Discussion of A. Loeffler E. Segalla, G. Valitova & U. Vogel

Charles O’Donnell

Banque de France

Global Financial Linkages And Monetary Policy Transmission
Conference Banque de France 30 June 2017

*The views are those of the author and do not necessarily reflect the views of the Banque de France or the Eurosystem*
Lending Channel Recap

- Some banks cannot substitute liabilities with alternative external funding
- Shock transmits to asset side of balance sheet

Inward transmission

- Banks who rely more on funding in currency j / region j affected more by MP of currency/region j
- Banks capacity to manage liquidity shock is proxied by liquid assets ratio
- Assume that shock transmits to all assets of balance sheet i.e. domestic lending in DE and AT

Outward transmission

- Similar as above but now domestic MP transmits to foreign assets
The paper

- Authors look both at the currency and region dimensions

- Find weak evidence for inward spillovers
  - Only for German banks
  - But lending channel is stronger for banks with more liquid balance sheets

- Find evidence for outward spillovers
  - More bank is funded in euros the more foreign lending is impacted by EA MP
  - But lending channel is mitigated for banks with more liquid balance sheets
Interesting paper

- Dollar funding important for banks of these countries
- German banks play important role as lenders in foreign markets

My discussion

- Bank’s liquidity management in mitigating/propagating shocks
- Transmission of MP shocks on asset sides of banks balance sheets
- MP transmission and demand sided effects
Bank liquidity management

- Authors assume banks only have one liquidity management strategy proxied by liquid assets ratio.

- Funding models - maybe authors can exploit heterogeneity in alternative liquidity management tools which make some banks more/less sensitive to monetary policy spillovers.
  - Internal Capital Markets (Cetorelli & Goldberg, 2012) and bank lending channel.

- Authors have data limitations on intrabank funding across borders.
  - Can’t replicate Cetorelli & Goldberg measure of net parent lending.
  - But CG provide other proxies for funding model - higher lending in foreign country to total assets may imply more commitment in that country.
Solution: do you have data on liabilities in country j?
- then use portion of local funding to assets financed in country j as sorting principle
- higher portion of local funding for financing assets in country j may imply foreign country less sensitive to EA MP
- $\rightarrow$ MP shocks are ring-fenced

Role of local funding versus cross-border flows should be important
- (McCauley, McGuire and von Peter, 2010) find that local positions proved to be more stable during the crisis than those funded across borders and currencies
- Alternatively, can you get legal information on whether foreign affiliates are branches or subsidiaries? - might act as a proxy for internal capital flows vs local funding
If there are supply side effects which type of credit is affected most?
- Two theories

Global banks hit by negative shock (capital/funding) cut back lending across all markets

- Spillovers from Japanese banks to US lending (Peek and Rosengren, 1997, 2000)
- Spillovers from US subprime to German lending (Puri, Rocholl and Steffen, 2011; Ongena, Tumer-Alkan and v. Westernhagen, 2015)
- Authors then consistent with this literature in assuming that all domestic lending is reduced for affected banks
But affected global banks may cut back financing of some assets more than others

- European banks during dollar crisis cut back lending of dollars more than euros in EA (Ivashina, Scharfstein and Stein, 2015)

Maybe effects of MP in currency/region j would be stronger if L/S was domestic lending in currency j

Authors could do more to justify why euro-denominated domestic lending in DE and AT ought to be affected by foreign MP

Also works for outward transmission - supply of euros to foreign more sensitive to countries lending more in euros
Authors tell a pure supply side story

- Foreign MP affects liabilities and this affects lending

But there is a demand side story

- US MP tightening
  - → dollar appreciates
  - → German/Austrian exports become cheaper
  - → domestic credit demand increases
Controlling for demand effects

- Authors may then underestimate the true effect
  - Domestic lending is negatively correlated with foreign MP (supply side)
  - But domestic lending is positively correlated with error term (demand side)
- Problem is made worse if dollar funded banks (measure of treatment) are more likely to fund German/Austrian exporters (highly likely)
  - (Berthou, Horny & Mésonnier 2017) show that French exporters are severely hit by dollar shortage of 2011
- Solution: use disaggregated credit register data
  - Benchmark German papers cited above on international transmission of shocks use disaggregated data
  - May also solve problem of strange results for Swiss and Japanese MP
To summarize

- Paper asks very important questions for understanding monetary policy

- Countries used are potentially very important for both outward and inward MP transmission

- Authors can improve paper
  - by teasing out more clearly the mechanisms in play
  - enhance empirical framework by exploiting further identification strategies