Tracing the Impact of MMF Liquidity Supply Shocks:Evidence from the COVID-19 Market Turmoil

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This paper studies how liquidity shocks to money market funds (MMFs) propagate to short-term funding markets during the COVID-19 crisis. Adapting the identification strategy of Khwaja and Mian (2008) to a non-bank setting, we exploit security-level data and the fact that issuers borrow simultaneously from multiple MMFs to disentangle MMF supply shocks from issuer demand shocks. We show that a 1 percent decline in MMF liquidity reduces an issuer's securities issuance by approximately 0.5 percent, even after controlling for issuer fixed effects that absorb time-varying demand and unobserved heterogeneity. MMF balance sheet deterioration also raises issuance yields and increases the likelihood that MMF–issuer relationships terminate, indicating effects at both the intensive and extensive margins. At the issuer level, lost funding from distressed MMFs cannot be offset by borrowing from other MMFs, implying that private market substitution fails during stress episodes. These findings highlight the systemic importance of MMFs and provide empirical support for central bank interventions such as the Federal Reserve's Money Market Mutual Fund Liquidity Facility.

Keywords: Run on Money Market Funds (MMF run); COVID-19 crisis