Discussion of “Government Guarantees and Bank Liquidity Creation,” by Berger, Li and Saheruddin

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Summary

This paper:
- constructs index of liquidity creation by banks — $l_{i,j,t}$
  - Berger and Bouwman (2009), more countries
- constructs index of government guarantees — $g_{j,t}$
- shows that $\text{corr}(l_{i,j,t}, g_{j,t} | x_{i,j,t}) < 0$
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- constructs index of liquidity creation by banks — $l_{i,j,t}$
  - Berger and Bouwman (2009), more countries
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Why do we care?
- theory: DI supports “liquidity creation” by banks, but might lead to excessive risk-taking
- case studies, but no systematic evidence
Comments

1. Measuring liquidity creation
2. Regression results
3. Interpretation
Measuring liquidity creation (1/2)

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- mortgage loans vs. C&I loans: is relative liquidity stable?
- correlation w/ \( \frac{D}{A} \) ?

\[ LC = \frac{D}{A^{tot}} \quad \text{for a bank holding only cash} \]

\[ LC = \frac{D}{A^{tot}} - 1 \quad \text{for a bank holding only C&I loans} \]
Measuring liquidity creation (2/2)

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- **should** banks score high on this measure?

  liquidity/maturity transformation?
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- how to think of a change in portfolio composition from, e.g., mortgages to C&I loans?
Regression results (1/1)

- OLS: 1 unit increase in $g_{j,t} \implies l_{i,j,t}$ falls by 7% relative to its mean
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- IV: tendency of national culture toward individualism; disease prevalence
  - time-varying?
  - “exclusion restriction”: banking sector concentration?
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- IV: tendency of national culture toward individualism; disease prevalence
  - time-varying?
  - “exclusion restriction”: banking sector concentration?

- Directionally interesting, but difficult to interpret
  - distribution of $g_{j,t}$ across countries? (use just an indicator for DI instead?)
  - which guarantees? what liquidity?
- Decomposition by type of gov’t guarantee
  - “government guarantees on deposits”: negative effect
  - “explicit insurance scheme”: positive effect
  - examples/mechanisms?
Interpretation (1/2)

- Decomposition by type of gov’t guarantee
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- By component of liquidity creation
  - assets: “less liquid” (less MBS, more C&I loans?)
  - liabilities: “more liquid” (less sub. debt, more deposits?)
  - fewer loan commitments
- Endogenous policy response

Gov’t guarantees are re-affirmed and extended in times when liquidity creation in the banking sector is low.
- Endogenous policy response

Gov’t guarantees are re-affirmed and extended in times when liquidity creation in the banking sector is low

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(Size of effect, relative to baseline?)
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- Focus on non-crisis countries?
Conclusion

- Deposit insurance helps avoid runs, and therefore facilitates deposit creation
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- More descriptive stats! And delineate relationship btw. liquidity creation and risk-taking more precisely