

Repurchase agreements and systemic risk in the European sovereign debt crises: the role of clearing houses

Abstract

This article investigates the European repo market and its role as an amplification channel for sovereign-debt crises. We focus on transactions cleared via central clearing counterparties (CCPs), which account for the bulk of the repo market in the Eurozone. In particular, we collect novel data on repo haircuts applied on sovereign bonds and assess the methodologies used by CCPs for margining. We find that haircuts on peripheral sovereign bonds substantially increased in response to the rise in sovereign risk. Moreover, we document that the volume of the European repo market is strongly concentrated between few large financial institutions and few clearing houses. The procyclicality of haircuts and the concentration of secured transactions raise concerns about the CCP-intermediated repo market as a source of systemic risk in the Euro area.

Keywords: repo, haircut, central clearing counterparty, systemic risk, sovereign debt crises

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