Discussion: "Monetary Policy Shocks and Financial Stability: Evidence from the Great Depression"

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The views expressed are my own and do not represent those of the Federal Reserve Board or the Federal Reserve System.

Background: The September 1931 Banking Crisis

Context: Third wave (of four) of Great Depression bank suspensions

- First **national** crisis (vs. regional crises in Oct 1930, March 1931)
- Triggered by Britain leaving gold standard (Sep 21, 1931)
- U.S. gold outflows → Fed raised discount rate (Oct 9 & 16)

Existing Explanations are Limited:

1. **Micro-level:** Richardson (2007) - Portfolio problems caused 40% of suspensions
2. **Macro-level:** Friedman & Schwartz (1963); Eichengreen (1992); Temin (1993)
    - Fed's rate hike → aggregate collapse

Paper: Test the interest rate risk channel at bank level

The Setup:

- 1930s banks held large bond portfolios as liquidity buffers
- Limited hedging tools (no swaps, competitive deposit markets)
- Vulnerable to interest rate shocks

The Mechanism:

Interest Rate Risk → Valuation losses + Depositor withdrawals → Bank failures

Key Finding:

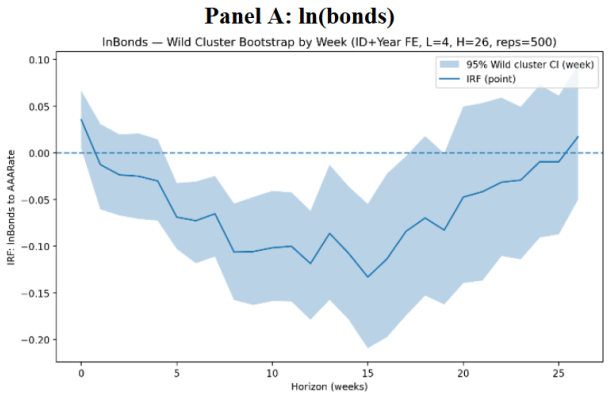
Banks with higher bond exposure → Greater exit rates after the rate shock

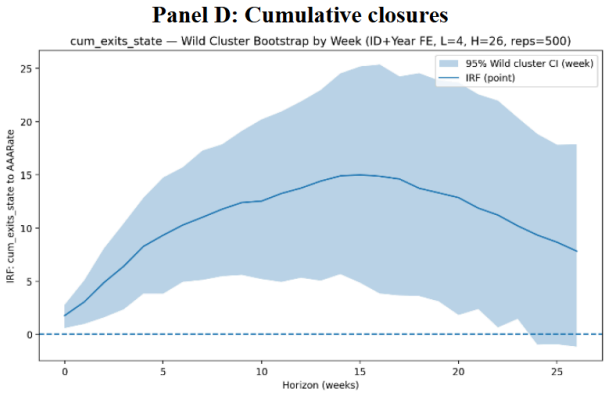
Aggregate: Bond Values Fell, Suspensions Rose

Key Takeaways:

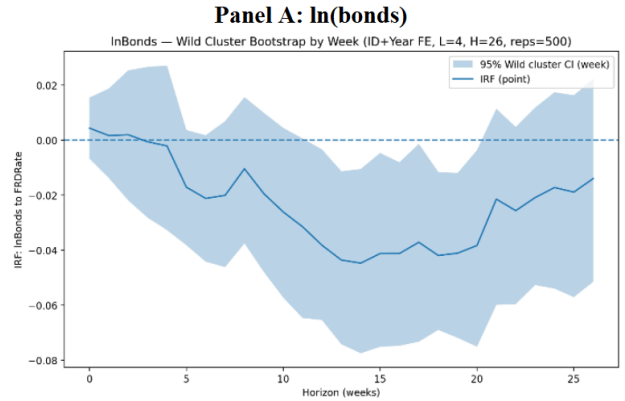
- **Bond holdings fell** ~10%
- **Bank suspensions rose** sharply (1-2 per state/week)
- Effects **peaked** at 10-15 weeks

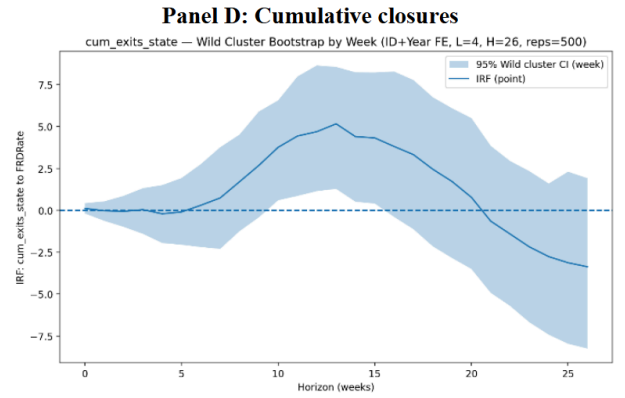
Aaa Corporate Bond Yield





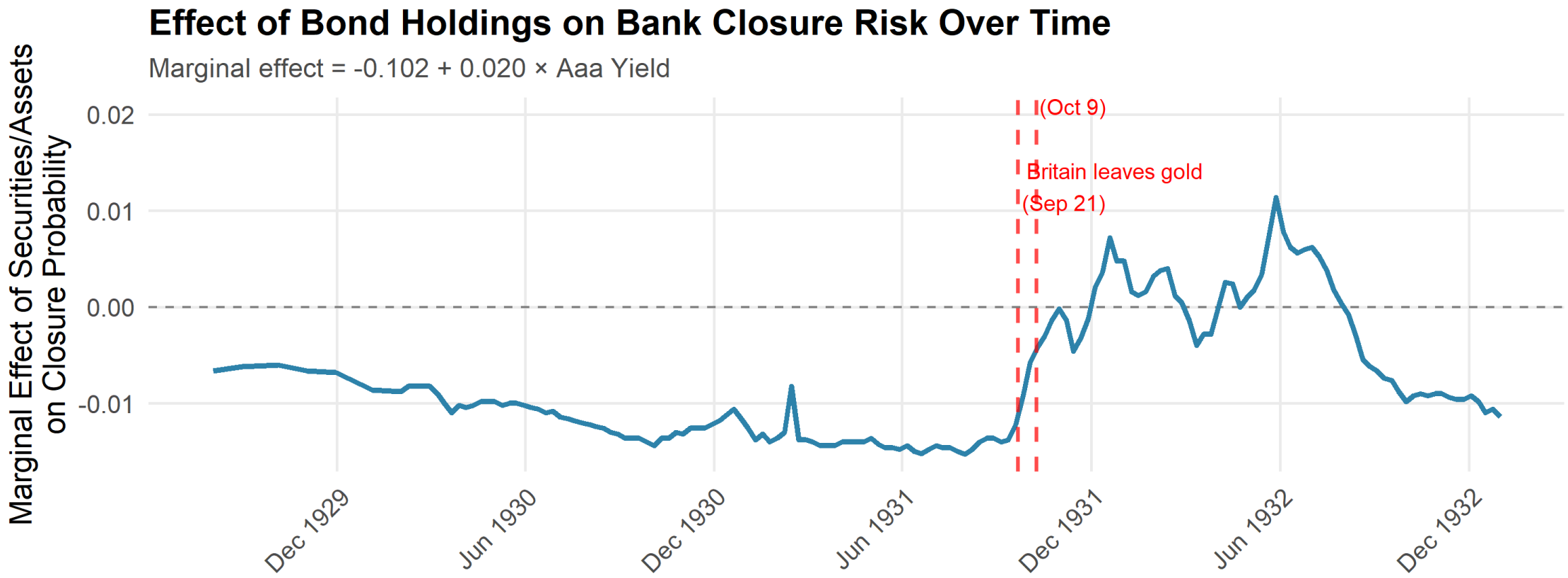
Fed Discount Rate





Cross-Section: Banks with More Bonds Failed More

Key Finding: The same bond holdings that protected banks during 1929-mid 1931 (falling rates) became a vulnerability after October 1931 (rising rates).



This Paper's Contribution

What's New:

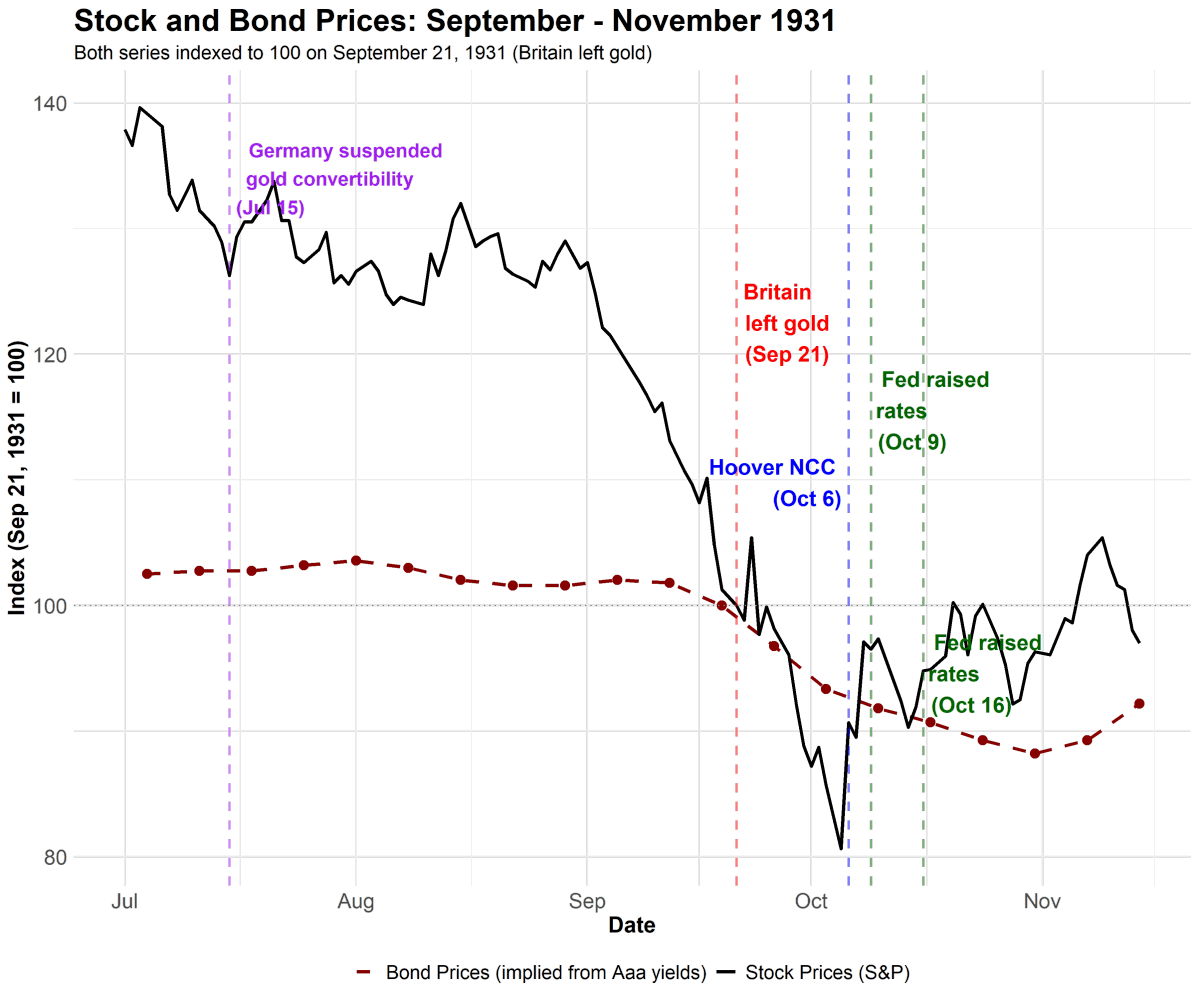
- First direct **empirical test** of interest rate risk causing bank failures
  - Bank-level balance sheets (entire U.S. banking system 1928-1932)
  - Exogenous shock (Britain leaves gold → Fed defends dollar)
  - High-frequency data (weekly transmission)

Why It Matters:

- **Specific portfolio vulnerability** tied to interest rate movements
  - Not just liquidity panics (Friedman & Schwartz)
  - Not just regional shocks (Caldwell collapse)

Modern Parallel: Is this similar to SVB 2023?

High-Frequency Data Is a Strength — But What Is the Shock?



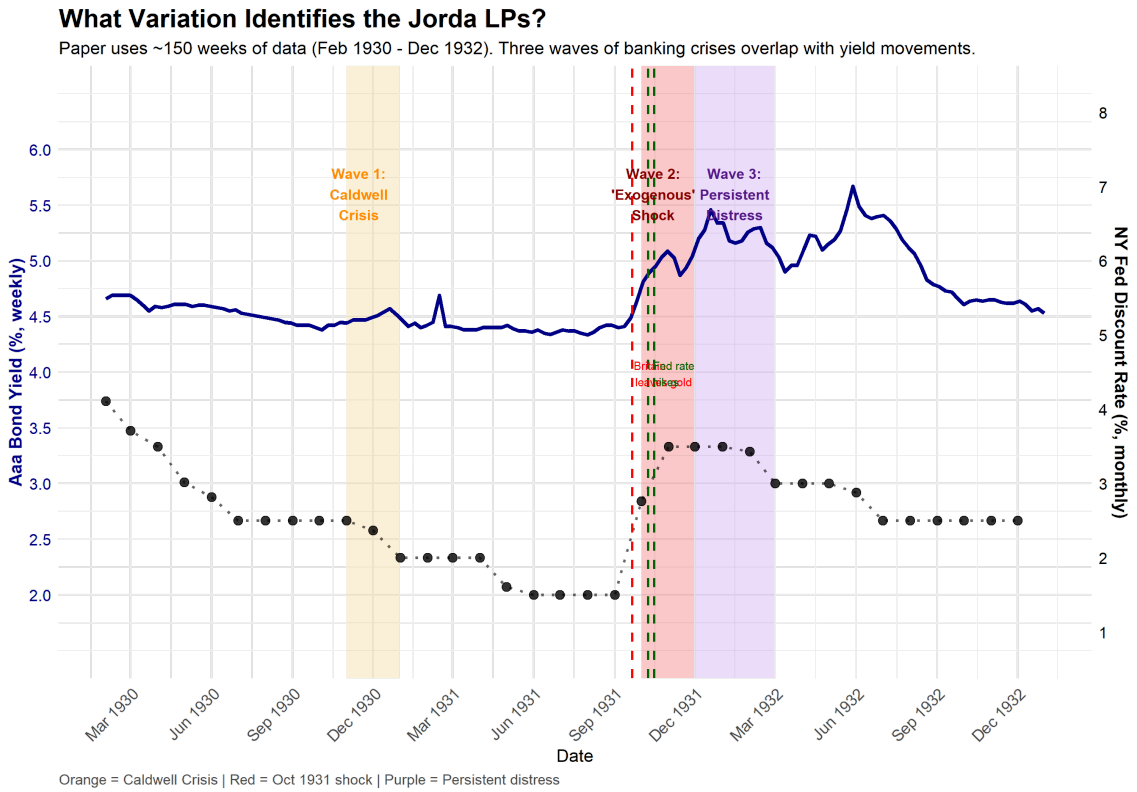
The high-frequency data reveals two distinct shocks:

- Sep 21: Britain leaves gold → **Aaa yields start rising immediately**
- Oct 9: Fed defends dollar → **Discount rate jumps**

But Aaa yield ≠ clean Oct 9 shock:

- NYT (Oct 16): investors *anticipated* the rate hike (Sumner 2015)
- NCC organized Oct 6, formally established Oct 13 — markets expected a backstop
- Sep 21 event expands the LP event window — how much of the estimated effect predates Oct 9?

Are the Stronger LP Results Driven by the Noisier Measure?



Request: Show "Wave 2-only" LP results

The Aaa problem compounds: ~150 weeks pooled, but only Wave 2 is exogenous.

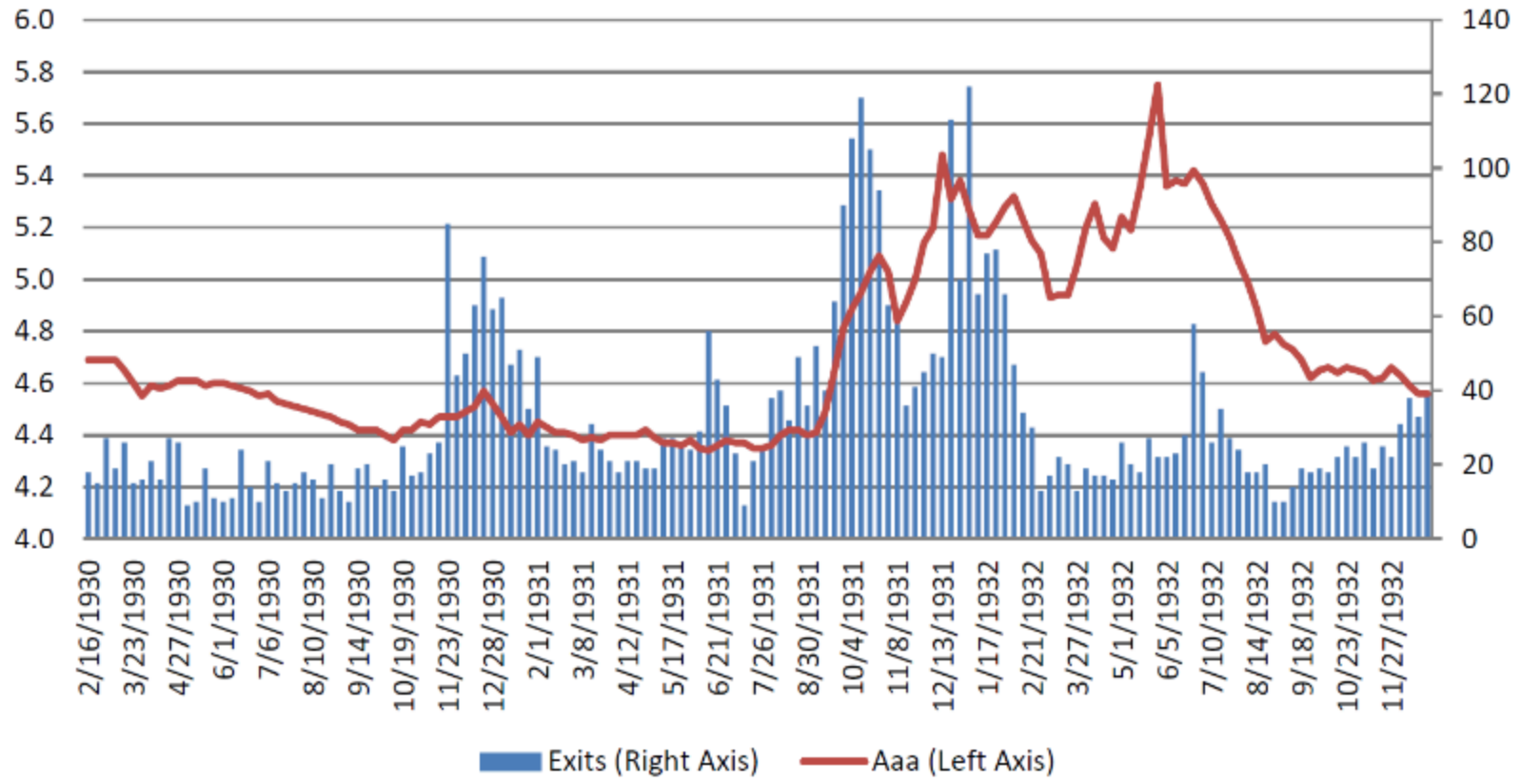
	Moves in	LP results
Discount rate	Wave 2 only	Weaker
Aaa yield	All three waves	Stronger

Two reasons Aaa results may be inflated:

1. **Waves 1 & 3** — banking crises drive yields, not vice versa
2. **Pre-shock** — Aaa starts moving Sep 21, 3 weeks early

Bank Suspensions from First Wave in Sample

Figure 1: Bank Closures and Aaa Bond Yields by Week



Notes: Figure provides the number of US commercial banks that closed and the Aaa commercial bond yield in each week.

What Is the Securities/Assets Coefficient Actually Capturing?

Q1: Interest rate or credit risk?

Corporate bond prices fell in Oct 1931 — purely rate-driven, or also anticipated defaults?

- Bank portfolios include below-Aaa bonds — these reprice for *both* interest rate and credit risk
- Securities/Assets coefficient may capture both

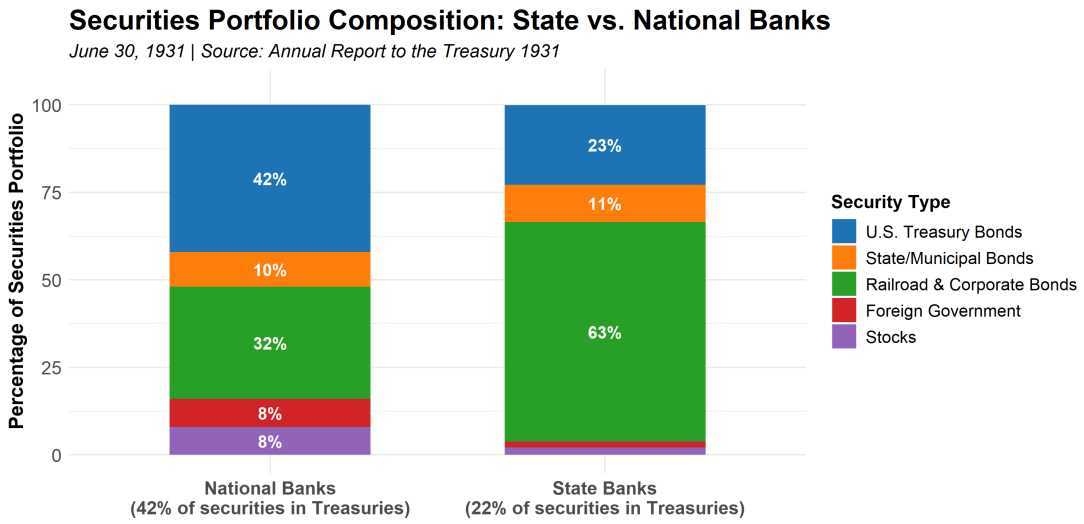
Q2: Solvency or fire sales? *(conditional on Q1)*

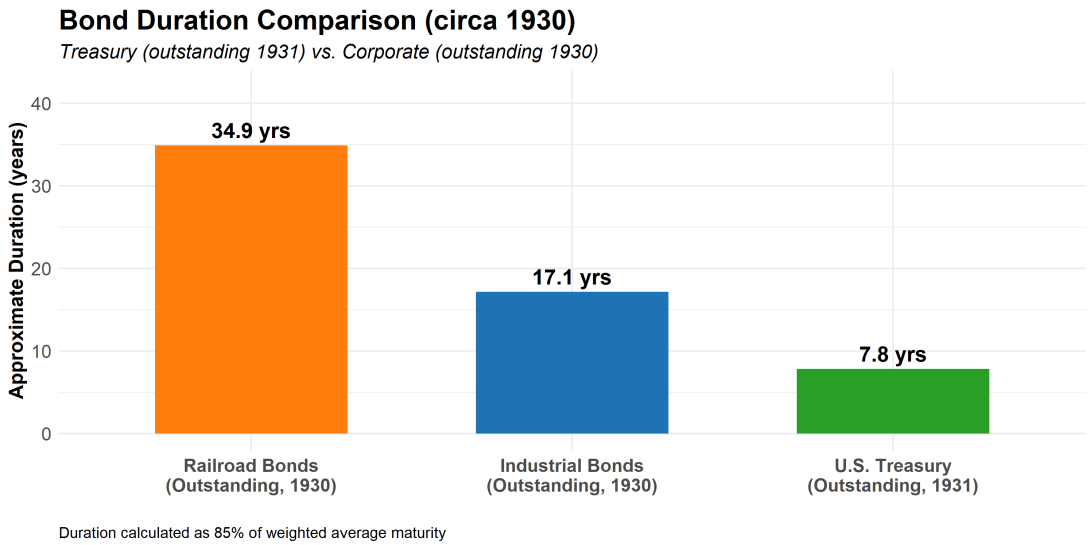
Ideal test: interact Securities/Assets × Rate × **bond maturity** from balance sheets

- Solvency: steep duration gradient in failures
- Fire sales: shallower gradient

> If balance sheet maturity data unavailable: state vs. national banks as proxy — but they differ in supervision, discount window access, and credit risk exposure too

Some Variation Exists to Run This Test





State banks hold more corporates

Corporates have longer duration

Duration from AI-scraped 1930 issuance data (Annual Report of the Treasury 1931 p.828; Hickman 1960)

Also: clearinghouse membership — interacting it with Securities × Rate tests whether interbank liquidity access attenuated the bond vulnerability.

Additional Minor Comments

1. **Book value vs. market value:** Unclear whether Rand McNally data reflects mark-to-market adjustments or realized sales — if the latter, declining securities is itself evidence of fire sales, not just a control variable.
2. **HHI triple interaction:** Paper controls for deposit market concentration but doesn't interact it with Securities × Rate — would directly test whether franchise value moderates the bond vulnerability, connecting to their own SVB policy argument.
3. **Pre-shock deposit growth:** Were banks already experiencing outflows before October? An endogeneity check: if yes, failures may reflect pre-existing fragility rather than the shock itself.
4. **Where does the SVB parallel break down?** In 2023 the Fed's BTFP valued bonds at par — directly offsetting duration losses. No equivalent existed in 1931 (NCC tried and failed). The historical case may be the more fragile one.

Conclusion

A very nice paper — first bank-level test of the interest rate risk channel with a genuinely exogenous shock, high-frequency data, and important modern parallels.

Main comments:

1. **The shock:** Sep 21 and Oct 9 are distinct — show Wave 2-only LP results with the discount rate
2. **The mechanism:** Solvency vs. fire sales needs more sharpening: some bank heterogeneity is the path forward

Thank You!