Discussion of “Nonbank Fragility in Credit Markets: Evidence from a Two-Layer Asset Demand System” by Darmouni, Siani, and Xiao

Antonio Falato, Fed Board

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This Paper: Backdrop

- Spectacular growth of NBFIs (mutual funds) in the bond market

Data source: Flow of Funds (Federal Reserve Board Financial Accounts, Z.1).
This Paper: Summary

• Combines an asset demand model in the tradition of Koijen and Yogo (2019) with data to examine the consequences of NBFIs for corporate bond market fragility
  – Topical issue with potentially consequential policy implications

• Three main forces:
  – Feedback loop via inst. flow-performance relation
  – X-asset contagion via bond demand elasticity
  – X-institution contagion via inst. holdings overlap
This Paper: Summary (continued)

• Results
  – HY and ST bonds more systemic than IG and LT
  – More bang for the buck from targeted policies (MF lending) relative to policies that “get in all the cracks” (MP)

• Will focus my comments today on a few additional exercises which may help to maximize paper’s impact
Spelling out NBFIs Fragility
Apply the model beyond the COVID crisis

• For example, Taper Tantrum in June-July 2013 was less severe than COVID yet the other most stressful episode over the last decade (Feroli et al. (2014))
  – Were the sources of fragility the same as in the COVID crisis?
  – Was any of the three forces more/less important?
  – (How) do your conclusions about stabilization policy change?

• Can also do a “placebo test” by applying the model to normal times
  – What makes normal times “normal”?
  – Is any of the three forces still at play even in normal time?
Quantify the three sources of fragility

- Do an additional set of counterfactuals that “switch off” each of the three sources of fragility sequentially
  - For example, how much volatility/price impact with a counterfactually low flow-performance relation?
  - How much with counterfactually low demand elasticity?
  - How much with counterfactually low demand cross-elasticities?
- Can use them to gauge relative importance of different sources of fragility
- Also would speak to presence of interactions/non-linearities
  - Is fragility due to both high flow-performance *and* high demand elasticities?
Quantify which NBFIs lead to fragility

• Do an additional set of counterfactuals that change investor clientele
  – For example, surge of MF and decline in insurers
  – Or surge of insurers and decline of MF

• Would provide direct quantification of relative contribution of different types of NBFIs to fragility
  – Are the implications for fragility of growth vs. decline of MFs linear or there a cliff effect past a certain MF size?
  – Are the implications of increase/decrease in MF size symmetric?
  – Do they depend on the composition of the rest of the investor clientele?
In Summary

• Nice paper
  – Consequential question and promising research approach

• Is it useful to have an empirical demand model to assess NBFIs fragility?

• I think so, but would be great to further leverage the model
  – Current setup is a rich laboratory
  – Expanding the quantitative analysis will help to clarify the relative importance of different channels/sources of fragility