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Stigma in Financial Markets: Evidence from Liquidity Auctions and Discount Window Borrowing During the Crisis

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Abstract


While the perception of stigma attached to borrowing from the discount window complicates the Fed's efforts to help banks in urgent need for funds during times of crisis, there exists little evidence supporting the presence of stigma in financial markets. In this paper, we provide rigorous evidence of the existence and incidence of discount window stigma during the financial crisis of 2007. For example, during the summer of 2008, banks preferred to pay on average at least 34 basis points more to borrow from the Fed's Term Auction Facility than from the discount window. The probability of paying a borrowing premium is higher for banks in greater need of liquidity, and in periods when market funding conditions worsen. Finally, we find that the perception of stigma is associated with real effects in asset markets. In particular, banks' interbank borrowing rate is higher the day after a discount window visit and its stock return is lower. Our results have implications for the best way for central banks to supply liquidity during crisis periods.

Keywords: Treasury Auction Facility, Discount Window Borrowing

JEL Classification: E44, E58

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