

The Transmission Mechanism of Credit Support Policies in the Euro Area

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The opinions in this presentation are those of the authors and do not necessarily reflect the views of the European Central Bank or the Eurosystem

What the paper is about

Examines the effectiveness of non-standard monetary policy measures on lending rates and volumes

Use novel monthly euro area bank level data over the turbulent sample 2007-2014

In the spirit of Kashyap and Stein, asks the question: do bank characteristics matter?

What the paper finds

1. Credit policies have been successful in stimulating the credit flow to private sector

2. Bank lending channel of monetary policy transmission is active

3. The role of bank capital has been ambiguous

Five sets of remarks

1. On micro data

2. On related literature

3. On methodology and shock
identification

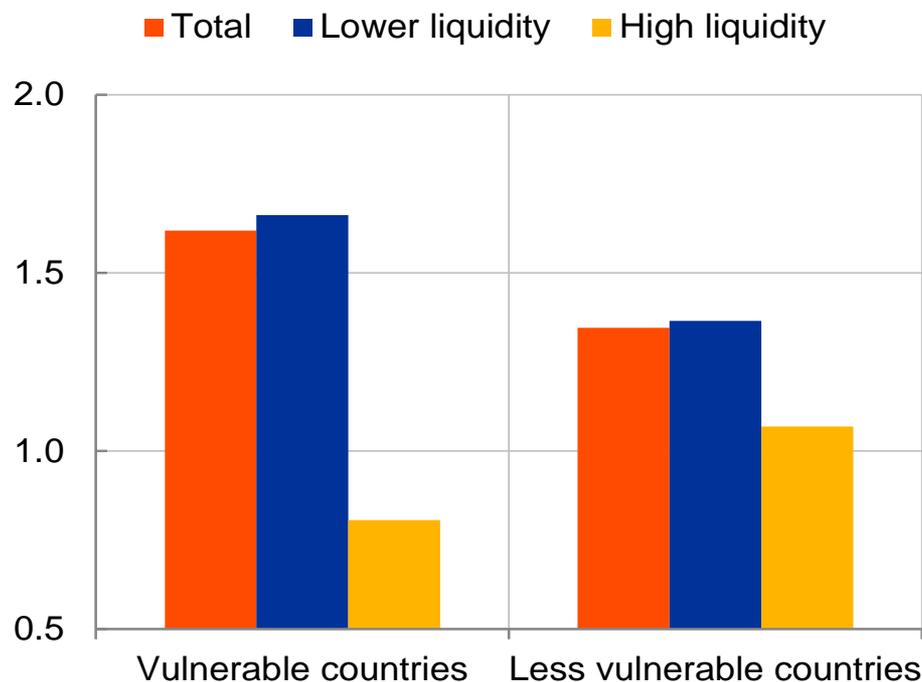
4. On results

5. On macroeconomic implications

1. On the importance of using micro data

The crisis revealed significant heterogeneities in the way that banks, firms and households react to economic shocks both across and within countries

Interest rate on NFC loans according to liquidity and location of bank

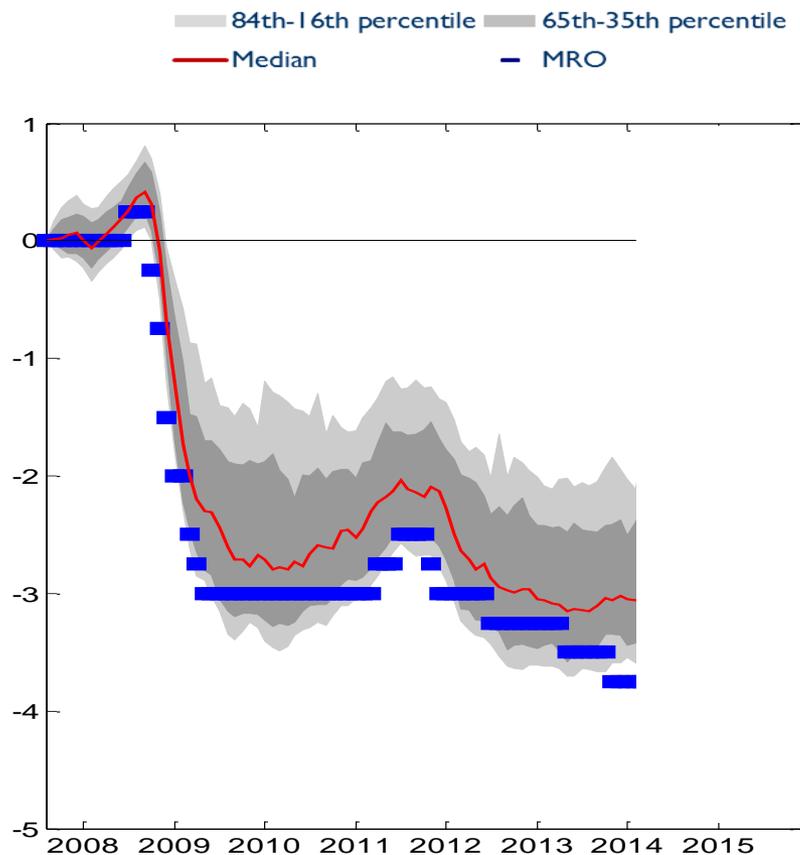


Micro data also potentially allow 'matching' bank-level information with borrower characteristics

1. On the importance of using micro data

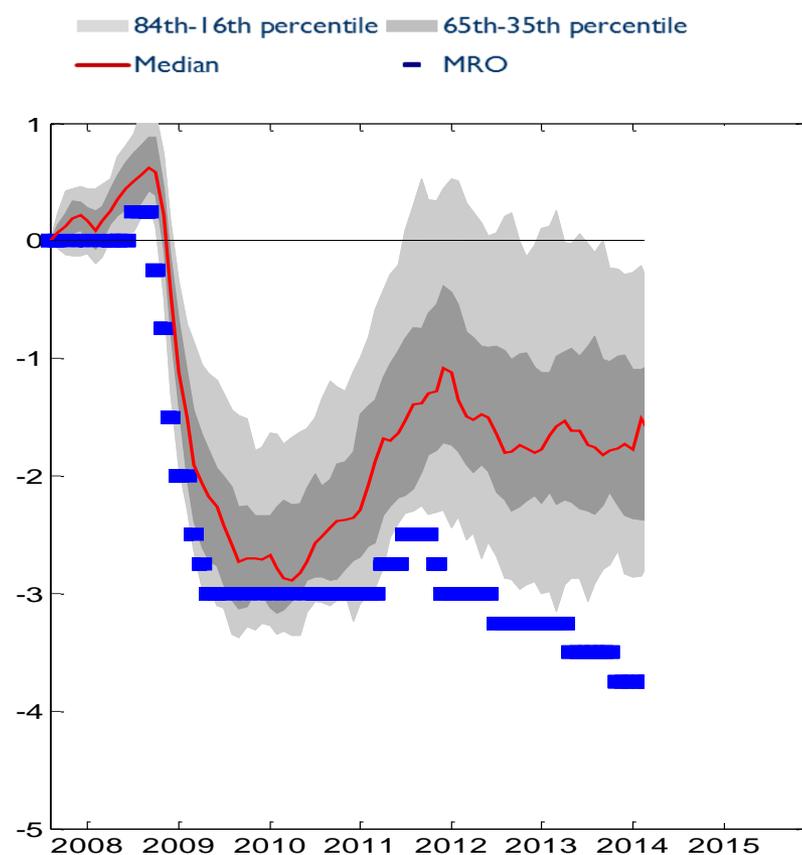
Significant heterogeneity in lending rates recorded across different jurisdictions during the financial crisis

Banks in Non-stressed Countries



Note: Non-stressed comprise 131 MFIs from DE, AT, FR, BE, NL. Weighted averages, with weights represented by the corresponding loan outstanding amounts. Last observation: December 2015.

Banks in Stressed Countries

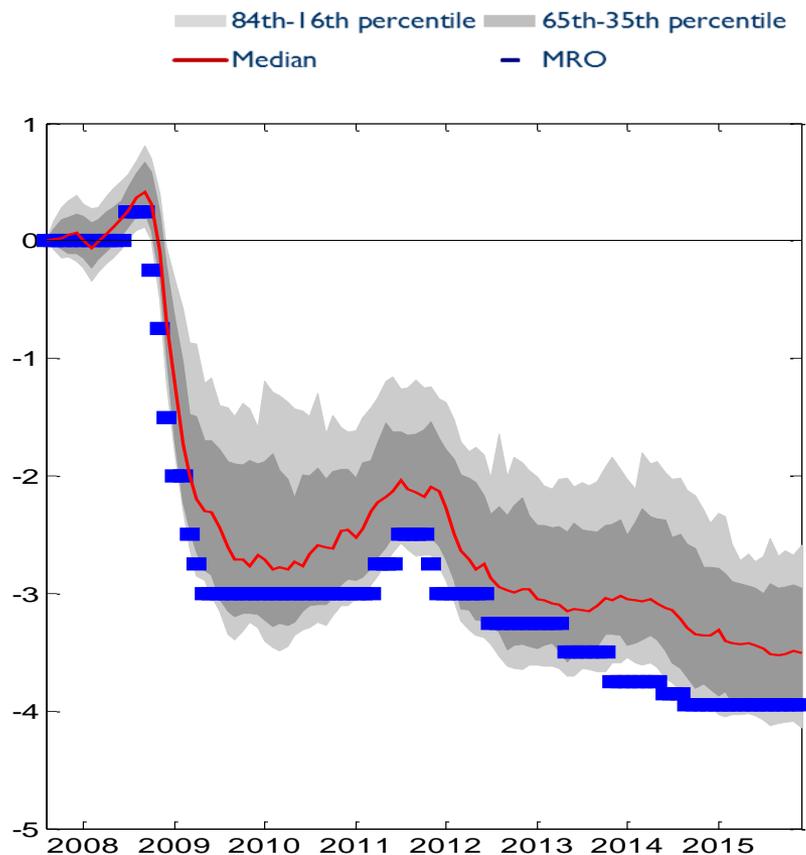


Note: Stressed comprises 80 MFIs from IT, ES, PT, IE, GR. Weighted averages, with weights represented by the corresponding loan outstanding amounts. Last observation: December 2015.

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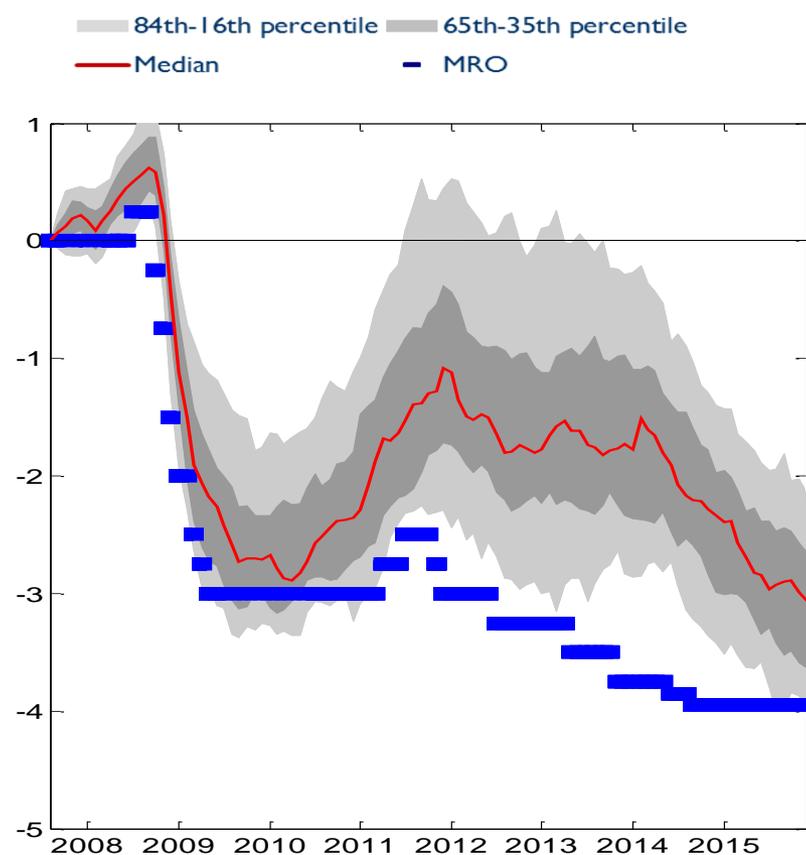
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2. On related literature

What we know in normal times

- **monetary policy pass-through is influenced by banks' balance sheet characteristics**
- **the pass-through is stronger for small , illiquid , poorly capitalized banks**

What we still don't know well in “unconventional times”

- **the emergence of economic and regulatory binding constraints might, in principle, substantially change these conclusions**

References: Kashyap and Stein, 1995; Stein, 1998; Kashyap and Stein, 2000; Peek and Rosengren, 1995; Kishan and Opiela, 2000; Van den Heuvel, 2002; Altavilla, Ciccarelli, Canova (2016)

2. On related literature

There are at least four papers in circulation that use the same data set covering (some times) a longer time span and at least one that asks the same question about the importance of banks' characteristics in the transmission mechanism and concludes with similar answers:

1. Albertazzi, Nobili, Signoretti (2016)
2. **Altavilla, Canova, Ciccarelli (2016)**
3. Altavilla, Pagano, Simonelli (2016)
4. Rodriguez d'Acri, Holton (2016)

The contribution of this paper is at present marginal with respect to those papers and should be carved more clearly

3. On methodology and shock identification

1. Dynamic panel estimation with common slopes

$$Z_{i,t+h} = \alpha_{i,h} + \delta_{i,h}(L) Z_{i,t-1} + \rho_{i,h}(L) X_{t-1} + \theta_h MPshock_t + \varepsilon_{i,t+h}$$

- How do you estimate it?
- Heterogeneity missing precisely where it should be accounted for (θ)
- Estimates potentially biased and inconsistent

2. Regressors are orthogonal to the balance sheet shocks by construction as they are the same variables that have been used in the VAR to obtain the MP shock.

- Better use the variable itself and instrument it with the shock (Ramey 2016)

3. On methodology and shock identification

3. Local projection?

- The LP point estimator tends to be more biased and variable than the VAR IRF (Kilian-Kim, 2011)
- Need a well identified shock

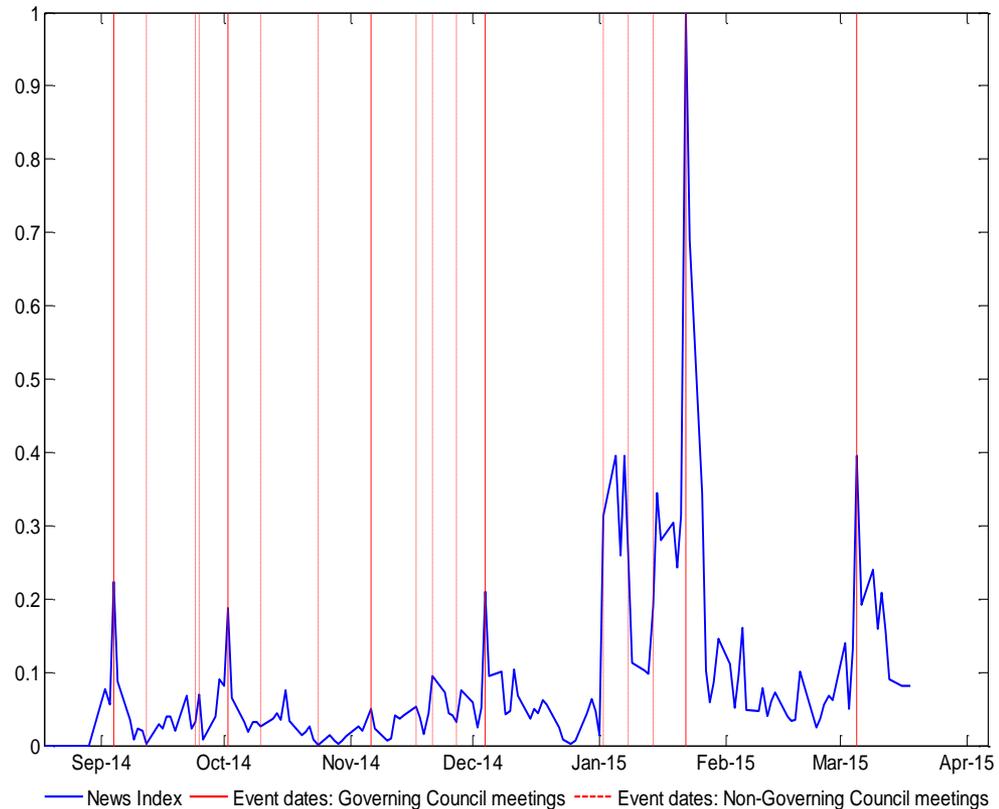
4. The identified shock captures well movement in BS but is it a (non-standard) monetary policy shock?

- To identify such unconventional shocks in a VAR you need to:
 - ✓ Account for expectation (Altavilla et al. 2016)
 - ✓ Identify the announcements (Altavilla et al 2015)
 - ✓ Control for the expected path of BS increases (Ciccarelli et al. 2016)

3. On methodology and shock identification

- ✓ A “narrative approach”: GC meetings and official communication by ECB
 - ✓ Cross-check with an “agnostic” approach based on an index of intensity of news (Factiva)

How would your MP shock compare to this or similar index?



Source: Altavilla, Carboni , Motto (2015)

Note: The figure reports the News Index computed from Factiva. The query is set so that for an article to be included in our sample it should simultaneously contains at least one word coming from two different sets. The first set is “ECB”, “European Central Bank”, and “Draghi”. The second set is “QE”, “quantitative easing”, “asset purchase”, and “APP”. The vertical red solid lines represent the date of the ECB’s Governing Council meetings, i.e. September, 04 2014; October, 02 2014; November, 06 2014; December, 04 2014; January, 22 2015; and March, 05 2015. The vertical red dashed lines represent the non-Governing Council events.

4. On results

Small, illiquid and poorly capitalised banks adjust rates more in reaction to balance sheet shock in crisis time. Hence, no change with results in normal time?

If you could identify standard vs non standard-type measures you would discover that in response to a “standard-type” shock in crisis time liquid, highly capitalised and less exposed to sovereign respond more (Altavilla et al 2016)

- in line with bank strategic decisions (Gilchrist et al, 2015), risk shifting incentives (Altavilla et al. 2016) and sluggish adjustment of poorly capitalised bank (Van den Heuvel, 2003).

This could explain the ambiguous results on bank capital

5. On macroeconomic implications

Let us talk about Bank Lending Channel

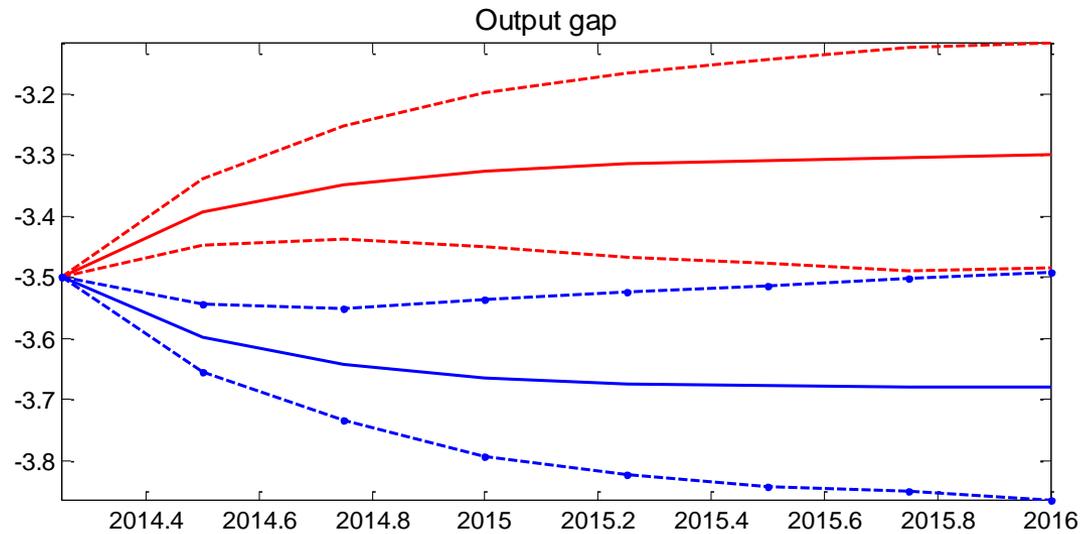
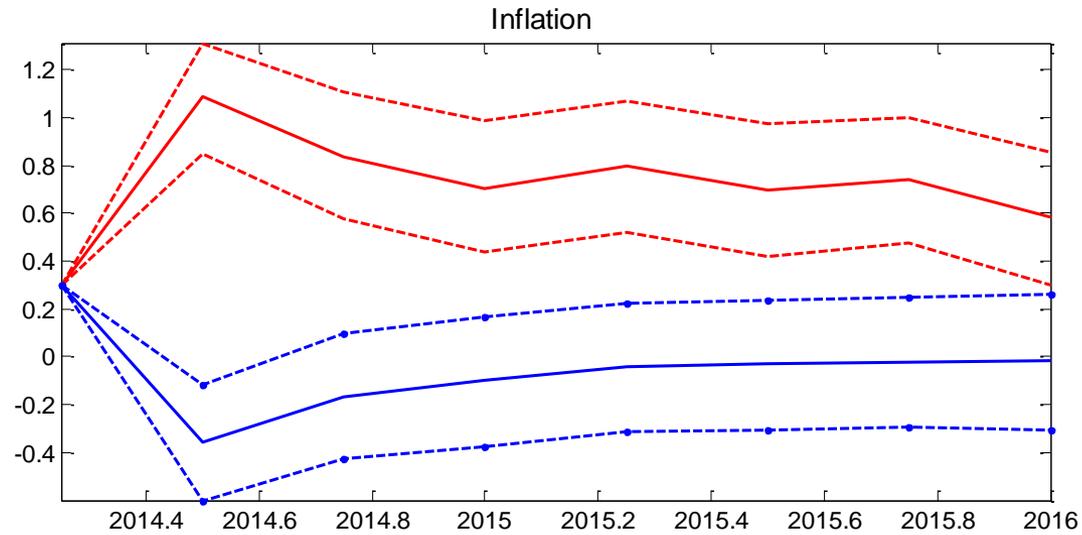
- To properly discuss the bank lending channel we need to distinguish between demand and supply of credit
- Impossible to disentangle between demand and supply in such a (univariate) framework
- Ciccarelli, Maddaloni, Peydró (2016) show that, on the same sample, the credit frictions that amplify the effect of the shock is neither pure demand nor pure supply but borrowers' quality

5. On macroeconomic implications

Missing: What are the implication for the macroeconomy?

- Use a Standard New Keynesian model and assume the steady state level of the variables are the averages of Euro area over the period 2000-2007.
- Do counterfactual experiments with 2 Scenarios:
 - i. **Policy:** policy, lending and deposit rates equal to the paths obtained in a carefully conducted event-study
 - ii. **No-policy:** the three rates are held constant at their 2014q1 values.

5. On macroeconomic implications



— policy - - - - - - - - - - — no policy - - - - - - - - - -

The paper needs major adjustments

- **Put in perspective with respect to previous literature and differentiates clearly from the one that asks the same questions using the same data.**

Thereafter:

- Do (and explain) better the panel estimation, check carefully monetary policy shock and identification, and possibly unify the setting into one framework
- Change/understand/improve analysis on the effects of supply and bank lending channel, as well as on the interpretation of bank capital results which might be related to the identification issue

