.g., Gromb and Vayanos (2002), Brunnermeier and Pedersen (2009), Acharya, Gale, and Yorulmazer (2009), Martin, Skeie, and von Thadden (2013)
Secured funding and Central bank	E.g., Ashcraft, Garleanu, and Pedersen (2010), Koulischer and Struyven (2014)
Unsecured funding	E.g., Acharya and Skeie (2011), Acharya and Viswanathan (2011)
Unsecured funding and Central bank	E.g., Freixas, Martin, and Skeie (2011), Allen, Carletti, and Gale (2009), Acharya and Tuckman (2013)
Secured and Unsecured funding	Ranaldo, Rupprecht, Wrampelmeyer (2016)
Secured, Unsecured funding, Central bank	Ranaldo, Rupprecht, Wrampelmeyer (2016)

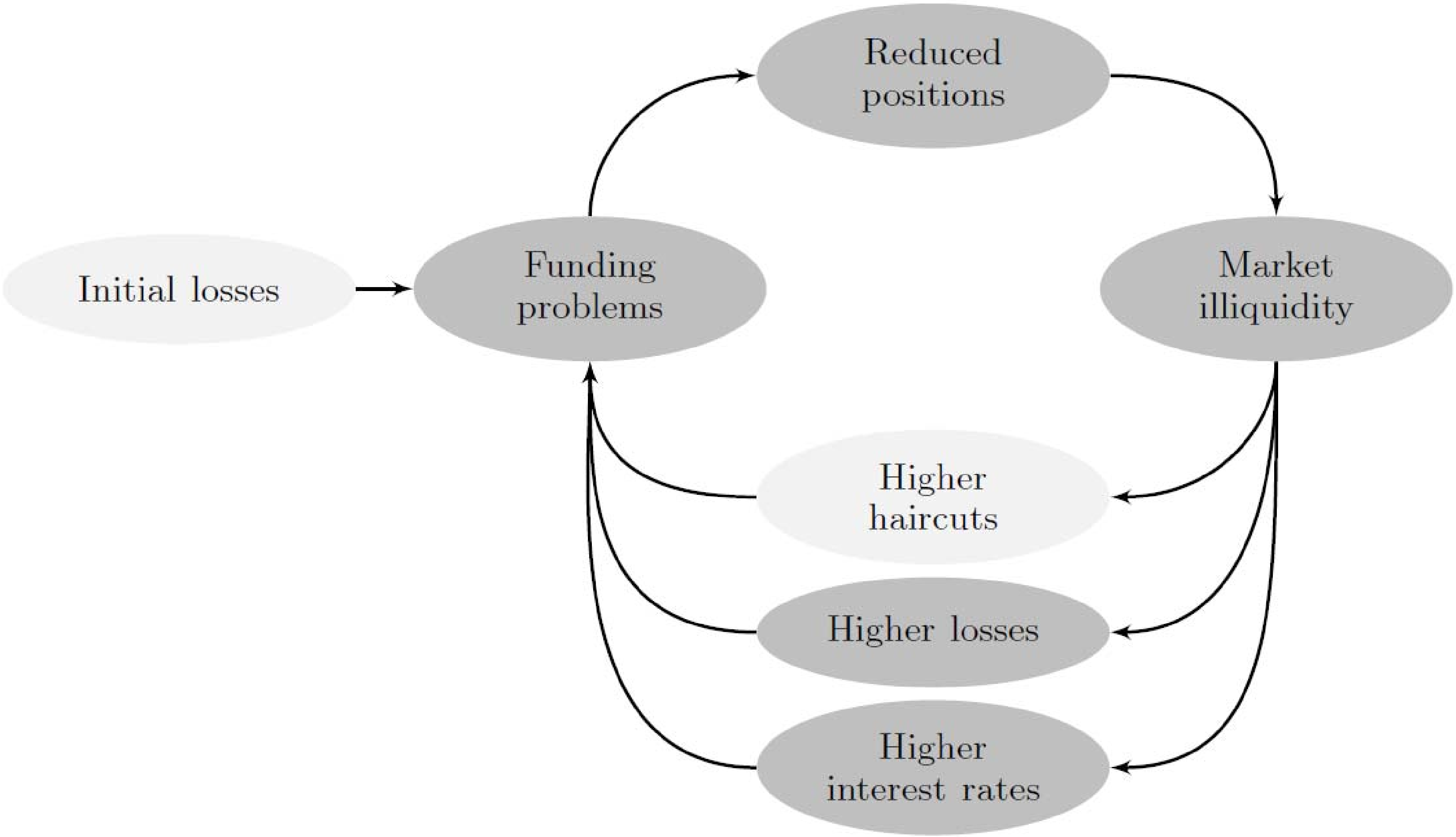
Brunnermeier and Pedersen (2009)

Margin and loss spirals in the secured market



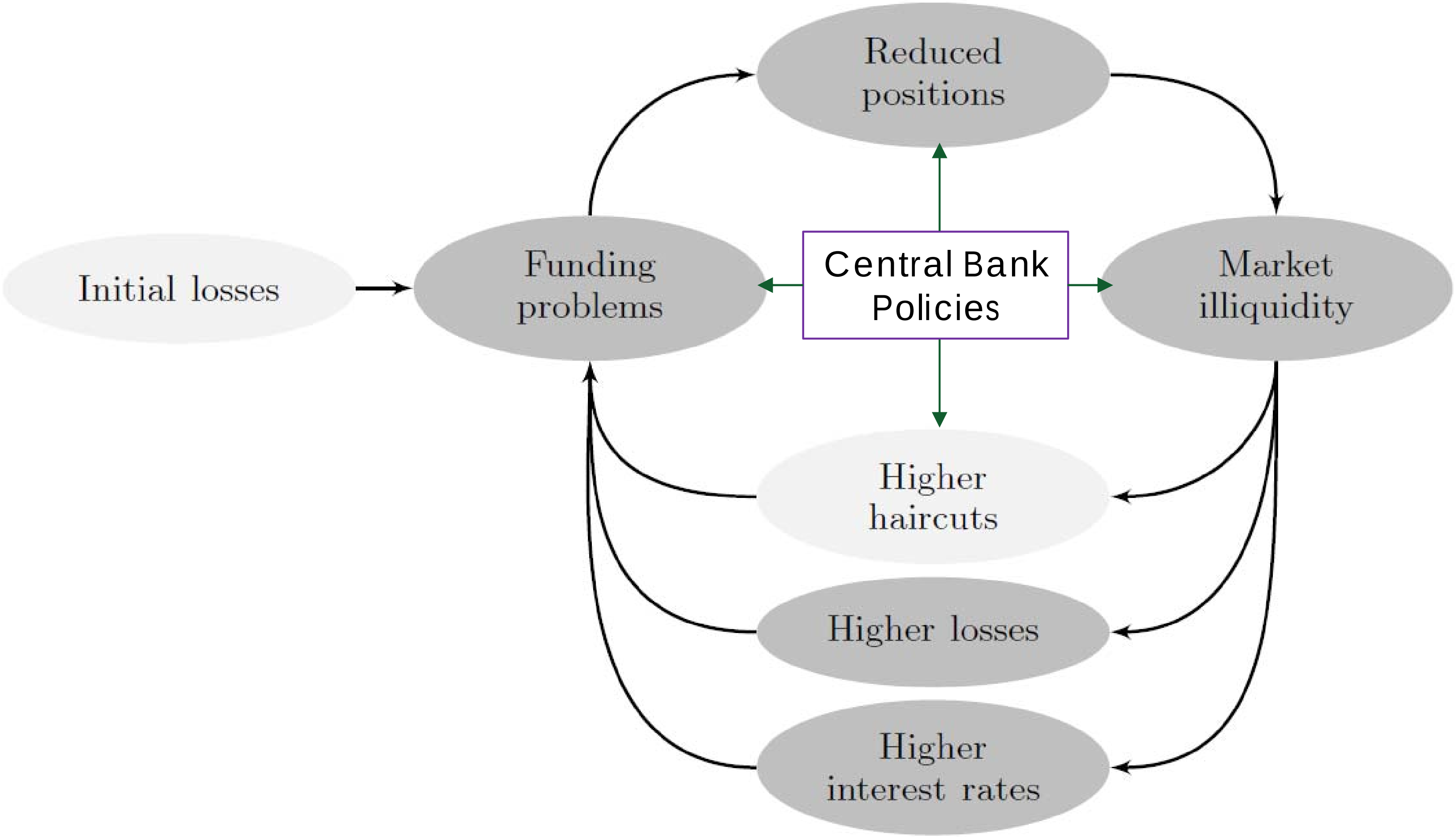
Ranaldo et al. (2016)

Liquidity spirals in the secured **and unsecured** money market



Ranaldo et al. (2016)

Liquidity spirals in the secured **and unsecured** money market



Comment 2: Other liquidity sources

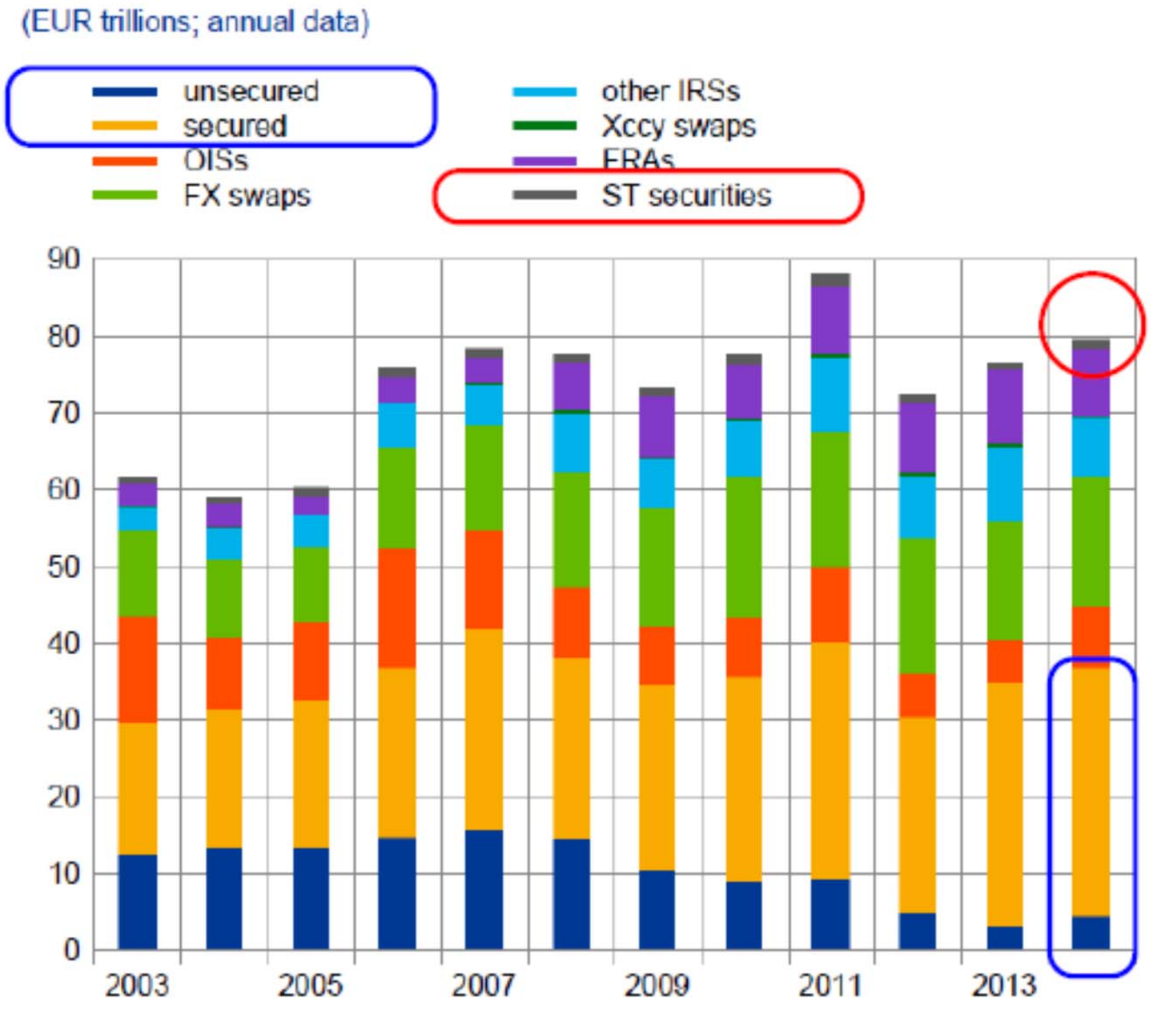
- Need to control for alternative liquidity sources
- If you cannot do it at bank level, at least on aggregate!

- Important? It seems so …
  - On aggregate level, Mancini, Ranaldo, and Wrampelmeyer (2016)
  - At bank level, Di Fillipo, Ranaldo, and Wrampelmeyer (2016)
  - Jointly analyzes European unsecured and secured interbank market at bank level
  - Banks with higher credit risk tend to reduce unsecured borrowing and lending, but at the same time increase secured borrowing and lending

Comment 3: Stretched

- Size and importance of CD stretched twice: as part of the European money market, and as part of the European wholesale funding market (☹ title)
- Resilience of CDs
- Consistency and strength of the results

Comment 3: Size / relevance of CDs stretched



Source: European Central Bank (2015)

Comment 3: Size / relevance of CDs stretched

- CB liquidity: not only MRO but LTRO as well!
- Repo market much larger and outstanding vs **traded** volumes
- Is it the CD the cheapest wholesale funding market? No! With S. Corradin (ECB), we see that …
  - Average rates from Eonia Plus transaction-based data: Interbank < Other < Financials Official Sector < **Short-term Papers** < Non-financials
  - CD market almost **frozen** in 2012, i.e. 2/3 evaporated! And **substitution** with non-financials
  - …

Comment 3: Resilience stretched

- Impact of new regulation proposed for MMFs in 2013 (e.g., required capital buffers)?
- Since October 2008, ECB's unprecedented UMP including Full-Allotment mechanism. But you use theories more consistent with liquidity-deficit regimes …

Comment 3: Consistent, strength of the results

- Table 5 – Dry-ups forecast future changes in ROA: it works for partial but **not** full dry-ups
- Table 6 – Dry-ups forecast future CDS spread changes but **not** stock returns. And why nbr. of obs increases? (from 516 in Tab 4 up to 956 in Tab. 6)
- Table 7 – Dry-ups forecast future changes in asset quality: you use (Impaired loans / Loans) which was **not** significant in Tab. 4 and now … Opposite for (Impaired loans / Equity) …