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Authors: Ivo J.M. Arnold, Beau Soederhuizen

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Bank stability and refinancing operations during the crisis: which way causality?

Ivo J.M. Arnold^{1,2} & Beau Soederhuizen^{1*}

¹ Nyenrode Business University, Breukelen.

² Erasmus School of Economics, Erasmus University Rotterdam, Rotterdam.

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Abstract

This paper explores the causality between refinancing operations of the ECB and the stability of the European banking sector during the recent crisis. We hypothesize that causality may run both ways. The ECB's role in safeguarding the stability of the financial system suggests that refinancing operations may contribute to greater stability. Alternatively, instability in the banking sector may stimulate banks to tap liquidity at the ECB. Using country-level data on refinancing operations and bank CDS rates, we find a positive relationship between bank instability and liquidity uptake. High bank CDS rates are significantly related to the decision to tap liquidity, yet the liquidity uptake itself does little to bring these rates down quickly.

Keywords: ECB refinancing operations, unconventional monetary policy, credit default swaps, bank stability, euro crisis

JEL Codes: C33, E52, E58, G01, G13, G21, G15

1. Introduction

Since the start of the crisis, central banks have employed unconventional monetary policy measures to support financial stability and stimulate macroeconomic performance. It is

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