Discussion:
Exorbitant Privilege? Quantitative Easing and the Bond Market Subsidy of Prospective Fallen Angels

By Viral V. Acharya, Ryan Banerjee, Matteo Crosignani, Tim Eisert and Renée Spigt

Jian (Jane) Li
Columbia University

FSB Conference on NBFI, June 2022
Motivation

- Large increase in the amount outstanding of BBB-rated bonds since 2009, with low offering spreads
  - From 17% of IG in 2001 to > 50% in 2019
- Massive downgrades during the COVID-19 shock
- What are the forces driving this unique pattern of BBB-rated bonds? What are the implications?
This Paper

- Document subsidy for “prospective fallen angels” in the corporate bond market since 2009
  - Driven by investors exposed to Fed’s QE program

- Real effect: more risk taking by the subsidized firms ⇒ more materialized downgrades during COVID-19
  - Capital misallocation and risk build-up
  - Negative externalities on other firms

- Very important work on the consequences of unconventional monetary policy (QE)!

- Rich policy implications
Why Important?

- Different from the transmission of conventional MP, which mostly involves banks, the transmission of QE relies on heterogeneous NBFIs
  - Specific objectives and regulatory constraints
- Investor base for the U.S. corporate bond market
  - IG: 20% mutual funds, 60% life insurance companies
  - HY: 60% mutual funds, 20% life insurance companies
- Frictions in credit ratings + regulatory constraints based on ratings ⇒ subsidy for risky BBB-rated firms
- Monetary policy does not seem to be market-neutral
Increased Maturity

Valuation is more sensitive to interest rate movements and downgrades

Long term impact: rollover risks in the future
The high demand for riskier bonds is usually rationalised by reaching-for-yield (“ignoring risk”)

But here the yield is lower among the riskier bonds!

Maybe it is other features of these bond that the investors value?

For example, the vulnerable bonds seem to have larger issuance size, which is correlated with liquidity
In 2021, the bond market had a record number of first time junk bond issuers...

Overall lesson: where is the liquidity being directed given the investor base?

- What are the objectives and constraints of these investors?
- Macro-prudential: more emphasis on market-based measurements
Thank You!