Discussion of:
Surviving the Perfect Storm: The Role of The Lender of Last Resort

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Monetary Policy Implementation in the Long Run

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This Paper

- Question:
  - Is the LOLR effective in preventing a credit contraction?
- How:
  - Sudden stop in Portugal in May 2010
  - ECB liquidity provision as a textbook LOLR intervention
  - Comprehensive credit registry matched with bank and firm characteristics
- Results:
  - Loan supply to firms unaffected by the shock
  - Large and better capitalized banks reduce credit supply
  - ECB liquidity also used to buy government bonds

Empirical Setting

- ECB as a LOLR since 2008
  - Provides unlimited collateralized loans to eurozone banks
  - Short maturity pre-2012 (2 weeks to 3 months)
  - Accepts wide range of collateral (govt bonds, ABS, MBS)
  - Attractive haircut and interest rate in eurozone periphery
- Portugal
  - Sudden stop in 2010 (fear of contagion)
  - Large uptakes of ECB liquidity (20% GDP)
  - Credit registry loan-level data
  - Large subset of firms with multiple credit relationships

Identification Strategy

- Ideal setting:
  1) ECB randomizes liquidity injections in bank balance sheets
  2) Firms and banks randomly matched

     $\Rightarrow$ Exploit heterogeneity in ECB liquidity provision

- In reality:
  - ✗ Banks *choose* how much to borrow from ECB

    $\Rightarrow$ Sudden stop is *exogenous* and banks simply substitute

    $\Rightarrow$ Bank-level controls
  - ✓ Endogenous bank-firm match

    $\Rightarrow$ Firm FE to isolate credit supply from credit demand

Endogeneity of ECB Uptakes

1) *corr*(Funding Shock, ECB borrowing)
   - If banks substitute $corr \approx -1$
   - "The increase in ECB funding *largely surpassed* the liabilities that needed to be refinanced"
2) What if ECB was not providing liquidity?
   - Credit contraction is *assumed*
3) Bank run unlikely to be exogenous
   - More on this run (ST Vs. LT, foreign Vs domestic)
   - Fundamental component likely
   - Show balance sheet summary stats depending on
     (i) Sudden stop funding contraction
     (ii) ECB borrowing

Suggestions

- Result on government bond holdings:
  - Very interesting, but no evidence to rule out risk-shifting
  - Analyze purchases of newly issued bonds
- More on credit quality
  - Use *ex-post* defaults
- Extensions
  - Extend to analyze longer maturity liquidity provisions
  - Include credit supply to households in the analysis
  - Include loan interest rates

Overall

Interesting paper and important findings

1) Needs a coherent theory behind bank portfolio choice
   - What drives bank heterogeneity
     e.g., large and better capitalized
   - What drives purchases of government bonds?

2) Caution in using the "LOLR language"
   - Unable to disentable liquidity vs solvency

Thank you!