Reciprocal Lending Relationships in Shadow Banking

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The Result

$$\Delta CD_{i,j,t}^{>30\ Days} = \beta * Time\ Deposit\ Dummy_{i,j,t-1} + \ \ldots$$

$$+ Controls_{i,j,t-1} + \ \ldots$$

All in all, $\beta > 0$

If, this quarter, an MMF had time deposits with a bank “J”,

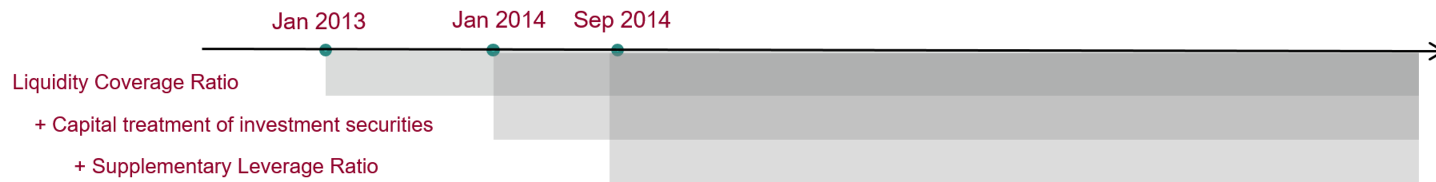
all else equal, it will increase its holdings of bank “J”’s CDs in the next quarter

by 8 to 15 (USD million?)

(mean CD holdings $75M domestic, $92 foreign)

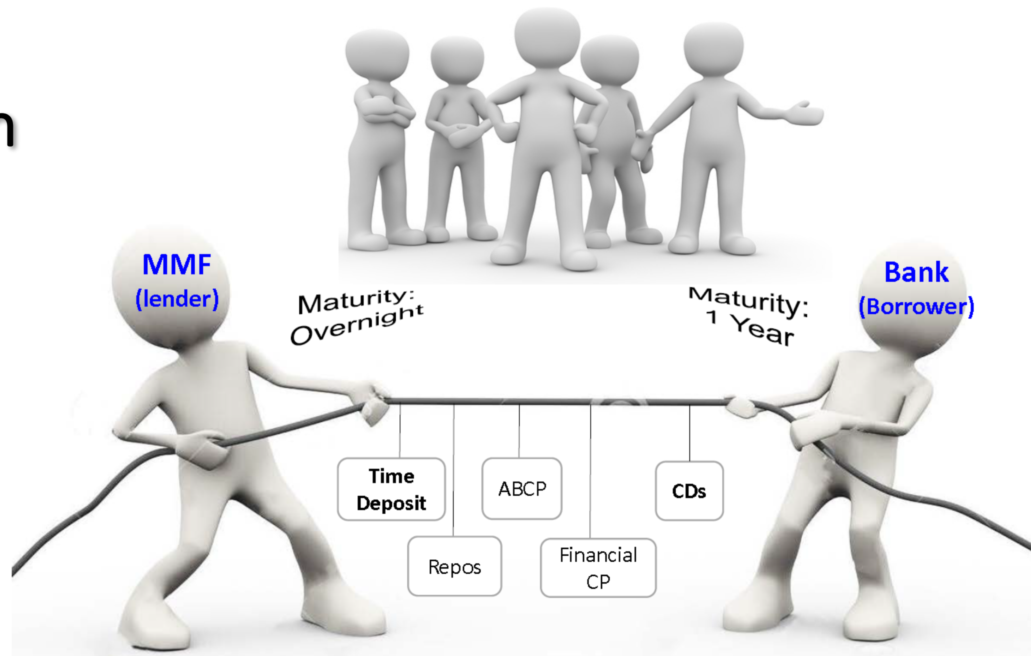
A Wishful Thought

- Cutting close, but still worth thinking about?



- Lack of “Before” and “After” handicaps the analysis; the testable hypothesis needs to be better conceptually grounded

Interpretation



Is inter-quarter the right frequency for the test?

- But it is not an eco-system of two; banks are not essential to the existence of MMFs (… unless there is some evidence that constraint is binding, and banks are the only solution)

- Regulation elevates the cost of interfacing with banks (as compared to other players!), it is not clear how or why banks & MMFs would try to undo it

- Although, foreign banks might desperately need U.S. MMFs for USD funding

Interpretation: The Foreign Banks' Effect

- Although, foreign banks might desperately need U.S. MMFs for USD funding

- Fact: Much of the foreign banks' lending is in USD

	Cross-Border Loans (Source: DealScan)				
Currency:	USD	EUR	GBP	JPY	Other
Region:					
EME: Africa	88.8%	5.3%	0.1%	0.8%	4.9%
EME: Americas	91.3%	1.1%	0.0%	0.7%	6.9%
EME: Asia	69.7%	1.3%	0.7%	4.2%	24.0%
EME: Europe	56.0%	30.9%	0.0%	0.6%	12.5%
DME	69.8%	19.7%	5.0%	0.7%	4.8%

"U.S. Monetary Policy and Emerging Market Credit Cycles" (with Falk Braüning)

Too bad the Sovereign Crisis test (Table 9) doesn't hold…

To be clear, it is not "reciprocity": only one counterparty is desperate (foreign banks) –
when in need of USD, a foreign bank would take any USD funding (CDs or Time Deposits) than an MMF is willing to give

What to Make of the Lower CD Yield

- To reiterate, it is not clear why an MMF needs a bank to satisfy its demand for short term investments

- But, say, MMFs and banks are mutually dependent, it is still unclear why would there be bundle pricing? MMFs take a hit by holding CDs, banks take a hit by engaging in short-term borrowing, why, on top of that, would there be any adjustment on yields?

What to Make of the Lower CD Yield (2)

- More evidence on plausibility of the “CD Discount”: The narrative here is that of MMFs being the “anchor investors” in CDs, are they? Who are the other investors?

- Credit risk is not ruled out: CD yield is a measure of credit risk
  - You can’t do much with a CDS quotes here, since it is a generic (not customized to security) and non-transactional measure of risk; you can always make an argument that CD yield captures credit risk

Motivation

- Without a fundamental link between MMFs and banks, “conflicting regulations” is not a strong motivation

- Worth thinking about who, if anybody is being hurt?
  - E.g., cross-selling in banking hurts small banks

- Is there a way to think about concentration of abnormal exposure to a single counterparty?