Three Essays in Finance

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This dissertation is composed of three essays on corporate credit markets and corporate finance. The first essay examines the impact of unconventional monetary policies (UMPs), including Quantitative Easing (QE), Operation Twist (OT), and Forward Guidance (FG), on corporate credit markets. These policies were expected to reduce credit spreads by decreasing credit risk premium and/or liquidity premium, and to further lengthen borrowing maturity. During the crisis, Quantitative Easing (QE) 1 reduced these risk premia as expected. However, after the crisis, QE 2 and Operation Twist announcements increased fears of a weaker economy and, consequently, widened credit spreads. In contrast, Forward Guidance reduced credit risk premia without increasing fear premia. I also find that QE had a minimal effect on corporate bond maturities, which most likely reflected the considerable increase of new Treasury issuance and the declining fraction of preferred-habitat investors. The largest impact on corporate bond maturities came from UMPs that significantly flattened the yield curve.

The second essay studies the impact of margin requirements on the Credit Default Swap (CDS) basis. The CDS basis was significantly negative during the 2007-2009 financial crisis, which was considered an anomaly. Using single-name CDS data, we find that the CDS basis decreases as the funding costs, credit risk premium, and market illiquidity increase. Further, cross-sectional results show that the sensitivities of the CDS basis to funding costs, credit risk premium, and market illiquidity are priced, even after
controlling for the individual bond liquidity and other firm characteristics. The results are consistent with the margin-based asset pricing theories that the difference in margin requirements on two otherwise identical securities gives rise to bases.

The third essay (co-authored with Yongqiang Chu) examines the relationship between a firm's leverage and that of its customers. We find that a firm's leverage is positively associated with its customer's leverage. We show that the positive leverage relationship is not driven by unobservable local and industry-specific shocks. To establish causality, we run two-stage least squares regressions with the customer's idiosyncratic volatility as the instrument for customer leverage and find that the results remain robust. Furthermore, consistent with the bargaining theory of capital structure, we find that the positive leverage relationship is stronger when the customer has higher ex-ante bargaining power.