



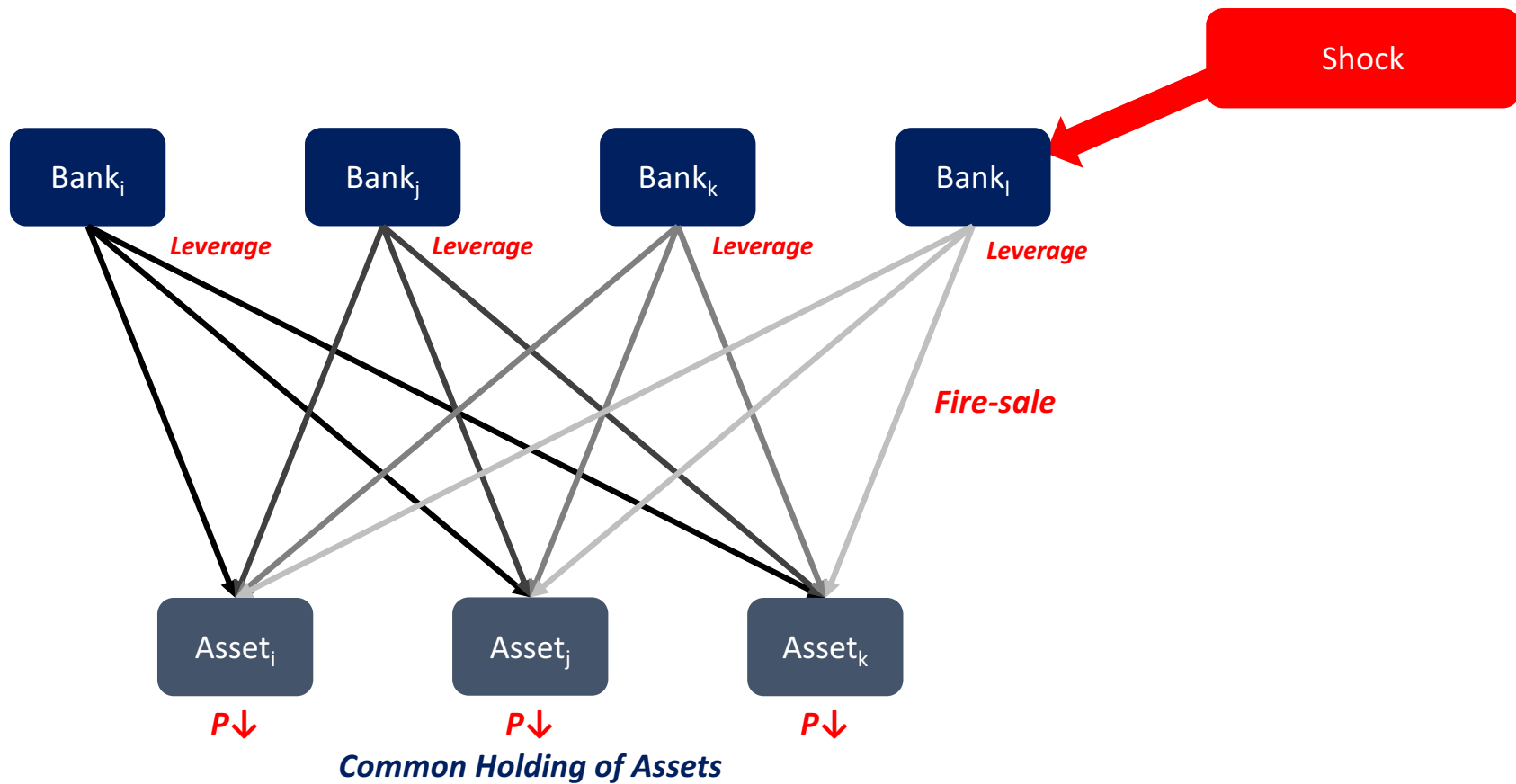
Fire sales, indirect contagion and systemic stress-testing  
Rama Cont & Eric Schaanning

Discussion by Tobias Adrian\*

Macro Financial Modeling Winter 2017 Meeting

\* The views expressed in this note are those of the authors solely and do not represent those of the IMF or IMF policy.

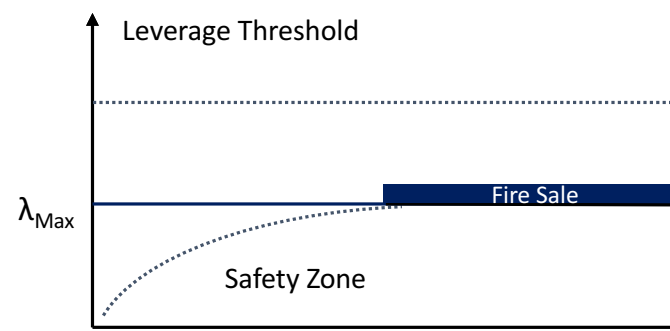
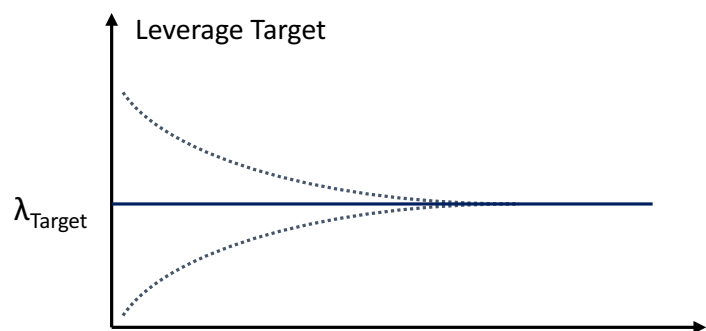
# THE MODEL



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## Main contributions:

- Common asset exposures as important channel of contagion
- Second round effects due to fire sales significantly contribute to system-wide losses
- Asymmetric balance sheet constraints generate more explosive contagion than symmetric constraints



- The Indirect Contagion Index (ICI) is a simple and practical way to measure potential for contagion

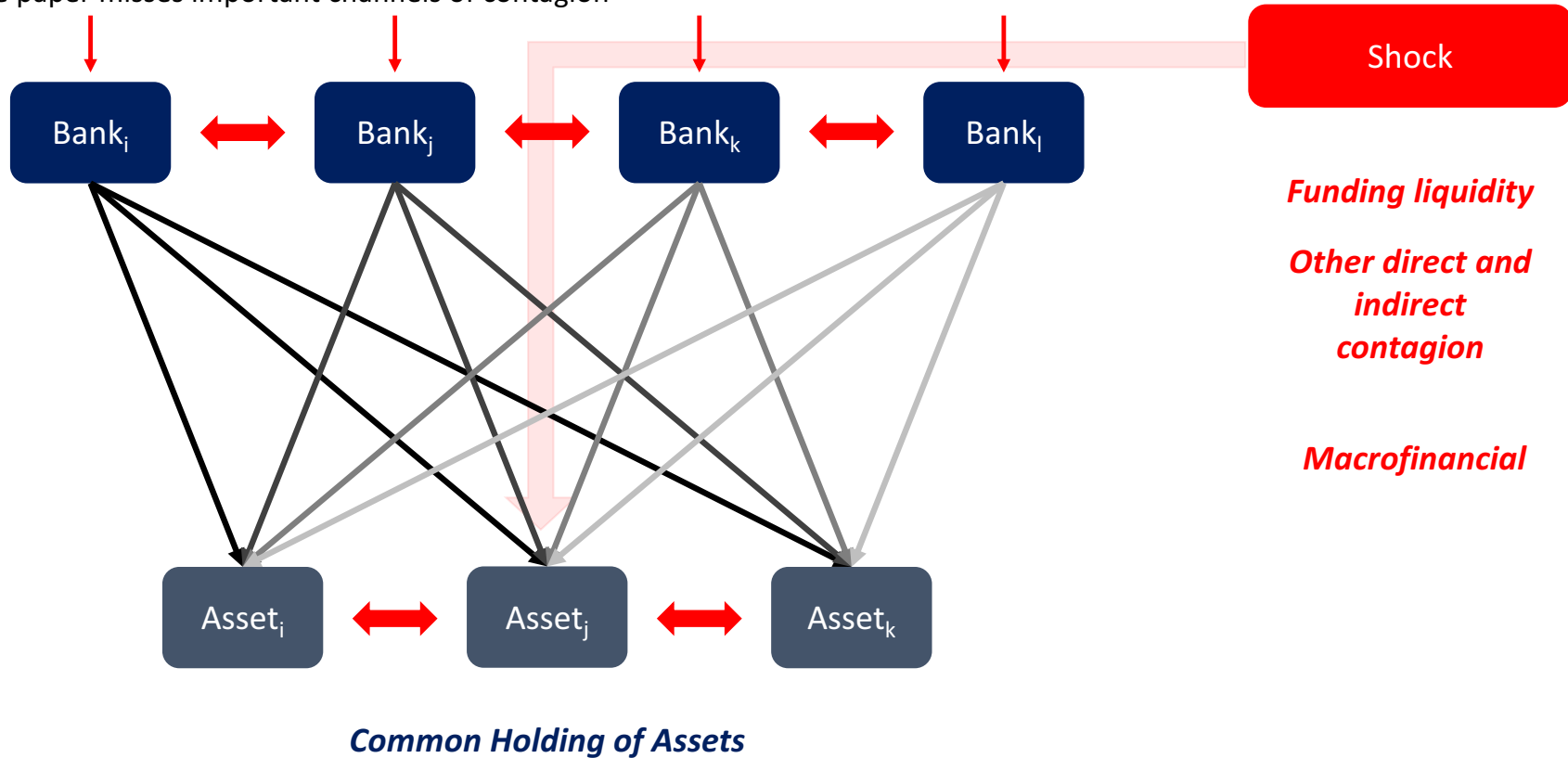
$$F(\Omega_{ij}, D_j) \xrightarrow{\text{Principal Eigenvector of } \Omega} \text{ICI}$$

# DISCUSSION



## The main limitations:

- The paper misses important channels of contagion



# DISCUSSION



## Main limitations:

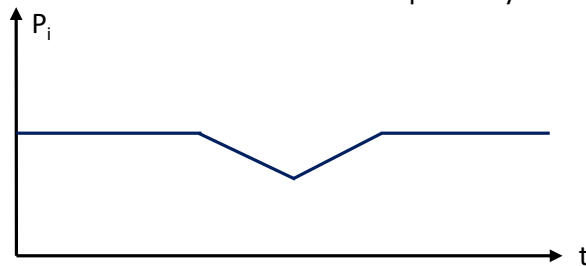
- **Misses important channels of contagion**
- **Requires granular data on the asset exposures and price elasticities for each bank**
  - Data is unlikely to be available in many countries
  - Is granularity of data correct?
- **Elasticities on asset prices and functional forms on “the market impact function” are an important inputs in the estimation of fire sales**
  - Assumptions on calibration of elasticities
  - Assumptions on the structural form of the “Market Impact function”

# DISCUSSION

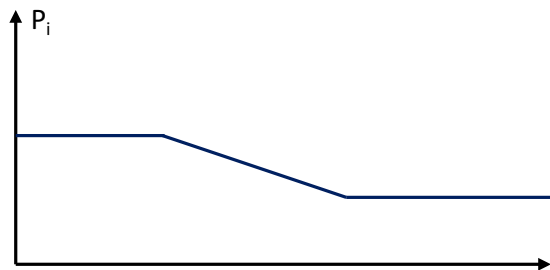


- **The banks' behavior is mechanical**

- In short-lived crises the model would probably over-predict contagion



- Whereas faced with structural shocks, the model might under predict contagion



- Would ICI represent a good proxy for contagion losses if key assumptions are relaxed?

# REFERENCES



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