Project Update

In our paper, entitled "The Bond Lending Channel of Monetary Policy", we use a high-frequency approach that combines identified monetary shocks with cross-sectional firm-level stock price reactions in the euro area to investigate how debt structure mediates the monetary transmission process.

We first show how to interpret stock market reactions to learn about the effect of monetary policy on firms. Illustrating our mechanism in a simple framework of debt structure, investment, and stock prices, we argue that the effect of a higher share of bond financing is ambiguous. On the one hand, the the bank lending channel implies a smaller shift in credit supply for bond-financed firms. On the other hand, the existence of frictions in bond financing dampens (and can even reverse) this effect. Specifically, because bonds are held widely, they are more rigid than relationship loans.

We find strong evidence that debt structure matters for the transmission of monetary policy in the data. Firms with more bond debt are relatively more affected by surprise interest rate changes. In particular, after a 25 basis point increase in interest rates, firms in the top quartile of the bonds-over-assets distribution have a 99 basis point lower stock return, relative to firms in the bottom quartile. This finding is hard to square with the bank lending channel, which would imply, irrespective of the exact micro-foundation, that bond-reliant firms are relatively less responsive—the opposite of what the data suggest.

On the other hand, this evidence is consistent with the existence of intense frictions in bond financing in the euro area. Importantly, the effect is equally forceful during the post-crisis period, when bond financing became much more prevalent. These findings are robust to several alternative specifications, including the inclusion of traditional balance sheet covariates that are thought to drive the response to monetary policy.

Note that the paper has been under submission since the end of 2020, and so there few major changes (if any) to report since the most recent update.

This paper is available at:
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3419235

Seminars, conference presentations, press releases and other academic activities:

We have presented at the following conferences and seminars in 2020:

- T2M Conference, Aix-Marseille University
- CEPR European Summer Symposium in International Macroeconomics
- Financial Intermediation Research Society (FIRS) Conference
- SFS Cavalcade
- MoFiR Workshop on Banking
- European Finance Association (EFA) Meeting
- Bank of Finland and CEPR Joint Conference
- Manchester (seminar)

- World Finance & Banking Symposium
- Econometric Society Winter Meetings

We have presented (or will present*) at the following conferences and seminars in 2021:

- LMU Munich (seminar)
- SED* (scheduled)

We have also published a VoxEU column about our paper:
https://voxeu.org/article/credit-during-crisis-bond-lending-channel-monetary-policy