Discussion of

ECB Euro Liquidity Lines

by S. Albrizio, I. Kataryniuk, L. Molina, J. Schafer

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Bank of England, CEPR, and CfM

Evaluating the monetary-policy toolkit: lessons for the future

Sveriges Riksbank - September 1, 2022

*The views expressed here do not necessarily represent those of the Bank of England or of any of its Committees.

Intro

- **What are the effects of central bank swap lines?**

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- Important and yet to be fully understood policy tool
- This paper brings in the euro perspective → Nice!
  - New theoretical analysis of spillbacks
  - New evidence based on ECB euro liquidity lines

My comments

[# 1] **The model**

[# 2] **Testing the mechanism**

[# 3] **The empirical specification**

[# 4] **Making most of the data**

The Model (as I understand it)

Recipient bank	
Assets	*Liabilities*
L_t^R (€)	C_t^R (€)
	B_t^R (LC)

Euro area bank	
Assets	*Liabilities*
C_t^R (€)	D_t (€)
	E_t (€)

- Stylized two-country model with currency-mismatched recipient banks and refinancing risk

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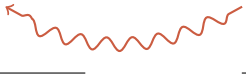

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  - Currency mismatched recipient banks' balance sheets

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Matures in t+2

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Matures in t+1

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  - Cross-border lending
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  - Refinancing risk

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- In $t+1$ the recipient bank has to refinance using B^R hedging FX risk at cost b_{t+1}
- If refinancing cost is too high, the recipient bank defaults
- By lowering the FX basis, liquidity lines
  - Lower the recipient bank's default probability
  - Increase the euro area bank's equity value

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- **Some questions**
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  - Why no recipient bank equity?
  - Why can't the recipient bank roll over using C_{t+1}^R
  - Where is risk? Is default probability assumed to 1?

[# 2] Testing the mechanism(s)

- **Key mechanism**
  - Liquidity lines lower CIP deviations [Bahaj and Reis (2022)]
  - Liquidity lines reduce recipient-country banks' default probability [This paper]

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- **Suggestion** Provide direct evidence in favour of proposed channel in empirical exercise
  - Recipient banks' CDS spreads

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- **Key mechanism**
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- **Suggestion** Other channels may be at work [Cesa-Bianchi, Eguren-Martin, Ferrero (2022)]
  - Recipient country's equity prices and non-financial credit spreads

[# 3] The empirical specification

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  - Residualize currency *i*'s FX basis using a set of country-specific controls

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  - Compare affected vs. non-affected currencies in narrow window around announcement

$$res_{i,t,e} = \mu_{i,e} + \beta_1 \left(T_{i,e} \times Post_t\right) + \Lambda X_t + other\ controls + u_{i,t,e}$$

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- **Question** Why the residualized regression approach (instead of going one-step)?
  [1] Generated regressor uncertainty
  [2] Pollutes exercise on omitted global events

[# 4] Making most of the data

- Not many events, exploit cross-section of affected vs. non-affected currencies
  - 24 eligible liquidity line announcements, 15 countries

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  - 24 eligible liquidity line announcements, 15 countries
- Sample selection
  - [1] G10 countries to avoid confounding effects of reciprocity
  - [2] Countries targeted by the lines but use the euro as main currency (e.g. San Marino)
  - [3] North Macedonia, Romania, and Albania due to data limitation for the construction of FX basis
  - [4] Latvia, since it was included in the ECB press releases
- **Final sample** 9 liquidity line announcements, 7 countries...

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- **Suggestions**
  - No need for [2] and [3] for recipient country's CDS, equities, spreads, etc
  - 14 eligible announcements in the 2020 to 2022 sample...

In sum

- Great paper → Advances our knowledge on an important policy tool

- My suggestions
  - Tighten the model exposition
  - Provide more direct evidence on the proposed mechanism
  - Robustify empirical analysis

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