Monetary Tightening and U.S. Bank Fragility in 2023: Mark-to-Market Losses and Uninsured Depositor Runs

Discussion: Rajkamal Iyer

Imperial College London, CEPR

Motivation

- Thinks of the shock that happened in the context of SVB and tries to understand the underlying mechanisms:
  - Banks bought lots of treasury when interest rates were low
  - High amount of uninsured deposits

- High Interest rate environment:
  - Treasury prices drop-balance sheet weakens
  - Uninsured depositor run risk

Theory:

- Old debate about Information based runs vs panic-based runs.

- Fundamentals act like a coordination mechanism (Goldstein and Pauzner, 2005).
  - When fundamentals are weak, this can get people worried about solvency of the bank.

- The model in the paper has some flavor of this intuition.

- Run equilibrium possible for banks in a certain range of solvency.

Empirical part

- Need to measure losses on the asset side.

- Main problem is that most assets are held in banking book (HTM).

- Make assumptions calculate the mark to market value of assets

- Estimate the risk of failure assuming a % of uninsured depositors withdraw.
  - % Uninsured deposits withdrawn range from 10% to 100%.
  - At around 40% of uninsured deposits withdrawn 200 banks fail worth half trillion of assets.
  - At around 100% of close to 1600 banks fail worth 5 trillion of assets.

- Iyer and Puri (2012); Iyer et al., (2016): the likelihood of uninsured depositor withdrawing in case of solvency shock is close to 30%.

- The magnitude of uninsured deposits at risk higher- larger deposits

Comments

- If possible, validate at least for a few banks using supervisory data, whether there is a discrepancy between the actual value vs estimate value.
- Stock market reaction, CDS—available for around 60 banks (leave the large ones).
- Netting of uninsured deposits with loans (common practice)-amount of uninsured deposits at risk potentially much lower.
- Is covid causing a problem- banks got deposits and did not have lending opportunities so invested more in securities.
- Did the balance sheet of banks look similar in other previous monetary cycles like in 2006?
- Would be useful to understand if this is special setting? (aside fed stress test was using 2% rate scenario).

- Interesting paper

- Looking forward to reading the updated version of the paper.

- Thank you.