The transmission mechanism of credit support policies in the euro area

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Discussion by:

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Summary of the paper

- Central question: do credit support policies (July 2007 - December 2014) stimulate the economy?

- Method
  - IBSI and IMIR data (lending volume and lending rates, bank characteristics)
  - Measure of exogenous Eurosystem balance sheet shocks (Boeckx, Dossche and Peersman, IJCB forthcoming)
  - Direct estimation of the IRFs via panel methods (regress lending rates/volumes of individual banks on own lags, lags of controls and balance sheet shocks) and interactive terms to "open the black box" of shock transmission

- Intuition of baseline regression with simple AR(1)

$$y_t = \rho y_{t-1} + u_t$$

$$y_{t+1} = \rho y_t + u_{t+1}$$

$$y_{t+2} = \rho y_{t+1} + u_{t+2} \Rightarrow \rho^2 y_t + \rho u_{t+1} + u_{t+2}$$

$$\Rightarrow \rho^3 y_{t-1} + \rho^2 u_t + \rho u_{t+1} + u_{t+2} \Rightarrow \alpha y_{t-1} + \beta u_t + v_t$$

- Main results
  - Exogenous balance sheet shock have a statistical and significant impact on lending volumes (persistent) and lending rates (short-lived)
  - For banks with and in times in which banks have higher capital, the effect is amplified (non-standard measures function more for healthy banks)

General comment

Nicely executed paper, relevant policy question, interesting results.

Thought-provoking results on the role of bank capital, maybe need to further study.

More specific comments, part 1: Bank Capital

- Findings on the role of capital robust to method (Altavilla, Canova and Ciccarelli 2016)

- Maybe, an explanation for macro findings and for other type of policies (e.g. findings in the Eurosystem Task-Forcs on APP: NSMs seem particularly powerful in "healthy" countries)

- Theoretical framework of Arce, Hurtado and Thomas (2016) to interpret the results?

Several papers using IBSI data about the impact of policy on loans and lending rates. A couple of questions:

- Why not to look at the effects on capital itself? How do (different) NSM policies interact with microprudential policy considerations?

- How is the potential endogeneity of capital treated in the analysis? Capital might react to the policy impulse, but this does not seem to be accounted for in the evaluation of the IRFs

More specific comments, part 2: Policy Variable

- Exogenous balance sheet shocks: robust to perturbations (measure of shocks and related IRFs)?

- What do the shocks capture?

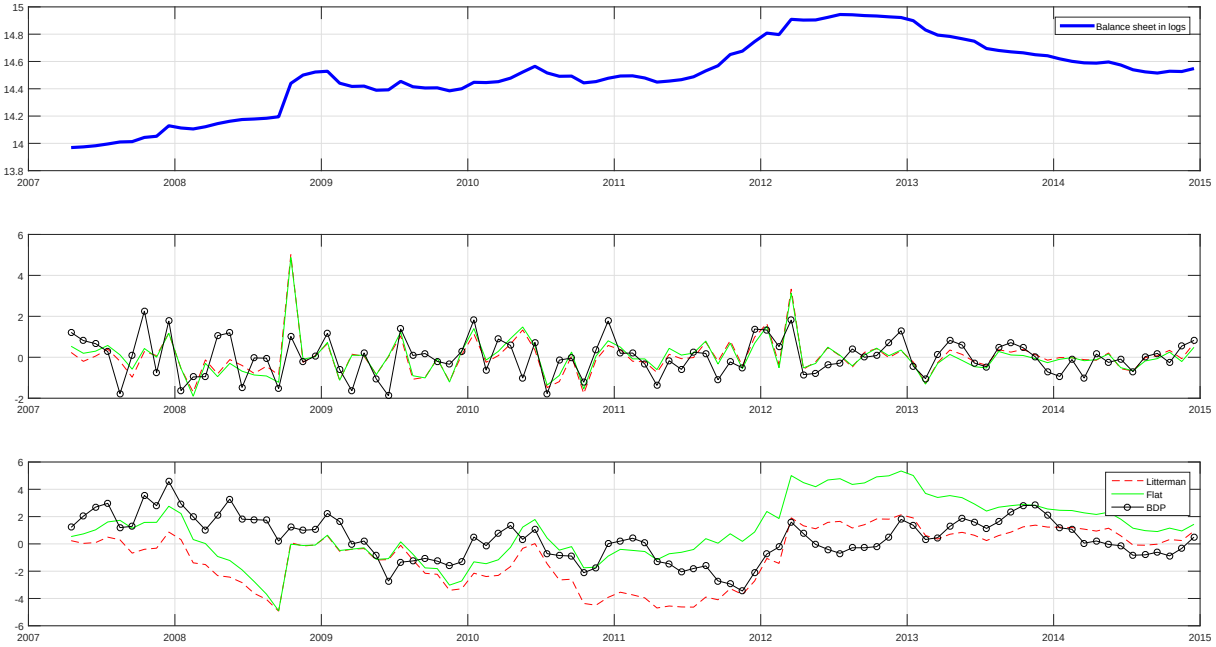
Exogenous balance sheet shocks: robust to perturbations?

VAR of Boeckx, Dossche and Peersman (2016) estimated with two alternative and plausible choices of priors for the VAR coefficients: flat priors and Minnesota prior with conventional tightness values

Variables: GDP, HICP, Balance Sheet, Eonia, Spread Eonia-MRO and CISS

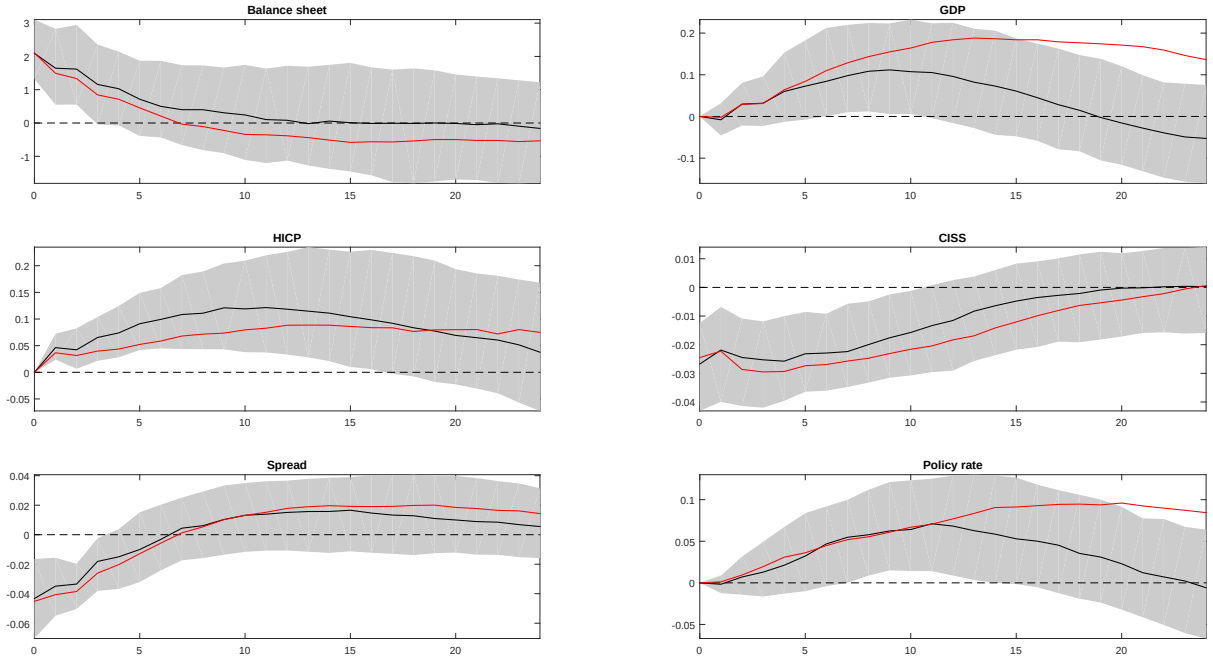
Same identification as in the paper (mix of sign and zero restrictions)

Let's look at the implied shocks in these two different scenarios (together with the original shocks)



Relevant differences in residuals, but we care about the elasticities! The exogenous shocks are only a tool to trace elasticities

What about the macro IRFs? Check in the VAR



Flat very similar to paper, some differences between Minnesota (median, red) and Flat (black line and grey area)

However, considering uncertainty and small sample, overall differences are not enormous, at least in the short-run.

A few remaining questions:

- What about the IRFs of micro variables?
- How exogenous the balance sheet is in the VAR?

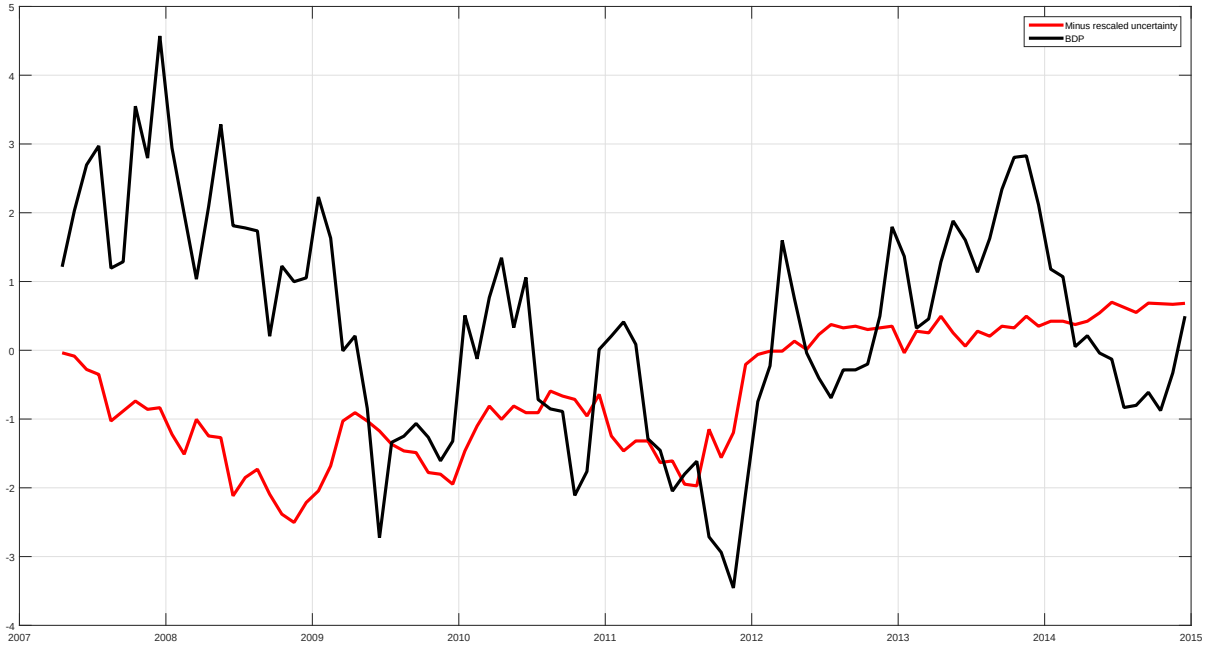
What do the policy shocks capture?

Expectations of policy can already mitigate the issues in financial markets and impart an impulse to the economy

For example, liquidity policy actions from the ECB might have calmed down financial markets before implementation, reassuring the banks about the future availability of market liquidity (GPLR, EJ 2011).

If true, maybe the balance sheet shocks may neglect this part of the effect of liquidity policy

Example from Altavilla, Carboni and Lenza (2016): possible effects of policy via reduction of uncertainty over future market liquidity conditions

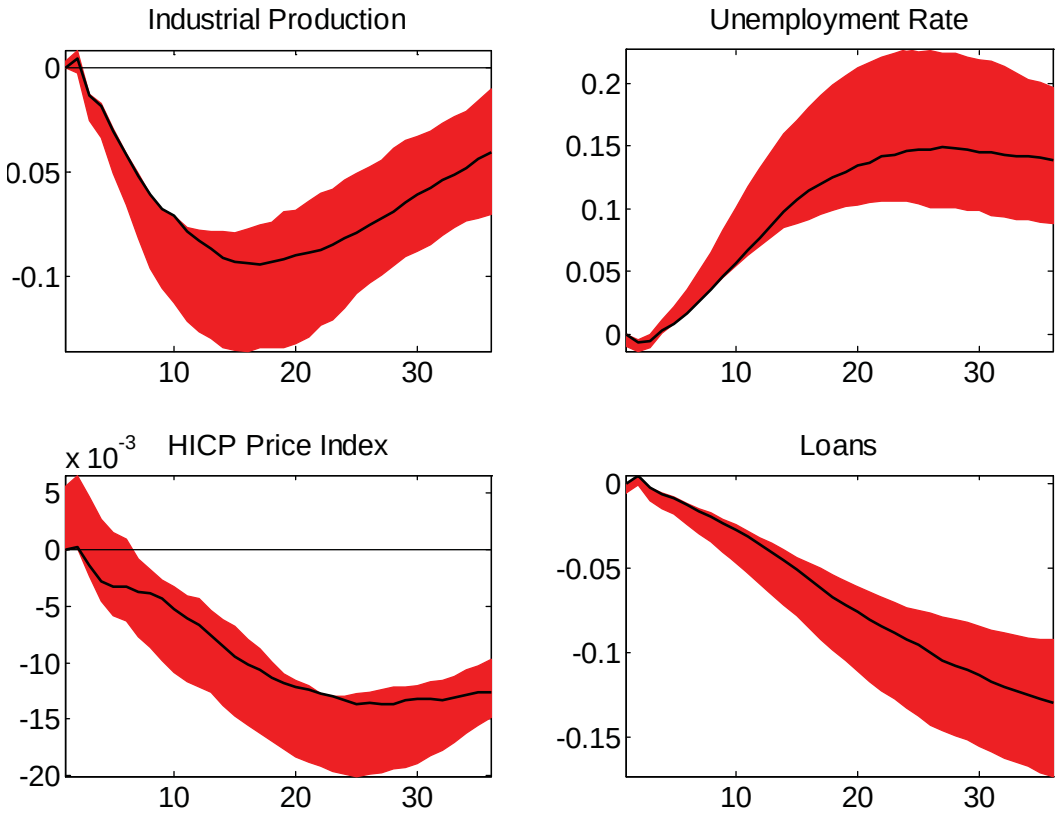

Minus rescaled uncertainty
BDP
5
4
3
2
1
0
-1
-2
-3
-4
2007
2008
2009
2010
2011
2012
2013
2014
2015

Selected micro findings in Altavilla, Carboni and Lenza (2016):

Changes in money market-wide uncertainty affect, to a non-trivial extent, the pricing of loans of individual banks

The channel is stronger for banks/times of higher funding stress

Selected macro findings in Altavilla, Carboni and Lenza (2016):



Conclusions

Nice paper, thought provoking: credit support policy has been succesful, particularly through the balance sheet of well capitalized banks

Important to carefully think of the policy variable in the exercise: (i) robustness to obvious alternatives and (ii) how well it captures the full extent of the policy actions

First issue might not be a problem, after all. Second needs at least a caveat on the interpretation of ther results (underestimation of the effects?)

Look more into the effects on bank capital?