Report on Master Thesis

Institute of Economic Studies, Faculty of Social Sciences, Charles University in Prague

Student:	Bc. Gladiola Gjuzi
Advisor:	Doc. Ing. Zdenek Tuma, CSc.
Title of the thesis:	Liquidity creation and banks' capital effect: GIIPS countries case

OVERALL ASSESSMENT (provided in English, Czech, or Slovak):

Contribution

The main value added of the thesis is researching the link between bank capital and liquidity creation for the five EU countries that were hit most during the global financial crisis – the GIIPS countries (Greece, Ireland, Italy, Portugal and Spain). Existing literature has not yet analyzed these countries separately, with studies on the same topic available for the euro area as a whole or selected country cases including the Czech Republic. Within the fixed effects panel framework and using bank-level data from BankScope over 2006-2016, the author further analyzes this link by bank size as well as by two sub-periods (no-crisis versus crisis period).

Methods

The thesis uses panel data fixed effects method, which is properly described, to test several hypotheses specified in a separate section.

However, the first two hypotheses are however in direct contradiction, as the first one is suggesting a negative link between capital and liquidity creation, while the second one a negative relationship. This should not be the case - hypotheses should be specified in a way so that the empirical research can support and reject them.

Ideally, to test liquidity creation, one should use a measure developed by Berger and Bowman (2009) that classifies and aggregates bank balance sheet items by their level of liquidity. Thus, a bank with a large maturity transformation (large share of illiquid, long-term loans financed by large amount of short-term, i.e. liquid liabilities) would show a high liquidity creation level. However, due to the lack of data, the author decided to use liquid assets as a proportion of total assets. However, there is usually an inverse relationship between liquidity of the bank (as measured by liquid asset ratio) and liquidity creation – the more liquidity creation is observed, the higher liquidity risk (more short term liabilities, more long term assets and thus less liquid assets), the higher maturity transformation, and thus the worse are traditional bank liquidity ratios. The regressions that has been made thus test a link between bank capital and bank liqudity rather than liquidity creation – if these two are in direct contradiction, the conclusions on page 37 should be re-interpreted – the results actually support the 2nd hypothesis on risk absorption, i.e. banks with higher capital are thos with higher liquidity creation (and lower liquid assets).

Literature

Obligatory review of literature on key issues in financial intermediation, capital regulation, and bank liquidity is included. The author also cites relevant literature throughout the thesis where appropriate.

Unfortunately, the review section is quite confusing, throwing in and mixing various concepts without explaining in detail their differences, links, and the relationship with the research conducted in the thesis. This part should also include the discussion of the two main hypotheses related to the link between capital and liquidity creation, which is missing. The review of literature is structured into 5 parts, but at least the last two parts (on in GIIPS and regulatory environment) seem more like sections on development than literature, and should be carved out from the review and presented as a separate section.

When reviewing literature on liquidity (and also later in the thesis), the author does not differentiate enough between the funding liquidity (or balance sheet liquidity), market liquidity, and liquidity

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creation, the last concept which is actually a measure of the degree of maturity transformation provided by banks. The review discusses Basel liquidity regulation (LCR, NSFR), but this has nothing to do with liquidity creation. The discussion of ECB operations during the crisis and research using TARGET balances data is very confusing and not sufficently described, similarly to the regulatory development area where Basel and CRR/CRD regulation are described in a very poor way.

Manuscript form

The thesis is very well formatted and structured, but the writing style could be improved. Sometimes it is not clear what the main argument of a paragraph is, several concepts are often mixed together, some descriptions of the developments are not precise, wrong terms are used (e.g. p. 11 – „New measurements of monetary policies in 2014" instead of „New measures..."). In terms of charts and tables, they are all available in the Annex, but the usual best practice is to include the key charts and tables (to which the text is related) directly into the main part of the thesis.

Summary and suggested questions for the discussion during the defense

The thesis fulfils on the margin the requirements for a defendable thesis. Given the various issues raised above, especially the mixing up the key liquidity concepts and its impact on results of the research, I propose the grade E.

However, during the defence, the author should be able to re-interpret the empirical results and provide the corrected interpretation betweent bank capital and liquidity (either bank liquidity or liquidity creation, i..e de facto maturity transformation), including what factors can lead to such results in the GIIPS countries.

SUMMARY OF POINTS AWARDED (for details, see below):

CATEGORY		POINTS
Contribution	*(max. 30 points)*	20
Methods	*(max. 30 points)*	10
Literature	*(max. 20 points)*	10
Manuscript Form	*(max. 20 points)*	15
TOTAL POINTS	*(max. 100 points)*	**55**
GRADE	**(A – B – C – D – E – F)**	**E**

NAME OF THE REFEREE: Doc. Adam Gersl

DATE OF EVALUATION: 29.5.2018

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Referee Signature

EXPLANATION OF CATEGORIES AND SCALE:

CONTRIBUTION: *The author presents original ideas on the topic demonstrating critical thinking and ability to draw conclusions based on the knowledge of relevant theory and empirics. There is a distinct value added of the thesis.*

Strong	*Average*	*Weak*
30	*15*	*0*

METHODS: *The tools used are relevant to the research question being investigated, and adequate to the author's level of studies. The thesis topic is comprehensively analyzed.*

Strong	*Average*	*Weak*
30	*15*	*0*

LITERATURE REVIEW: *The thesis demonstrates author's full understanding and command of recent literature. The author quotes relevant literature in a proper way.*

Strong	*Average*	*Weak*
20	*10*	*0*

MANUSCRIPT FORM: *The thesis is well structured. The student uses appropriate language and style, including academic format for graphs and tables. The text effectively refers to graphs and tables and disposes with a complete bibliography.*

Strong	*Average*	*Weak*
20	*10*	*0*

Overall grading:

TOTAL	GRADE
91 – 100	A
81 - 90	B
71 - 80	C
61 – 70	D
51 – 60	E
0 – 50	F