

Title: Household Portfolio and Deposit Insurance: Implications for the Supply of Safe Assets

Speaker: Prof. Nishant Vats, Washington University

Area: F&A

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Abstract:

This paper investigates the effect of deposit insurance (DI) on household portfolio allocation between bank deposits and risky assets. Theoretically, limited DI creates a kink in the capital allocation line, causing depositor bunching at the DI threshold and increased equity holdings. Using a natural experiment in India and individual holdings on stocks, deposits, and mutual funds, we confirm depositor bunching at the DI threshold. Leveraging a bunching-in-differences design, we show that DI expansion shifts portfolios from equities and mutual funds to deposits, driven by unmet demand for safe assets. Bunchers increase their deposits between 3.6% and 5.1% by liquidating their stock holdings, which were more exposed to safer state-owned enterprises, transiently affecting the asset prices of these stocks. We show that the share of bunchers is a sufficient statistic to measure the depositor-implied risk of bank default. Our estimates of the welfare effect of changes in DI show that depositors gain at least 4% as DI increases, even after accounting for the resulting moral hazard by banks.

Speaker Profile:



Prof. Nishant Vats is an Assistant Professor of Finance at the Olin School of Business, Washington University in St Louis. Before joining Olin, he finished his Ph.D. in Finance from the University of Chicago Booth School of Business. His primary research interests include finance & development, financial intermediation, and corporate finance. He has a secondary interest in macroeconomics and political economy.

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