

Discussion of
**‘Asset Purchases in a Monetary Union with
Default and Liquidity Risks’**

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6th ECB biennial conference on “Fiscal Policy and EMU Governance”

The opinions expressed in this presentation are the sole responsibility of the author and should not be interpreted as reflecting the views of the European Central Bank.

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This paper an extremely timely contribution to this policy debate!

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 - Effective at stabilising economy especially in presence of liquidity risk

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- + Default probability depends on macro shock o_t & debt-to-GDP ratio:

$$P(s_{t-1} \geq B_t^*) = \frac{\exp(\eta^0 + \eta^1 o_t + \eta^2 s_{t-1})}{1 + \exp(\eta^0 + \eta^1 o_t + \eta^2 s_{t-1})}$$

The 'liquidity risk channel'

- + Financial intermediaries face an agency problem:

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$$\underbrace{V_t}_{\text{value of intermediary}} \geq \underbrace{\eta_t(Q_t^f f_t^i + Q_t^b b_t^i)}_{\text{funds that can be diverted}}$$

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- + Interpret η_t as **credit tightness**. Make it function of default prob.:

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Liquidity risk channel amplifies sovereign default risk (Bocola, 2016)

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- + An exogenous increase in s_{t-1} could equally capture an increase in debt-to-GDP driven by fundamentals as well as **beliefs** (Corsetti and Dedola, 2016)
- + Could the two be disentangled? Mere announcement of OMT sufficient to rule out belief-driven fluctuations

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- + This direction of propagation would capture how a credit crunch increases sovereign default risk

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- + Why not model this spillover directly by having intermediaries of Foreign country directly exposed to Home sovereign bonds?
- + Model intermediaries also in Foreign country. Assume:

$$V_t^F \geq \underbrace{\eta_t^F}_{\text{credit tightness}} (Q_t^{f,F} f_t^F + Q_t^{b,F} b_t^F + Q_t^{b,H} b_t^H)$$

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