Bank equity valuation and credit supply

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Bank stock prices lead loan growth

What drives this correlation?

- Demand factors
  - Stock markets leading indicator of future low activity / low demand for loans
- Supply factors (this paper)
  - Drop in bank stock prices increase cost of funding new loans hence limit credit supply
- Which factors prevail is an important question for CBs
  - Policies sustaining aggregate demand improve banks' profitability
  - Policies which lower banks' profitability could reduce loan supply with potential detrimental macro impact if effect strong enough

Methodology

Is the impact of changes in stock prices on credit growth well identified?

- Regression $\Delta L_{ist} = \beta \text{Return}_{ist-1} + \delta \text{Controls}_{ist-1} + \gamma_{ct} + \epsilon_{ist}$
  - "A 10% fall in the price of equity leads to approximately 0.5 pp decline in loan supply to NFCs"
- γ_{ct} controls for loan demand: uniformly addressed to every bank within a country
- However some banks might be specialised / maybe perceived less risky than others by customers
  - $\Rightarrow$ these banks capture a relatively higher share of loan demand than others
  - Higher ΔL_{ist+1} and Return_{ist} as a result $\Rightarrow$ this will bias your result upward

Methodology

Is the impact of changes in stock prices on credit growth well identified?

- Suggestions
  - Multibank firms (Anacredit!)
  - Control for additional bank characteristics (loan to assets ratio, capital ratio,...)

Should CB be concerned of banks' stock prices?

- Traditional answer No: pure a redistribution issue (MP always does)
- Yes if we believe the channel emphasized in the paper is large enough
  - in the limit it could completely offsets the impact of MP on demand
  - e.g. accommodative monetary policy reduces banks profitability $\Rightarrow$ hence loan supply $\Rightarrow$ hence new credits $\Rightarrow$ hence aggregate demand
- To get a sizeable effect of this channel one needs (at least)
  - Cond 1: Accommodative MP lowers banks' profitability / stock prices
  - Cond 2: Banks' stock prices have a large impact on their loan supply
- Probably not the case in normal times

Should CB be concerned of banks' stock prices?

Times of non-standard monetary policies?

- Cond 1: Do NSMs lower banks' profitability?
  - Some evidence that impact of QE on banks stock prices is positive (capital relief)
  - US: Chodorow-Reich (2012) – EA: Andrade-Breckenfelder-De Fiore-Karadi-Tristani (2016)
  - More work needed to analyse other policies (negative DFR...)?
- Cond 2: Is the impact of stock prices on credit supply large enough to offset the impact of NSMs on demand?
  - This paper: "A 10% fall in the price of equity leads to approximately 0.5 pp decline in loan supply to NFCs"
  - Would be useful to quantify share of variance in loan growth rate explained by changes in supply induced by stock prices