Discussion of "The Impact of Policy Initiatives on Credit Spreads during the 2007–09 Financial Crisis"

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This paper studies the effect on credit spreads from the various "unconventional" monetary policies, conventional monetary policy, and fiscal policies introduced during the 2007–09 financial crisis period. Based on credit-spread changes on policy announcement date, policy implementation date, and policy implementation size over time, the paper concludes that the multitude of "unconventional" monetary policies were modestly effective in reducing market spreads; fiscal policy announcements did not reduce credit spreads; and increases in the Taylor-rule residual (a measure of conventional monetary policy) is associated with an increase in credit spreads. Credit spreads are measured in this paper by LIBOR-OIS spread, repo-OIS spread, and corporate-Treasury bond spread.

The unconventional policies examined in this paper are classified along three dimensions: (i) an expansion of the type of counterparties receiving support, (ii) a broadening of the collateral eligible for support, and (iii) a lengthening of the maturity of the support. Using this framework, this paper finds that all three dimensions of policies were effective in reducing market spreads, with the most effective being policies that broadened the range of collateral eligible for secured funding from the Federal Reserve. Secondly, these policies were more effective in reducing unsecured and secured funding costs than bond spreads. Thirdly, these policies were more effective in reducing the level of spreads than their conditional variances.

More interestingly, this paper identifies an "implementation" effect and a "shock and awe" effect (termed "size" effect in the

paper). Specifically, the paper analyzes credit-spread changes on policy announcement date, policy implementation date, and policy implementation size over time. Methodologically, this covers a wider angle than some existing studies that focus more on announcement-day effect. This paper finds a discernible effect on all three dates. The effect is the strongest at implementation dates and when higher amounts are loaned from these programs. The result seems to suggest that the policy effect is stronger when (lots of) money is thrown at the problem compared with "talking down the market." However, a bit of caution is deserved when interpreting the result. For example, reverse causality—more-effective programs are used more by market participants than less-effective programs—might generate similar implementation and size effects. In this scenario, the size effect is a mere reflection of a program's effectiveness. A "shock and awe" but ineffective program may still remain ineffective. Nonetheless, the paper's findings on implementation and size remain interesting. They help to identify successful programs, in the sense of being widely used and simultaneously lowering credit spreads, even under the more conservative interpretation. "Shock and awe" per se may add to the effectiveness of a policy, but perhaps more studies would be helpful to solidify this important hypothesis.

In designing a policy prescription, it may be useful to know if the ordering of policies matters. For example, is it more desirable to expand counterparty before lengthening maturity? A casual look at the "unconventional" monetary policies tabulated in the paper seems to identify three policy phases. Phase 1, lasting from 2007 until mid-2008, largely focuses on lengthening maturity and expanding counterparty. Phase 2, lasting from mid-2008 to late 2008, mostly broadens collateral and continues to expand counterparty. The last policy phase, starting from late 2008, switches back to lengthening maturity and expanding counterparty. Is lengthening maturity more effective in phase 3, when counterparty has been expanded and collateral has been broadened, than in phase 1? Such a question is potentially answerable in future studies using the sample, subject to the caveat that not all lead-lag permutations are observed in this sample. For example, policy to broaden collateral started largely in phase 2, hence one does not observe how a policy to broaden collateral would have performed if it were introduced without first introducing the other two types of policies.

The paper also finds that the policy effect on credit spreads of different maturities have the same sign. The effect tends to be smaller for shorter maturities. Such variation across maturities potentially warrants deeper investigation and may shed light on issues related to debt maturities. Combining information from different maturities may help distinguish policy effects from different channels. For example, the Term Auction Facility is announced on December 12, 2007, and implemented five days later on December 17, 2007 (in this example, let us assume the implementation date is predetermined and known to market participants). The change in overnight credit spreads on December 12 contains the announcement-day effect but presumably little implementation-day effect. On the other hand, the change in one-week credit spreads on December 12 (loan matures after implementation) contains both the announcement and the (expected) implementation effects. Comparing the overnight and the one-week spreads may help further disentangle the announcement and implementation effects. In a similar way, can the time-series evolution of a credit spread such as the overnight spread on December 15 (loan is initiated and matures before policy implementation), on December 16 (loan is initiated before yet matures after policy implementation), and on December 17 (loan is initiated after policy implementation) contribute to the understanding of policy effect?

In conclusion, this paper provides interesting evidence on the effect of monetary and fiscal policies in the 2007–09 financial crisis. This is another useful step in the important study on the role of central banks in financial crises.