Discussion of De Fiore, Hoerova, and Uhlig

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Does interbank lending matter for the macroeconomy?

Motivation

Money market disruptions in the euro area

- Potential freeze and shift from unsecured to secured money market funding
- Additional possibility to switch from secured to central bank funding
  - As observed during the sovereign debt crisis
- Reallocation of wholesale funding vs. money market freeze (Pérignon, Thesmar, and Vuillemey 2017)

Motivation

This paper: GE model to assess effect on investment and output

- Unconnected banks hold government bonds which can be pledged as collateral, but face different haircuts in the private secured market vs. at the central bank
- Substitution relationship between lending and holding bonds/money
- Calibration suggests that money market disruptions $\Rightarrow$ total lending and output $\Downarrow$

The role of bank heterogeneity

Modeling choices

- A real tour de force!
- A key ingredient is bank heterogeneity
- Literature: adverse selection and counterparty risk (Heider, Hoerova, and Holthausen 2015)
- Here: connected vs. **unconnected** banks (cannot borrow in the unsecured market)

Connected vs. unconnected banks

- Why are some banks more connected than others?
  - Relationship lending mitigates concerns of counterparty risk (Bräuning and Fecht 2017)
  - Connectedness $\Rightarrow$ counterparty risk $\Downarrow$ $\Rightarrow$ connectedness $\Uparrow$

Connected vs. unconnected banks

- Why are some banks more connected than others?
  - Relationship lending mitigates concerns of counterparty risk (Bräuning and Fecht 2017)
  - Connectedness $\Rightarrow$ counterparty risk $\Downarrow$ $\Rightarrow$ connectedness $\Uparrow$
- But the same repayment schedule:

$$\overline{F}_t = (1-\kappa^F)\overline{F}_{t-1} + \Delta\overline{F}_t$$

(law of motion for funds from central bank)

$$\overline{B}_t = (1-\kappa)\overline{B}_{t-1} + \Delta\overline{B}_t$$

(law of motion for government debt)

Banks' response to ECB collateral policy

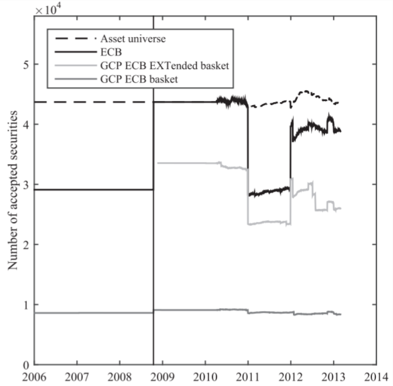
- Surge in secured vis-à-vis unsecured funding: compositional effect across exogenously connected vs. unconnected banks
- Weakly-capitalized banks borrowed more from the ECB as lender of last resort (Drechsler et al. 2016)
- Suggestions: (try to) endogenize connectedness and/or provide a richer characterization (capitalization etc.)

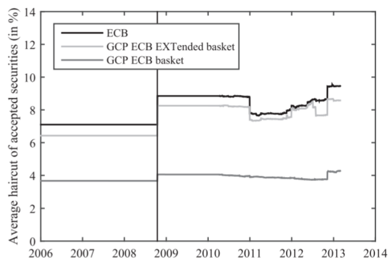
Haircuts in the private secured market vs. at the central bank

Implications for haircuts

- Determines banks' switching from private secured market to central bank funding
- **How crucial is the role of only one type of collateral (government bonds) subject to different haircuts?**

Number of vs. average haircut for accepted securities





Source: Mancini, Ranaldo, and Wrampelmeyer (2016)

Increase in ECB collateral eligibility

Private haircuts $1 - \tilde{\eta}$	
A	1%
B	2%
C	3%

CB haircuts $1 - \eta$	
A	1%
B	2%
C	3%

Increase in ECB collateral eligibility

Private haircuts $1-\tilde{\eta}$	
A	1%
B	2%
C	3%
D	**100%**
E	**100%**
F	**100%**

CB haircuts $1-\eta$	
A	1%
B	2%
C	3%
D	**100%**
E	**100%**
F	**100%**

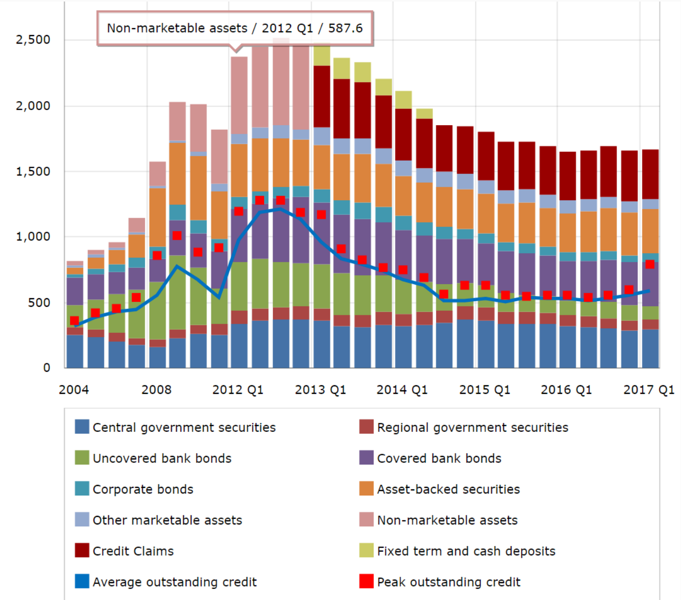
Increase in ECB collateral eligibility

Private haircuts $1-\tilde{\eta}$	
A	1%
B	2%
C	3%
D	**100%**
E	**100%**
F	**100%**

CB haircuts $1-\eta$	
A	1%
B	2%
C	3%
D	**4%**
E	**5%**
F	**6%**

"Haircut subsidy" on collateral increases with its risk (Drechsler et al. 2016) $\Rightarrow \tilde{\eta} < \eta$ is a reasonable comparative static for both **intensive and extensive** margin

Use of collateral and outstanding credit



Collateral eligibility requirements in the sovereign debt crisis

- ECB relaxed rating requirement for eligible RMBS
- **December 2011:** ECB made A-rated (Class 2) RMBS at issuance temporarily eligible as collateral
- **June 2012:** ECB made BBB-rated (Class 3) RMBS temporarily acceptable at a higher haircut (26% for BBB compared to 16% for AAA/A)

Implications for bank lending and risk taking

- **RMBS $\neq$ government bond:**
  collateral framework favors illiquid collateral $\Rightarrow$ effect on real economy through overproduction of illiquid real assets
- Increase in (ex-post risky) loan supply and lower mortgage rates (Van Bekkum, Gabarro, and Irani 2017)
- Meaningful interaction between CB collateral policy and bank lending behavior: added value of using ≥ 2 types of collateral in the model

Conclusion

- Interesting paper on an important topic!
- Clarity of mechanism depends on modeling choices: one type of collateral and exogenous connectedness of banks
- Implications for monetary-policy transmission in the euro area
  - Transmission of negative policy rates depends on banks' funding structure (Heider, Saidi, and Schepens 2017)