Summary for non-specialists
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Economic Papers index

The impact of state guarantees on banks' debt issuing costs, lending and funding policy

Study on behalf of EC DG Economic and Financial Affairs

Prepared by London Economics
Authors: Patrice Muller, Shaan Devnani and Rasmus Flytkjaer
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On behalf of DG ECFIN, London Economics carried out an empirical study on the effectiveness of state guarantees given to banks in 2008-10. It analysed the market value of state guarantees as reflected in banks' issuing costs and whether there were significant differences visible in the balance sheets of banks that used state guarantees and those that refrained from using them. The report presents a comprehensive ex-post evaluation of one of the main tools to restore the functioning of wholesale financial markets after the Lehman bankruptcy. The results of the empirical research suggested that the guarantee schemes were successful in lowering the costs of bond issuance of participating banks while having relatively little distortionary impacts on non-participating banks. Moreover, cross-border spill-over appear to be non-existent. Though the report stresses that the estimates do not necessarily suggest causalities, the following results are noteworthy:

- **Market value of state guarantees:** The direct effect from the use of state guarantees (SG) was limited to about 30 basis points, i.e. investors were prepared to accept 30 basis points less for a comparable debt security issued by a bank with a state guarantee than without one. Moreover, there was a second upgrade effect, insofar as lower-rated banks were able to issue bonds with a superior rating. This effect had sizeable statistically significant impact on the issuing costs of bonds rated BBB-/BBB/BBB+, in the order of over 200bps. In contrast to other research, there was no evidence found that differences across guarantors, i.e. related to different ratings of the Member State providing the guarantee, had a significant impact on issuing costs.
- **Spill-over:** While each individual state-guaranteed bond issue benefited from the state guarantee through a lower issue cost, all bond issues (state guaranteed and non-state guaranteed) were impacted negatively by the overall volume of state-guaranteed bond issues during a month. Quantitatively, each bond issue faced a higher issuance cost of 10.5bps, on average, as a result of the overall volume of state-guaranteed issuance activity in a given month. This indirect effect is entirely domestic, as the monthly volume of state-guaranteed bond issues outside a Member State is not found to impact on the issuance cost of state-guaranteed and non-state- guaranteed bonds in the domestic market.
- **Bank behaviour**: The econometric analysis shows that banks that issued state-guaranteed bonds a) lent less than banks that were eligible to issue state-guaranteed

bonds but did not so and b) reduced their leverage ratio. The descriptive statistical analysis covers further variables and suggests that banks having issued guaranteed bonds in the following year increased their short-term and long-term funding by more, their equity capital by less and show a worse post-issue profit performance than banks having issued non-guaranteed bonds.