Discussion of
Leverage constraints and liquidity: What can we learn from margin trading?
by C Bige Kahraman and Heather Tookes

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Funding liquidity

Area of interest – funding liquidity
Obvious source of interest: Financial Crisis

▶ liquidity spirals / shocks to market liquidity

Typical: Brunnermeier and Pedersen (2009)
Feedback loop
Funding:
▶ Liquidity of collateral affect funding

Liquidity:
▶ Funding possibilities affect liquidity provision

Empirically – Still investigating the channels involved
Funding liquidity

Prime interest of this literature:
- Market wide movements in liquidity
- How do funding shocks transmit

This paper – claim to put microscope on one aspect of funding liquidity.
My discussion: Keep at a more general level of funding liquidity not sure microscope view is desirable.
India

This paper – data from Indian Stock Market
Shock to particular institutional aspect of funding.
Usual motivation for looking at non-US markets:

- Some feature we can not identify/measure in other markets
- Lessons of general interest
Non-US studies

To Succeed, need to

▶ Give an overview of the institutional setup (here the Indian Stock Market) necessary to understand the unique features of interest.

▶ Link the analysis back to the theory, try to give us the lessons of general interest in the context of the theory.

These two points pillars of my discussion, issues with first presentation of the Indian environment, then the link back to theory.
Indian Institutional Setup

Not happy with presentation of the participants. Given theoretical issues of interest, want to look at system-critical financial intermediaries, here in the stock market, which may feed into a system-wide loop/shock.

Market professionals, (think market making).

But discussion about borrowing at the same rates as for holidays does not fit such professionals.

Do we have system-critical day traders in the Indian Market? → would like to get some feel for what these market participants look like.

- Size?
- How many stocks are they involved in?
- etc.
The Exchange’s regulation

The setup from the exchange’s point of view is interesting. They group eligible stocks based on

- Number of trading days
- Estimated effect of a price shock

These are micro-structure liquidity measures. But there is little discussion of why the exchange introduced exactly these regulations.

- Were they thinking of funding liquidity
- In 2004?

Some more discussion desirable here
Also for policy implications – see later.
In the theory discussion, may be better to get back to the full discussion of funding liquidity, get above the microscopic view. Suggestion of framing: Distinguish between

- *levels* and
- *composition*

of funding requirement.

Theory essentially talking about funding liquidity *levels*.

(in models assets move in same direction.)
Levels and composition

In this paper, two things going on each time there is a change

- The stocks eligible changes
  - (A crossectional effect)
- The total value of collateral available (product of stock prices and number of shares available) may change
  - (A level effect)

Thinking in this manner may (this only my suggestion) be a way for the authors to sharpen the analysis.

With that distinction:
Can ask questions such as:
Is crossectional effect only anything to worry about (all that happens is a change in composition of stocks involved).
Are however level effects (e.g. large falls in stock values) something to worry about?
Always useful to think about possible policy implications. Here the obvious one the one the authors are not discussing:

- The design of the rules to choose eligible stocks.

Are they “optimal” relative to a role for stabilization in typical funding liquidity spirals?
Minor Issues

- Additional liquidity measures?
- Can the regressions be done on changes in liquidity instead of levels (may get rid of some of the dummies)
- In the discussion, no need to be that defensive about endogeneity – embrace it.
Overall

Interesting paper, authors main task to make the link to theory clearer.