

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

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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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