MONEY MARKETS AND BANK LENDING: EVIDENCE FROM THE TIERING ADOPTION

Carlo Altavilla, Miguel Boucinha, Lorenzo Burlon, Mariassunta Giannetti, Julian Schumacher

Discussion by **Diana Bonfim**

ECB conference on Money Markets, 3-4 November 2022

BANCO DE PORTUGAL
EUROSISTEMA

SUMMARY OF THE PAPER

In 2019 the ECB implemented a tiering system on excess reserves.

The goal was to “**support the bank-based transmission of monetary policy**, while preserving the positive contribution of negative rates to the accommodative stance of monetary policy”.

How is this achieved?

SUMMARY OF THE PAPER

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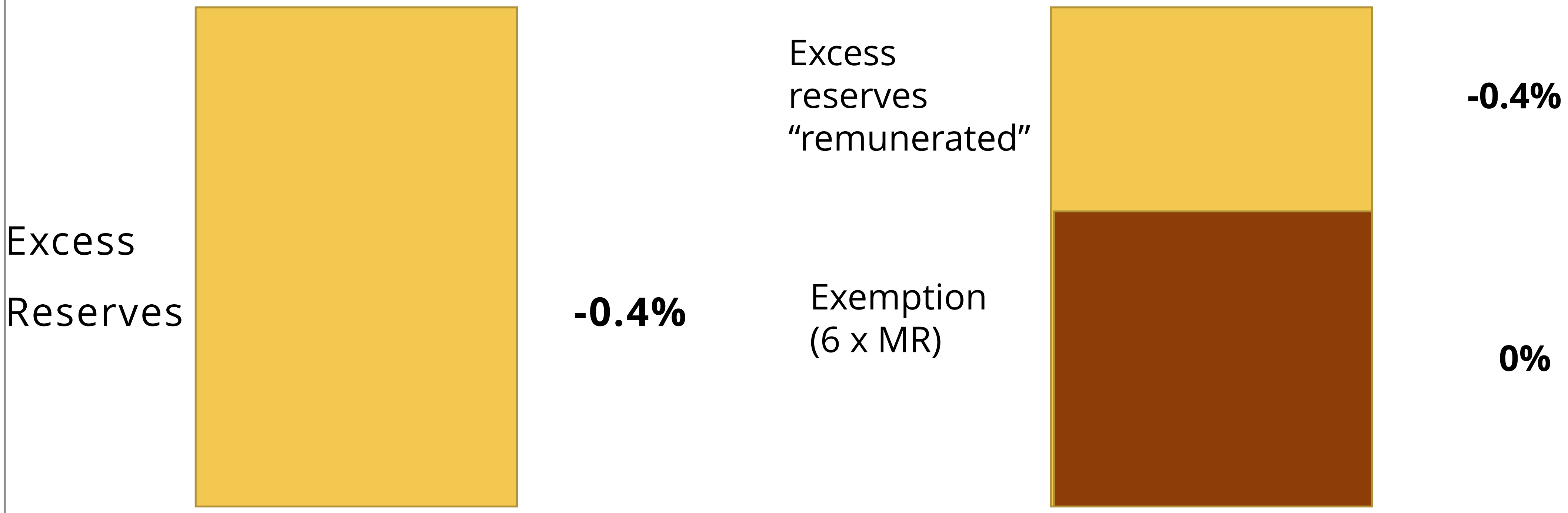
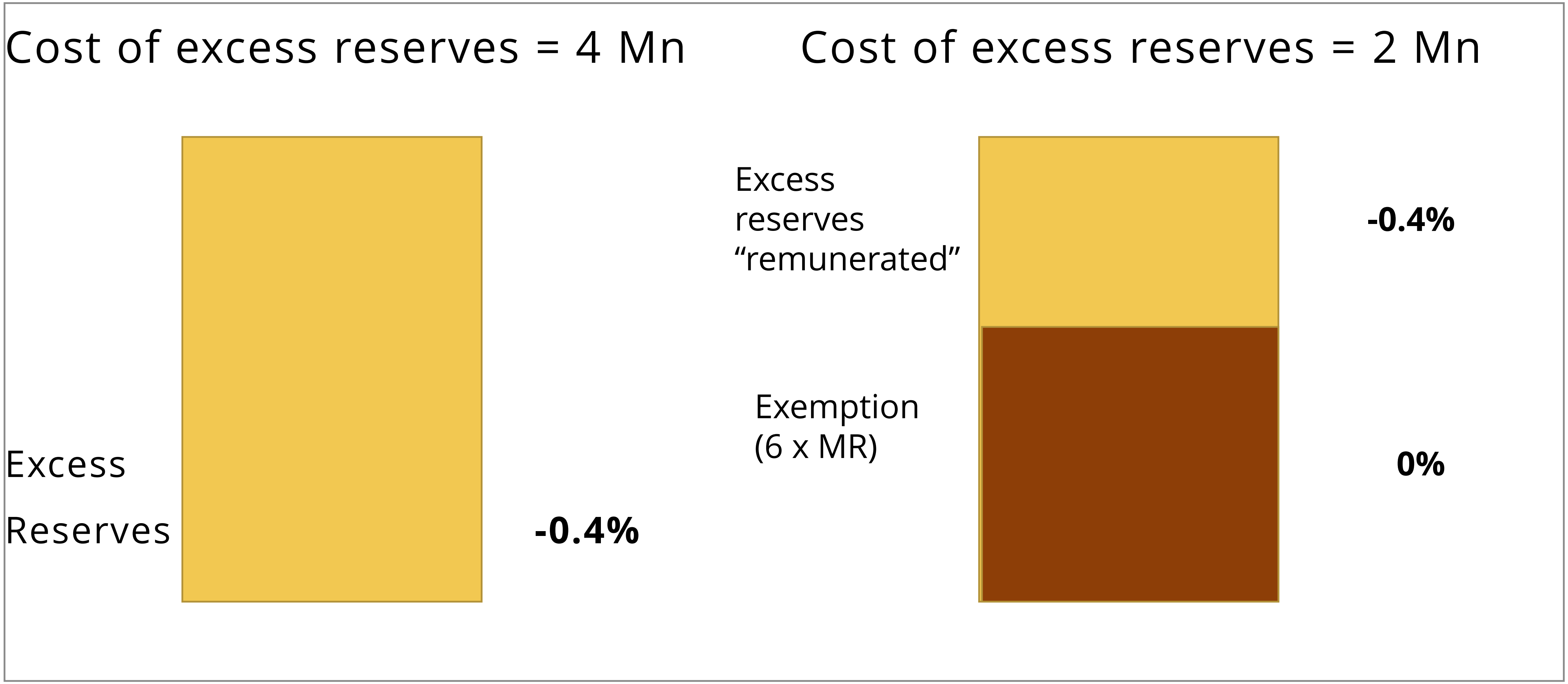


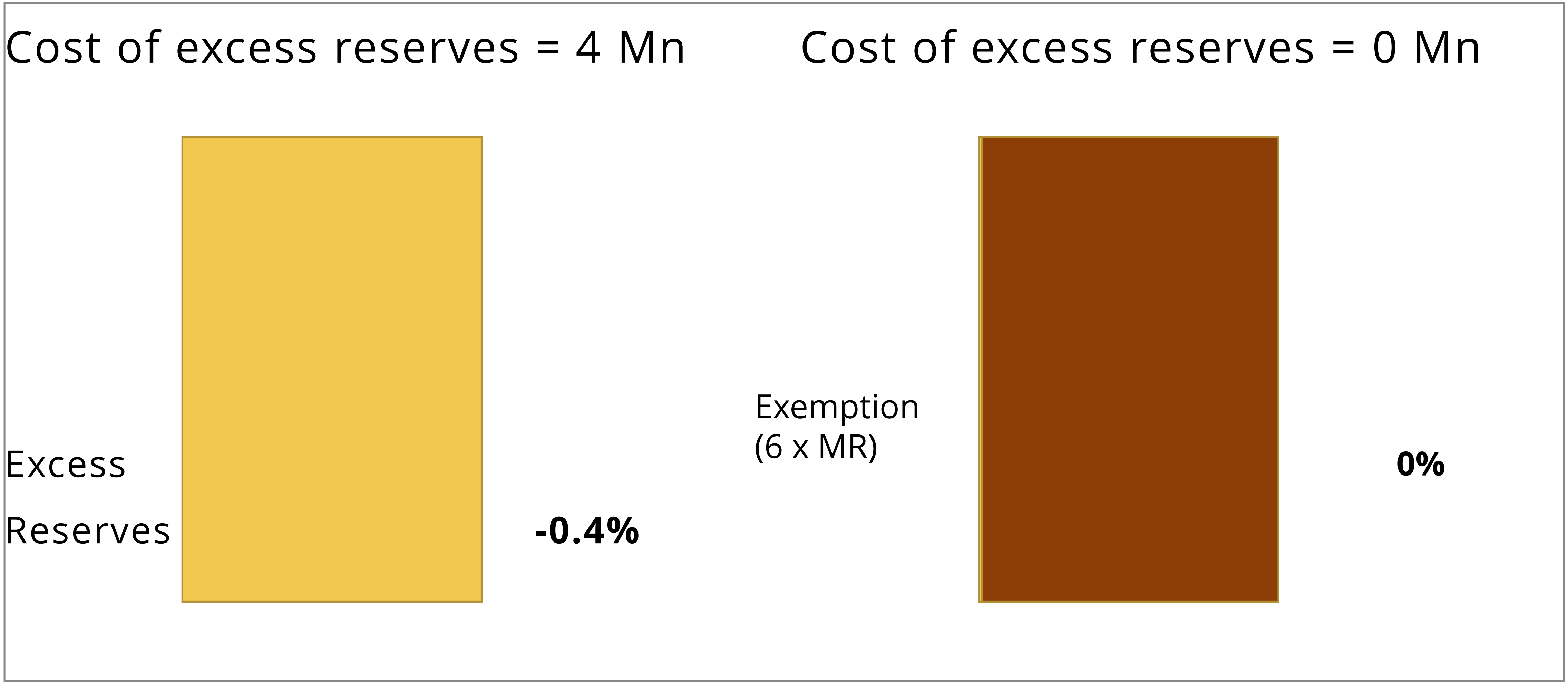
SUMMARY OF THE PAPER

Bank with 1Bn € excess reserves (with 50% exempt)



SUMMARY OF THE PAPER

Bank with 1Bn € excess reserves (with 100% exempt)



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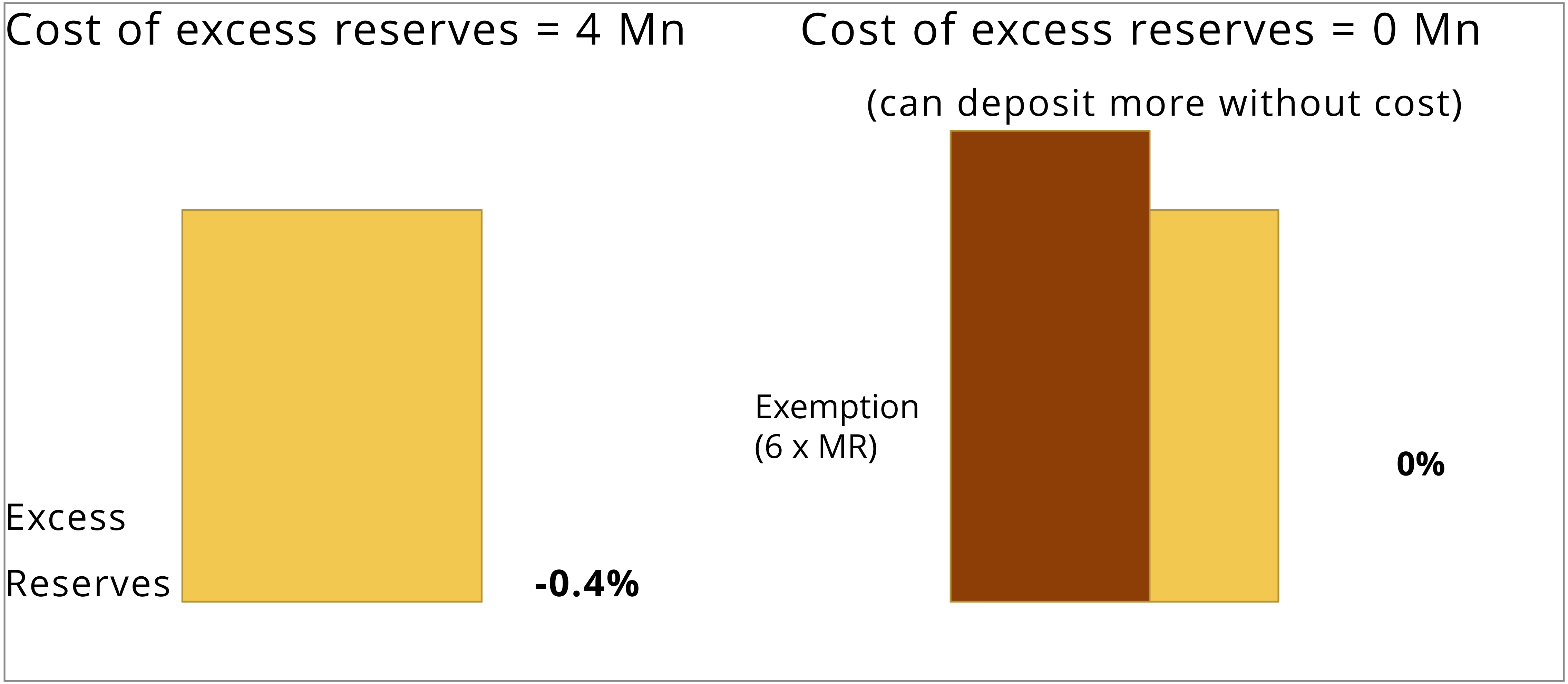
Bank with 1Bn € excess reserves (with 120% exempt)



SUMMARY OF THE PAPER

How is this achieved?

Possible **mechanisms**:

1) Positive effects on banks' net wealth (for those with **excess liquidity**) can encourage banks to **lend more**.

2) The higher value of excess liquidity may encourage banks with **unused exemptions** to **lend less**.

3) Improvements in the **functioning of the money market** (less uncertainty) may encourage **previously constrained banks** to **lend more**.

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How is this achieved?

Possible **mechanisms**:

1) Positive effects on banks' net wealth (for those with **excess liquidity**) can encourage banks to **lend more**.

Result: positive wealth effects.

2) The higher value of excess liquidity may encourage banks with **unused exemptions** to **lend less**.

Result: reallocation of liquidity to these banks. They lend more.

3) Improvements in the **functioning of the money market** (less uncertainty) may encourage **previously constrained banks** to **lend more**.

MY COMMENTS

01

MECHANISMS AT WORK

02

LOCAL VS AGGREGATE EFFECTS

03

NOT FROZEN, BUT NORMAL?

04

TOO SOON TO TELL?

1. MECHANISMS AT WORK

Two things may happen to banks with less liquidity:

- they may increase reserves (now less costly) and thus **lend less** (“unconstrained”)

- they may be able to borrow more in money markets (from banks with excess liquidity) and actually **lend more** (“constrained”).

“Which of these mechanisms prevails remains an empirical question.”

The results suggest that the second effect dominates, on average. But **can we learn more from the heterogeneity?** The results are explicit for the constrained banks, but more subtle for the unconstrained.

2. LOCAL VS AGGREGATE EFFECTS

The empirical strategies allow for a rigorous, causal interpretation of the results.

But in some parts, a bigger picture of the effects (even if at the cost of identification) could be helpful.

For instance:

- What happened to total liquidity in the banking system? Did it increase?
  Where does the additional lending come from? Reallocation? Profits?

- What happened to other assets? Mortgages? Consumer loans (TLTRO targets)?
  Government bond holdings?

3. NOT FROZEN, BUT NORMAL?

Most of the literature on money markets and bank lending is **focused on crisis periods**.

Afonso, Kovner and Schoar (2011), Acharya and Merrouche (2013), Iyer, Peydró, da Rocha-Lopes, and Schoar (2014).

This paper makes an **important contribution** by looking at what happens when the money market is not frozen.

That said, the market wasn't functioning normally either (**dormant**).

How **special** is this setting? How many banks were **effectively constrained** (in the sample)? Is the rate proxy a good one?

Can we learn from extending the analysis to **other episodes**? E.g.: mention in the ECB's press conference of March 10, 2016, announcements in other jurisdictions, TLTRO announcements.

4. TOO SOON TO TELL?

The results are generally very positive.

Can something be said about medium-term effects (again, even if at the cost of more precise identification)?

What happened when the DFR became 0, on July 27, 2022?

SUMMING UP

Rigorous and impressive evaluation of the effects of tiering on the functioning of euro area money markets (and on bank lending to firms).

No stone left unturned (exhaustive analysis of channels and mechanisms at work, using impressive data).

Very positive results on all dimensions.

But... Too soon to be sure? Aggregate effects? External validity?

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MINOR ISSUES

- “we observe that banks with unused allowances started to gradually increase their excess liquidity holdings.” Why would banks anticipate this (and bear the costs of doing so)?

- Interest rates also decreased in the announcement date. How to disentangle this from the effect of the tiering?

- The terminology on “excess liquidity”, “unused exemptions”, exposure, benefit, etc. could be streamlined. Different terms are used throughout the paper and make the reading challenging at times.

- It’s questionable that the calibration could have been anticipated already in the Draghi speech, as acknowledged in the paper. What about testing the Swiss and Danish calibration?