Accepted Manuscript

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PII: S0261-5606(17)30009-8
DOI: http://dx.doi.org/10.1016/j.jimonfin.2017.02.001
Reference: JIMF 1745

To appear in: *Journal of International Money and Finance*

Received Date: 2 July 2016
Accepted Date: 3 February 2017

Please cite this article as: S. Pagratis, N. Topaloglou, M. Tsionas, System stress testing of bank liquidity risk, *Journal of International Money and Finance* (2017), doi: http://dx.doi.org/10.1016/j.jimonfin.2017.02.001

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System stress testing of bank liquidity risk

Spyros Pagratis[*], Nikolas Topaloglou[†] and Mike Tsionas[‡]

December 2016

Abstract

Using a stress test methodology for bank liquidity risk we estimate the aggregate liquidity shortfall in the U.S. commercial banking system at the height of 2007-09 crisis, identifying key sources of funding vulnerabilities and the dominant composition of liquid asset holdings against liquidity shocks. The largest liquidity shocks to the system are estimated in the first half of the crisis, in line with Acharya and Mora (2015). Large banks experience the largest liquidity shortfall in 2008:Q1 ($154 billion or 14% of total assets) and small banks in 2007:Q4 ($117 billion or 11% of total assets). The dominant funding vulnerability to the system stems from large time deposits, while government securities largely dominate other classes of liquid assets as liquidity backstop. The analysis draws on detailed bank-level data on balance sheet flows of funds and applies stochastic dominance efficiency methods to capture liquidity risk diversification effects across assets and liabilities.

JEL classification codes: C14, C44, G11, G18, G21

Keywords: Banks; Liquidity Risk; Stochastic Dominance Efficiency.

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