“Strategic complementarity in banks’ funding liquidity choices and financial stability” by André Silva

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(*) discussions with F. Vinas are gratefully acknowledged

Summary of the paper

- The paper :
  - Analyzes the share of liquid assets that banks hold
  - Emphasizes the role of peer effects in bank's choice
  - Shows the negative impact in terms of financial stability (Fahri and Tirole, 2012)

- Scope of the paper:
  - Bankscope data on 1999-2013
  - Commercial banks in OECD countries

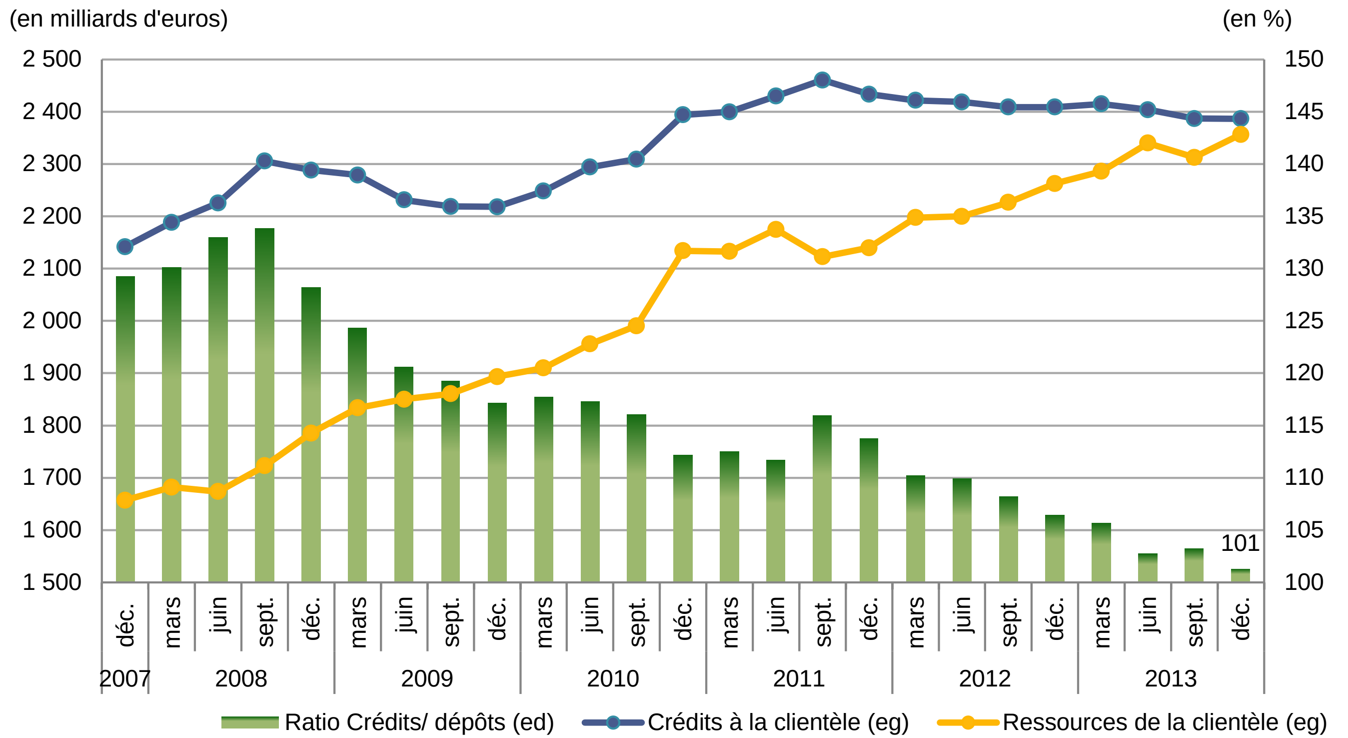
Main points developed

- The dependent variable
- Economic mechanisms of the results
- Empirical methods
- Strategic behavior and financial stability
- A point you might want to analyze

1. Definitions of the Liquidity measure

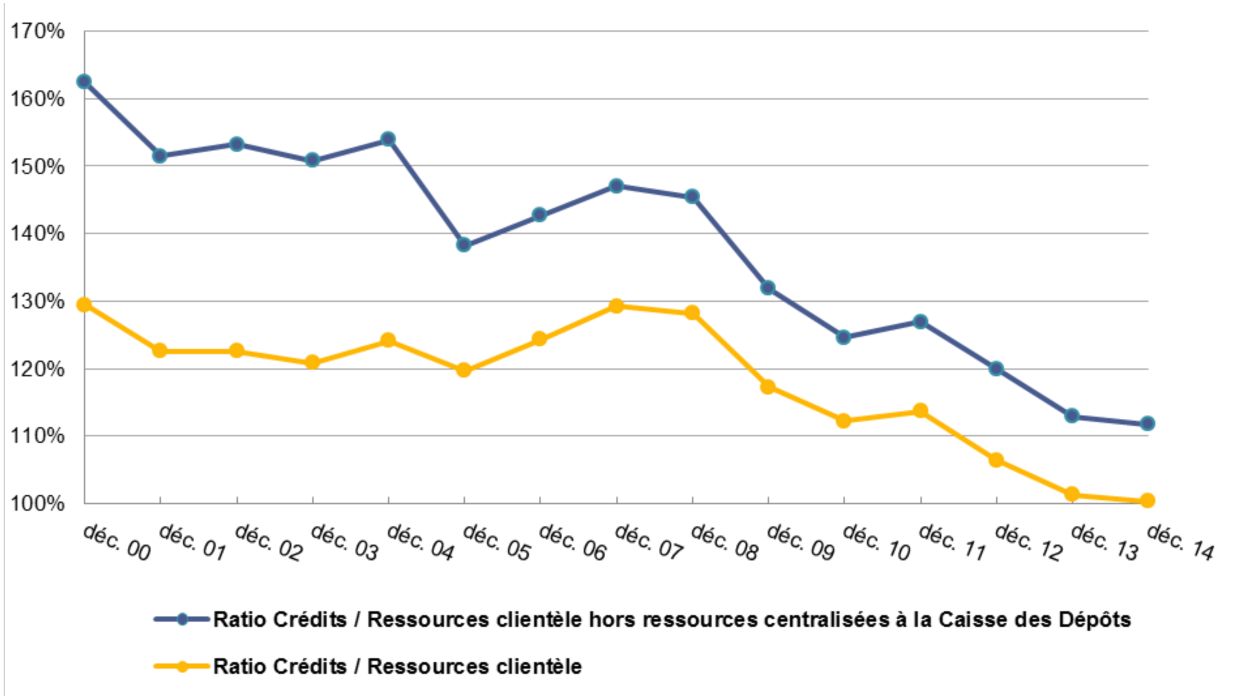
- Two definitions of the liquidity of the bank
  - Liquidity ratio (Asset side)
    - The liability side is strongly important for liquidity issues (cf. next slide)
    - This measure does not capture this
  - Liquidity creation (Asset and Liability side)
    - Economically more relevant
    - Note : It does not capture off balance sheet like funding commitment
- Not clear in the paper which one should be favored

Liquidity side matters : Loan/deposit ratio (1/2)



Périmètre : ensemble des établissements de crédit, ensemble de l'activité
Source : ACPR

Liquidity side matters (2/2)- various indicators of Loan/deposit ratio



Périmètre : ensemble des établissements de crédit, ensemble de l'activité
Source : ACPR et rapport annuel du fonds d'épargne de la CDC

2. Economic mechanisms of the results

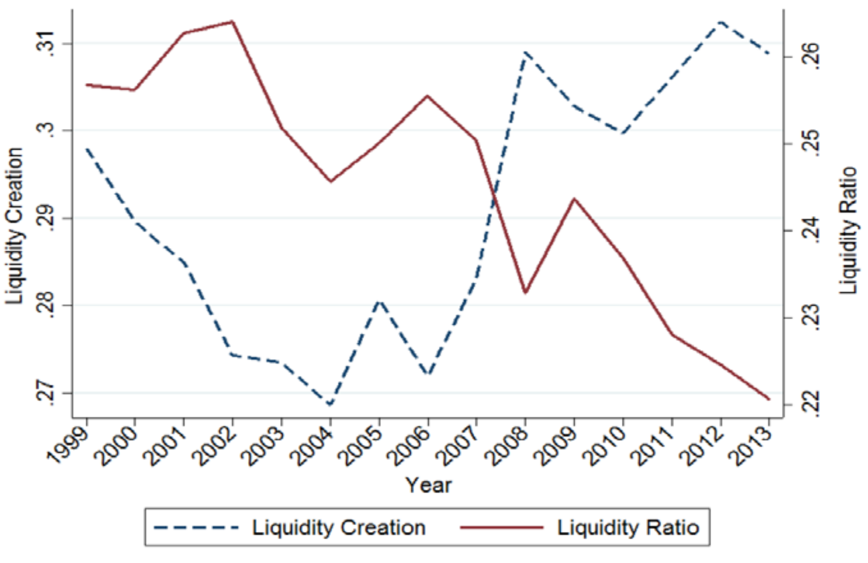
- Peer effects
  - proposed in the paper- lots of work to implement the empirical methodology
- Regulation effect
  - Do not neglect that some countries like France, already had a liquidity regulation « coefficient de liquidité »
  - Of course many countries did not have a liquidity regulation

3. Empirical methods

- Endogeneity: use IV , OK but need to check that the instrument (peer’s peer liquidity) is not correlated with the error term (can be tested within GMM)
- In addition links with financial stability (last section) indicate that may not be totally orthogonal, if financial stability is seen from a global perspective. Not clear whether approach is « micropru » (the definition of the ratio) or « macropru » (financial stability)
- Additional endogeneity issue : liquidity creation (risk) and ROE
- Negative impact of capital on liquidity creation : should be discussed further following Berger and Bouwman (2009)

4. Strategic behavior and financial stability

- Section 5.3 might be the least convincing part of the paper (also shorter).
- 2 step regression approach needs to be taken into account for inference
- Need to convince the reader that the results are not driven by the crisis (one time event)
- Said differently, try to show the development of financial fragilities (in terms of liquidity) prior to the crisis : B&B indicator and DtD spiked with the crisis, what about before and after –> test subsample stability.



5. A point you might want to explore:

- Dynamic behavior
  - The paper provides a static analysis, which raises econometric issues (endogeneity)
  - There are some dynamics in the dependent variable

  => why not using it more?

  => There is a strong interest in that field:

    - Similar to risk-taking literature which explains that risk taking has dramatic effects afterwards
    - But for liquidity issues : development of financial fragilities in liquidity