

Comments on “Estimating Systemic Risk in the Financial System” by Bartram, Brown, and Hund

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The paper in 1 slide

- Pursues three approaches to estimate systemic risk.
 - Stock price reaction
 - Credit risk model
 - Option pricing
- Applies these methods to five crisis periods.
- Finds no evidence of systemic risk.

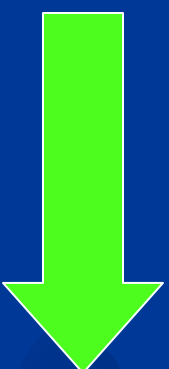
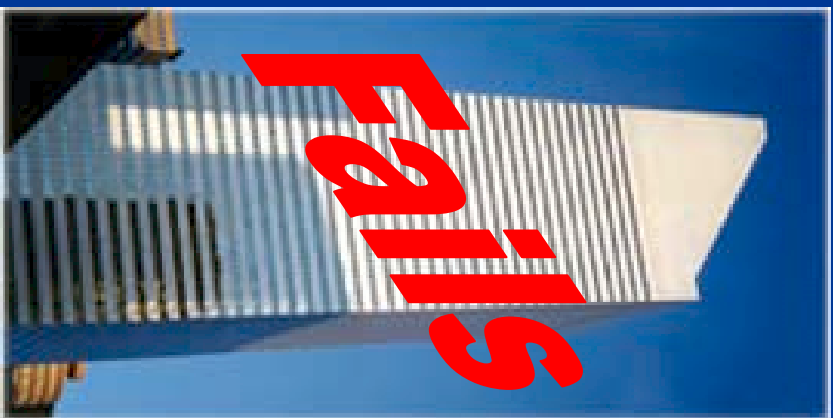
Alternative definitions of systemic risk

- Systemic risk. *Overused noun*. ORIGIN: CENTRAL BANKING
Expression used to justify any action taken by policymakers in the name of the common good.
- “The abrupt and disorderly closeout of Long-Term Capital’s positions would pose unacceptable risks to the US economy (McDonough 1998 p. 1051).”
- “... there is no reason for central bank involvement unless there is a substantial probability that a fire sale would result in severe, widespread, and prolonged disruptions to financial market activity (Greenspan 1998 p. 1047).”

Alternative definitions of systemic risk

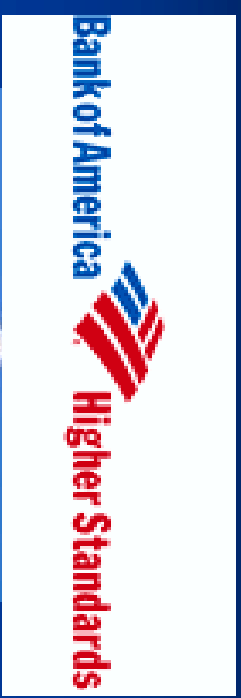
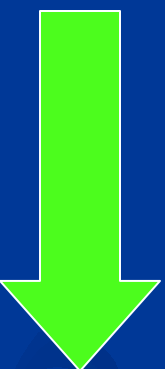
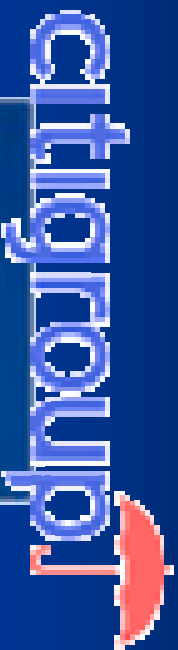
- Systemic risk. *Poorly defined noun.* ORIGIN: ACADEMIC RESEARCH PAPERS The risk that academic studies will be misinterpreted because they fail to clearly state what they mean by systemic risk.

Alternative definitions



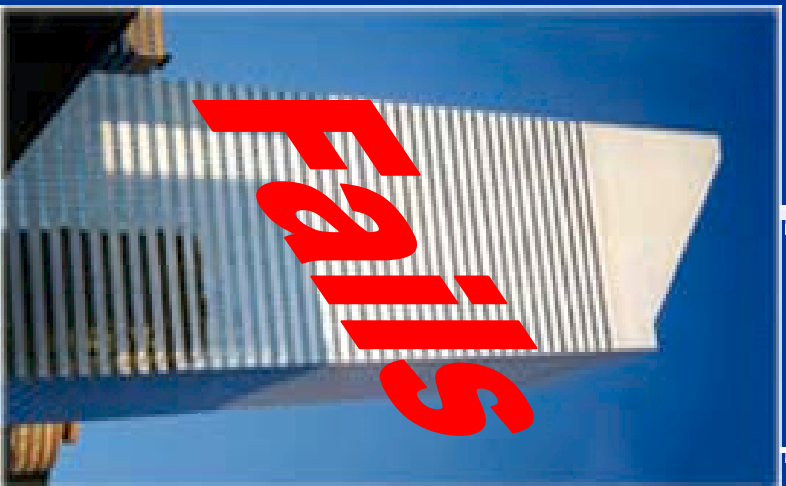
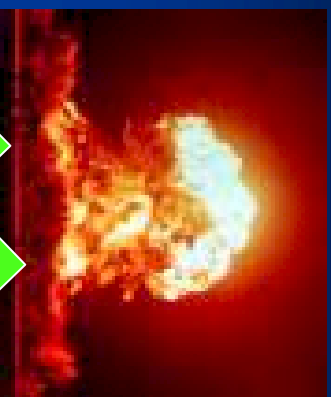
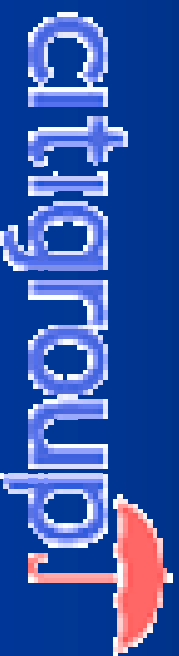
Systemically
important failure

Alternative definitions



Contagious default

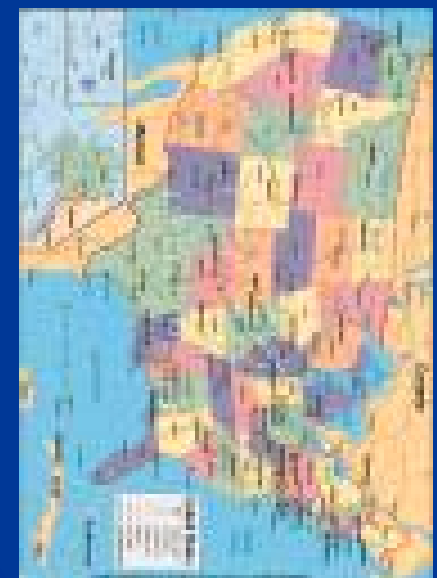
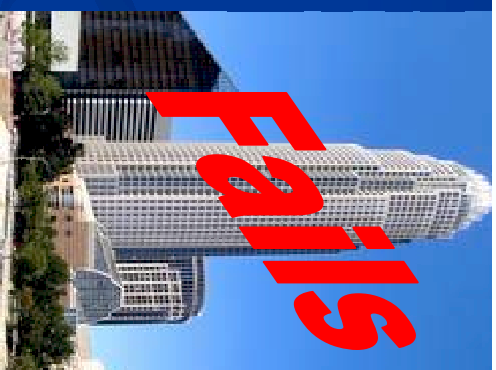
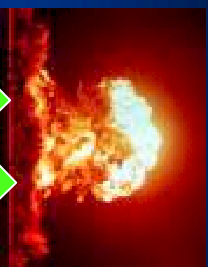
Alternative definitions



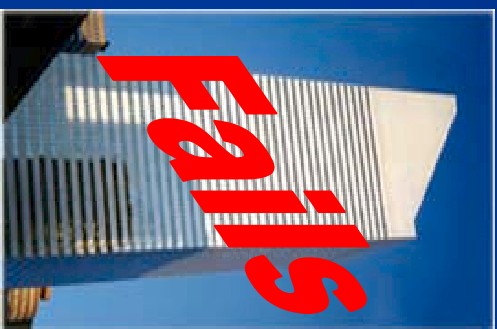
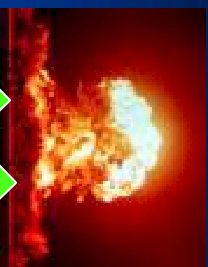
Contagious exposure
to common shock



Alternative definitions



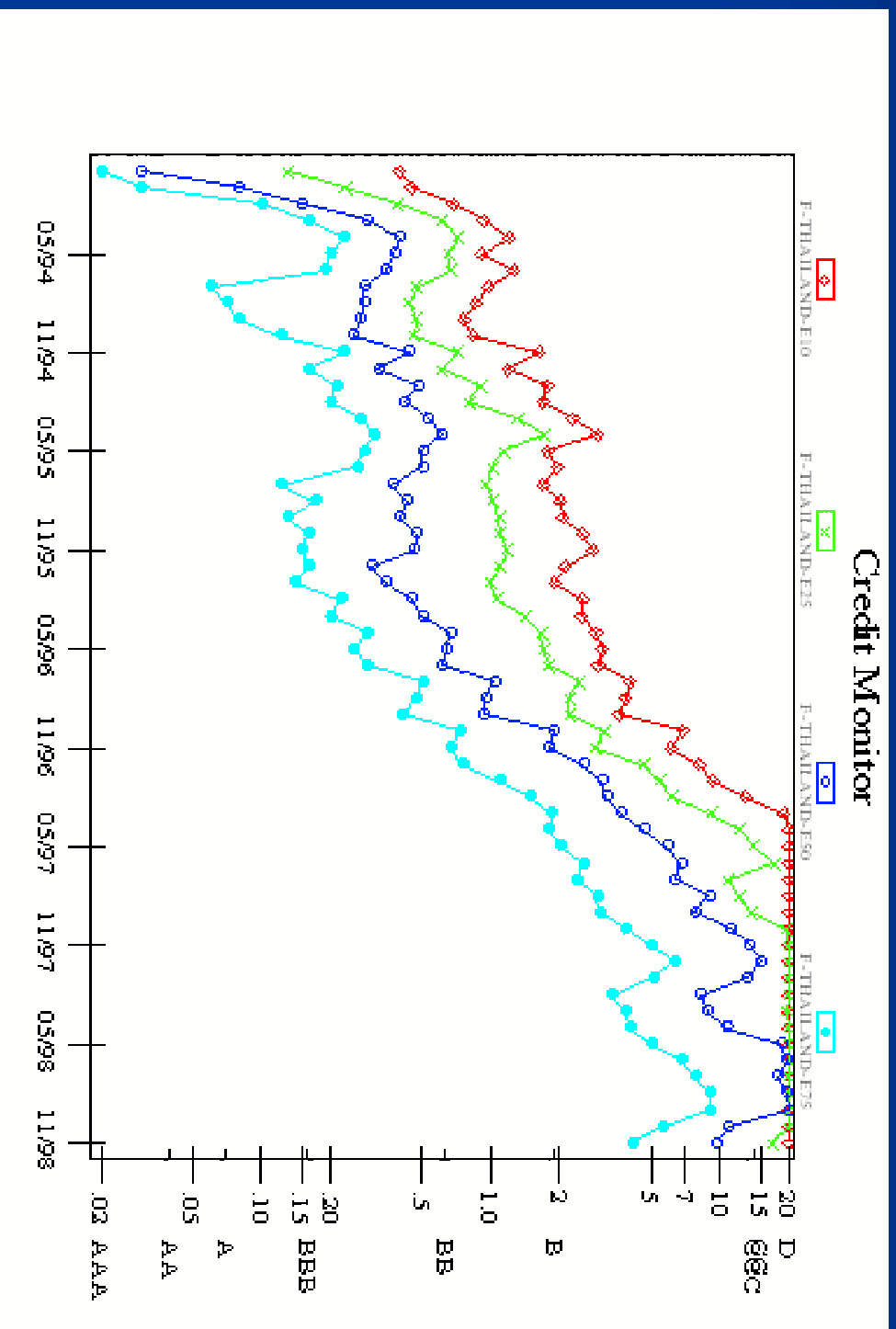
Alternative definitions



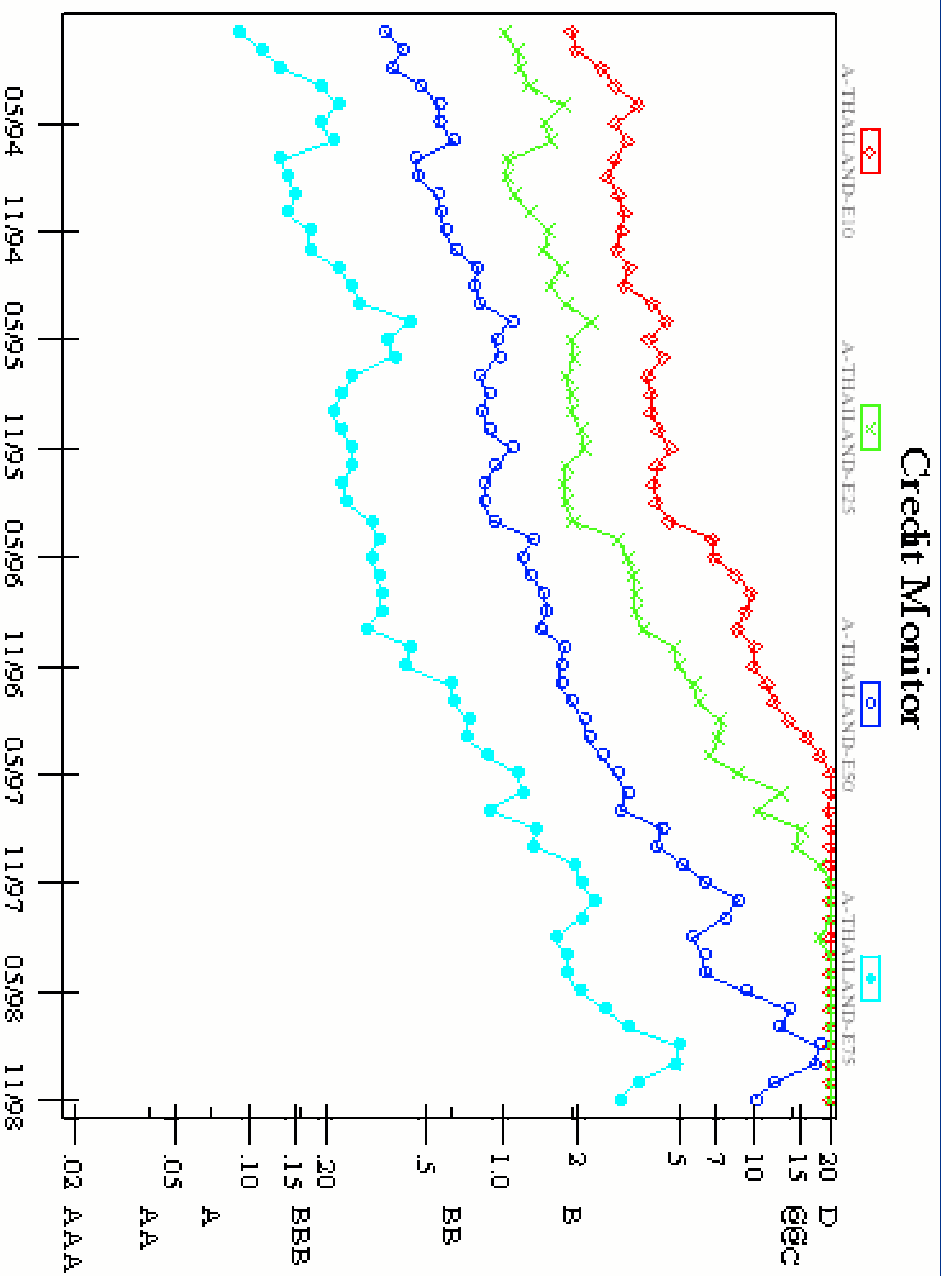
Interpretation of findings

- Paper searches for systemic risk in the least likely place to find it.
- So should policymakers relax?
 - Policymaking is national. Concerns about systemic risk are largely concerns about the safety and soundness of the domestic financial system.
 - Exposed versus unexposed institutions ... exposed may be the risk!

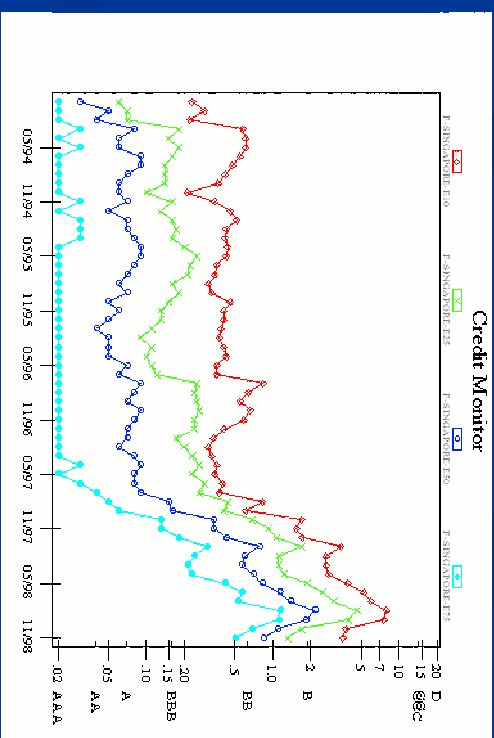
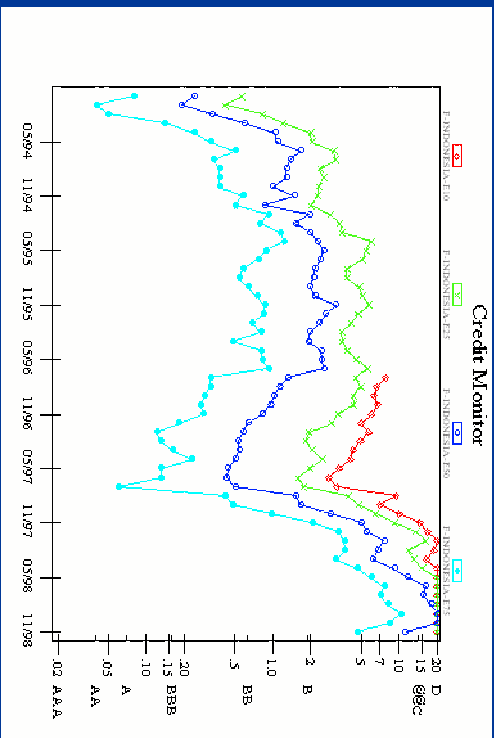
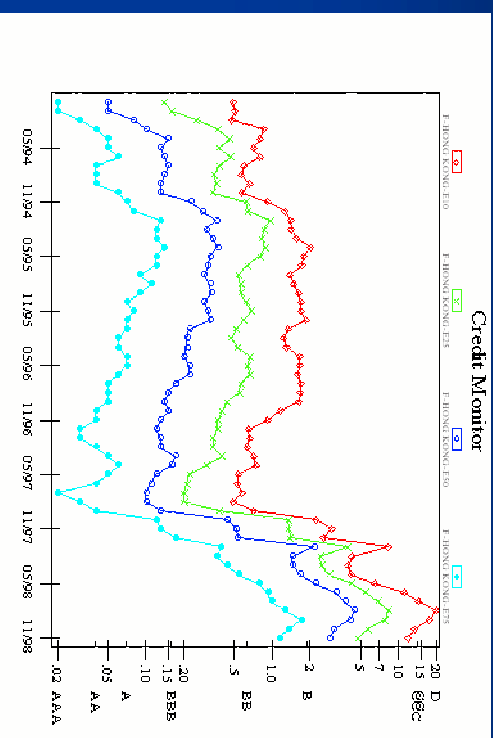
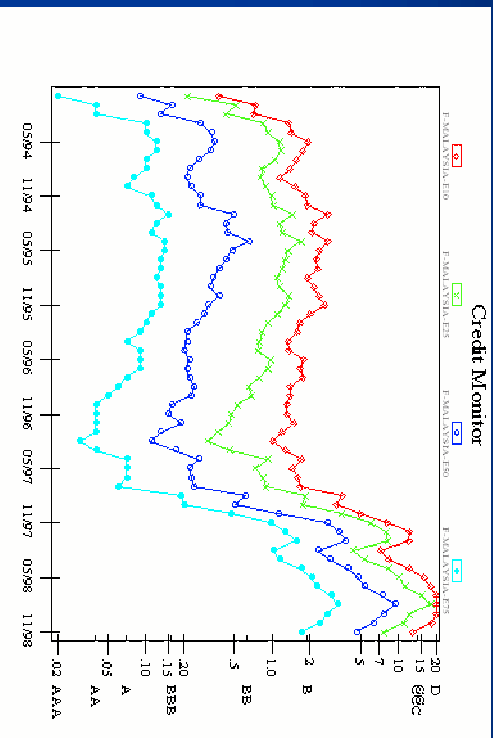
Systemic risk: Evidence from the KMV database - Thailand



Systemic risk: Evidence from the KMV database - Thailand



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Systemic Risk: LTCM?

- Furfine (2006) documents the behavior of US commercial banks in overnight money markets in the days surrounding problems at LTCM.
- Banks willing to lend unsecured to LTCM-affected institutions throughout period.
- Market perceives that LTCM not a solvency threatening event for major US banks.

Systemic Risk: 9/11?

Federal Reserve Release

Press Release



- *Release Date: September 11, 2001*
- For immediate release
- The Federal Reserve System is open and operating. The discount window is available to meet liquidity needs.

Systemic Risk: 9/11?

- On September 11, banks experienced difficulties in making their payments because of widespread damage to property and communications systems in Lower Manhattan. As a result, other banks received fewer payments than were expected.
- Since banks rely heavily on incoming funds to make their own payments, the normal coordination of payments broke down, and liquidity shortages developed at many banks.

Systemic Risk: 9/11?

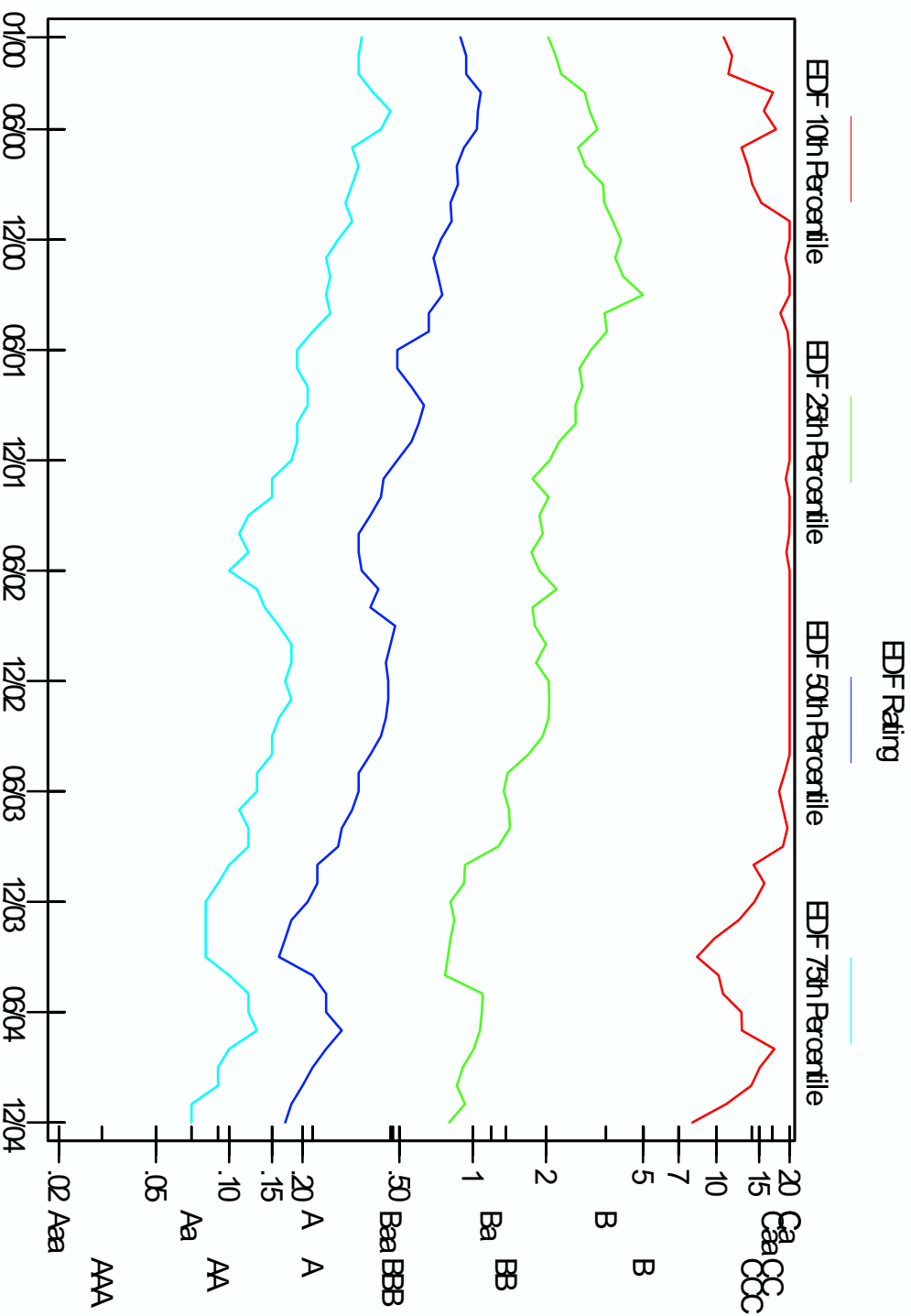
TABLE 1
Fedwire Funds Transfer Value and Volume,
and Aggregate Opening Balances with the
Federal Reserve: September 10-21, 2001

Date	Volume	Value (Billions of Dollars)	Balance (Billions of Dollars)
September 10	436,312	1,591	13
September 11	249,472	1,216	13
September 12	332,433	1,696	44
September 13	376,937	1,952	104
September 14	423,256	2,009	121
September 17	462,522	2,312	111
September 18	419,126	1,978	46
September 19	401,420	1,836	19
September 20	433,771	1,921	15
September 21	442,293	1,832	13

Source: Federal Reserve Bank of New York.

Systemic Risk: 9/11?

US-NY REGION



Final thoughts

- Policymakers may tend to overstate systemic risk in rationalizing questionable actions.
- Systemic risk exists! Entire financial systems crumble. Macroeconomic impacts can be large.
- This paper provides further evidence suggesting that markets can identify institutions that are exposed to a given shock from those that are not. (My preferred marketing strategy.)