Discussion of ‘Effects of the International Regulatory Reforms over Market Liquidity of Mexican Sovereign Debt’

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The views expressed are ours and do not necessarily reflect those of the Bank of England.

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How important is the liquidity of government debt?

A hypothetical scenario of a sovereign debt crisis

- Collapsing financial institutions (for some reason)
- The government needs funds to bail them out
- Liquidity of sovereign debt instruments are crucial

In this scenario, how big the banking sector is becomes crucial.

Even if it’s large, but the banks are resilient, the probability of the government having to bail out banks decreases.
How big is the banking sector in Mexico?

- The size of a banking system is often measured by the sum of assets held by banks on their balance sheets as a share of that country’s GDP.

- Mexico’s financial sector assets amounted to 90 percent of GDP in 2015, with over half being commercial banking assets.\(^1\)

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\(^1\)Mexico Financial System Stability Assessment, IMF, November 2016
The paper investigates the empirical evidence on the effects of regulatory framework on market liquidity of Mexican sovereign debt.

Liquidity of the Mexican Sovereign Debt

(Macro)Economic Conditions  Financial Resilience

Proxying market liquidity with turnover rate as the dependent variable.

Dummy variables corresponding to the regulation dates.

Additional explanatory variables: VIX, USD/MXN, S&P, MEXBOL, TIIE 28, FFR.
Results

Both negative and positive effects...

- For some of the reforms (Basel 2.5, Basel III and LCR) they find negative effects.
- For the rest (Dodd-Frank Act and the Volcker Rule) they find positive effects.

Reforms constraining government debt holdings $\rightarrow$ negative effect

Reforms increasing transparency so reducing uncertainty $\rightarrow$ positive effect
Strong points

- Literature contribution
- Novel dataset
- Extensive robustness checks
  - Different dependent variables
  - Controlling for the crisis and VIX threshold
  - Exploration of endogenous regime switching
  - Exploration of structural breaks
  - Checking the methodology for advance countries
- The results are robust to these additional analyses
Suggestions (1)

- Overlapping dummy variables across regulations
Suggestions (2)

- Potential correlation between the explanatory variables
  - For monthly data 1995-2017, the correlation of TIIE 28 and FFR is 0.68
  - For weekly data 2012-2016, the correlation of S&P500 and MEXBOL is 0.75.

- Splitting variance and mean regimes in regime switching model

\[ Turnover_t = \alpha_s + \varepsilon_s, \varepsilon_s \sim N(0, \sigma_s) \]

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