Discussion of

Le Pont de Londres
Interactions between monetary and prudential policies in cross-border lending

by Bussiere, Hills, Lloyd, Meunier, Pedrono, Reinhardt, Sowerbutts

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5th BdF-BoE International Macro Workshop
Banque de France - November 18, 2019

*The views expressed in this paper are those of the author and do not necessarily represent the views of the Bank of England or its committees.
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Intriguing paper. Great data and interesting facts.
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Some issues for discussion:

[#1] $Pru_{jt}$: Levels vs. changes.
[#2] Confounding factors.
[#3] Theoretical mechanisms.
[#4] Lags.
Macropru measure: Level vs. changes

- Prujt measures whether prudential stance in j was tightened (+1), loosened (−1), or unchanged (0) ⇒ Irrespective of the level.
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  * Larger $\theta \Rightarrow$ More amplification through $q \Rightarrow$ Larger expansion in $B_t$. 

INTRODUCTION, Levels vs. Changes, Confounding factors, Mechanisms, Lags, Conclusions
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- **Empirical model**: shows that **HIGH LTV** countries respond to a ‘push’ shock more than **LOW LTV** countries.

**NOTE.** Average responses to an international credit supply shock, estimated from a panel VAR including 51 countries, see Cesa-Bianchi, Ferrero, Rebucci (2018) for details. The solid line with crosses and circles plot the mean group estimate for ‘Low’ and ‘High’ LTV ratios.
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Simple example. Consider two countries:

* **HIGH LTV** with LTV ratio of 100.
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Assume that in period $t$:

* **HIGH LTV** tightens LTV ratio from 100 to 95 $\Rightarrow Pru_{HIGH\ LTV,t} = 1$.
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Are your results implying that **HIGH LTV** should experience a smaller contraction in x-border lending than **LOW LTV**?
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Are your results implying that **HIGH LTV** should experience a smaller contraction in x-border lending than **LOW LTV**?

Need to control for average level of LTV:

$$\ln \Delta B_{bjt} = f_b + f_j + f_t + \sum_{k=0}^{3} \alpha_{2k} (MP_{t-k}^{EA} \times Pru_{j,t-4}) \ldots$$
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$$+ \sum_{k=0}^{3} \beta_{2k} (MP_{t-k}^{EA} \times LTV_j) + \text{Controls}_{t-1} + \epsilon_{bjt}$$

Heterogeneous effect by LTV.
Main hypothesis I Receiving countries with tighter prudential policies should face smaller volatility in cross border lending in response to center countries’ monetary policy shocks.
### Confounding factors

- **Main hypothesis** I *Receiving countries with tighter prudential policies should face smaller volatility in cross border lending in response to center countries’ monetary policy shocks.*

- Obviously, this is only true *ceteris paribus*. Some confounding factors \((X_j)\):
  - FX regime, share of FX debt, fiscal position, CA-to-GDP ratio, etc.
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Heterogeneous effect by $X_j$
Main hypothesis II  *Bank size (or being part of a large banking group) affects the coefficient on the* $Pru_{j,t} \times MP_{t}^{EA}$ *interaction.*
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Well known that large (less constrained?) banks are less affected by monetary policy shocks than small banks (e.g. Kashyap and Stein, 2000).
Main hypothesis II  Bank size (or being part of a large banking group) affects the coefficient on the \( Pr_u_{j,t} \times M_{P^E}^A \) interaction.

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But why should this matter for the interaction with \( Pr_u_{j,t} \)?
Main hypothesis II  Bank size (or being part of a large banking group) affects the coefficient on the $Pru_{j,t} \times MPE_A$ interaction.

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But why should this matter for the interaction with $Pru_{j,t}$?

More in general, some discussion on the theoretical mechanisms/ingredients would be useful.
Baseline specification:

\[ \ln \Delta B_{bjt} = f_b + f_j + \sum_{k=0}^{3} \alpha_{1k} \cdot MP_{EA}^{t-k} + Controls_{t-1} + \epsilon_{bjt} \]
Lags in baseline specification

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Lag structure is a bit unusual \( \Rightarrow \) \( MP^{EA}_{t-1} \) affects \( Controls_{t-1} \). PROBLEMATIC?

Consider the alternative local projection specification for \( k = 0, 1, \ldots, K \):

\[
\ln B_{bj,t+k} - \ln B_{bj,t-1} = f_b + f_j + \alpha_{1}^{k} \cdot MP^{EA}_{t} + controls_{t-1} + \epsilon_{bj,t+k}
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- Baseline specification:
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- Lag structure is a bit unusual ⇒ \( MP_{t-1}^E A \) affects \( Controls_{t-1} \). → PROBLEMATIC?

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- Coefficient \( \alpha_{1}^k \) captures effect of shock on level of \( B_{bjt} \) at different horizons.
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- Looking forward to future versions!
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