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Discussant comments on

Regulatory solutions for bank loans pro-cyclicality
Is the cure worse than the illness?

Verónica Balzarotti and Alejandra Anastasi

Prepared for the BIS CCA Conference on

"Systemic risk, bank behaviour and regulation over the business cycle"

Buenos Aires, 18–19 March 2010

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* These comments reflect the views of the author and not necessarily those of the BIS or of central banks participating in the meeting.

Comments to:

Regulatory Solutions to Bank Loans Pro-Cyclicality Is the cure worse than the illness?

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- Innovative: Explores a different channel to procyclicality, the “cost of funds” channel.
- The paper has a good discussion of the context.
- Presentation of the exercise is a bit cryptical, more should be explained about the drivers of the results.

Comments

- I. Model
- II. General

Figure 4.4.1: Credit Pro-cyclicality

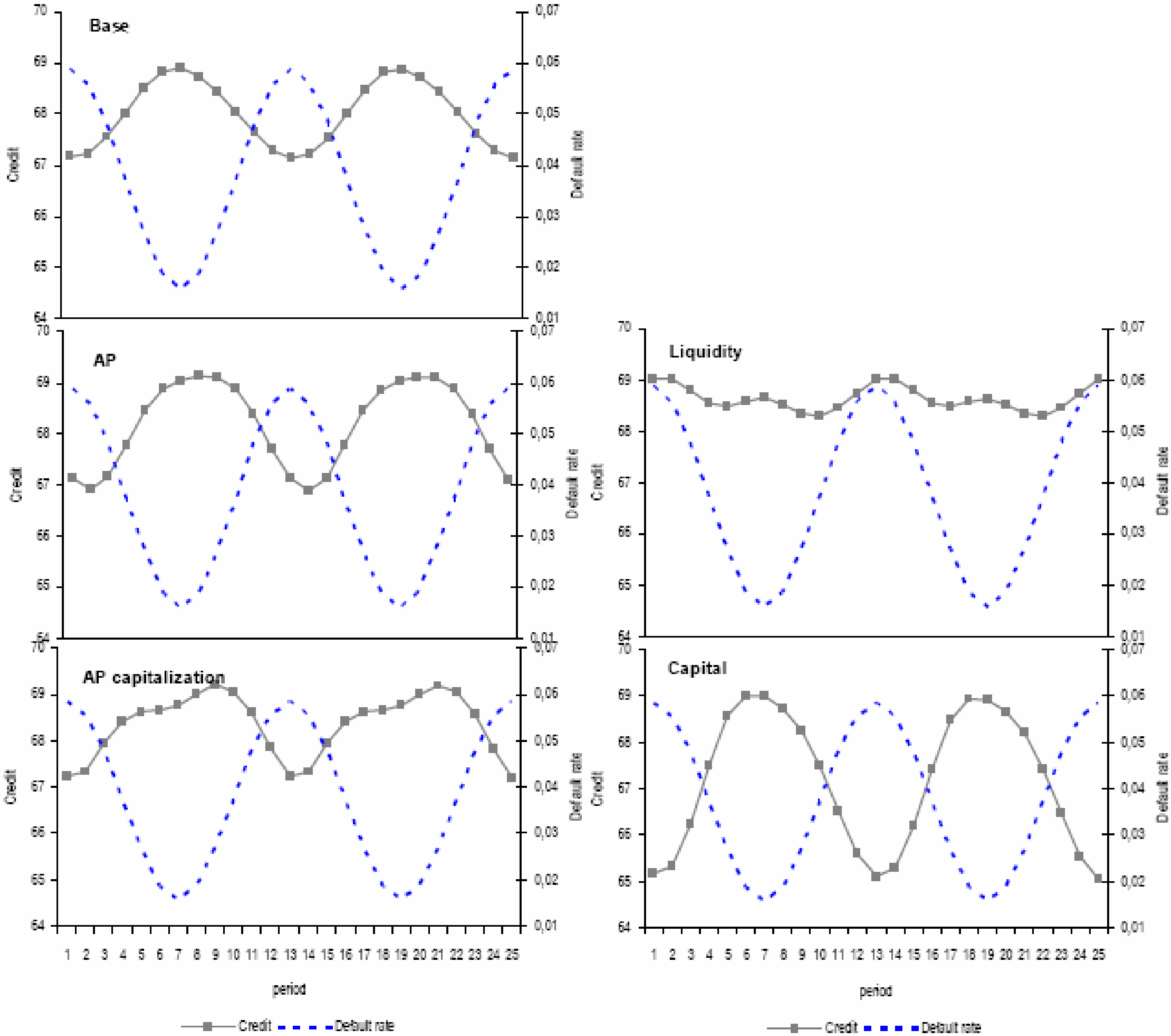
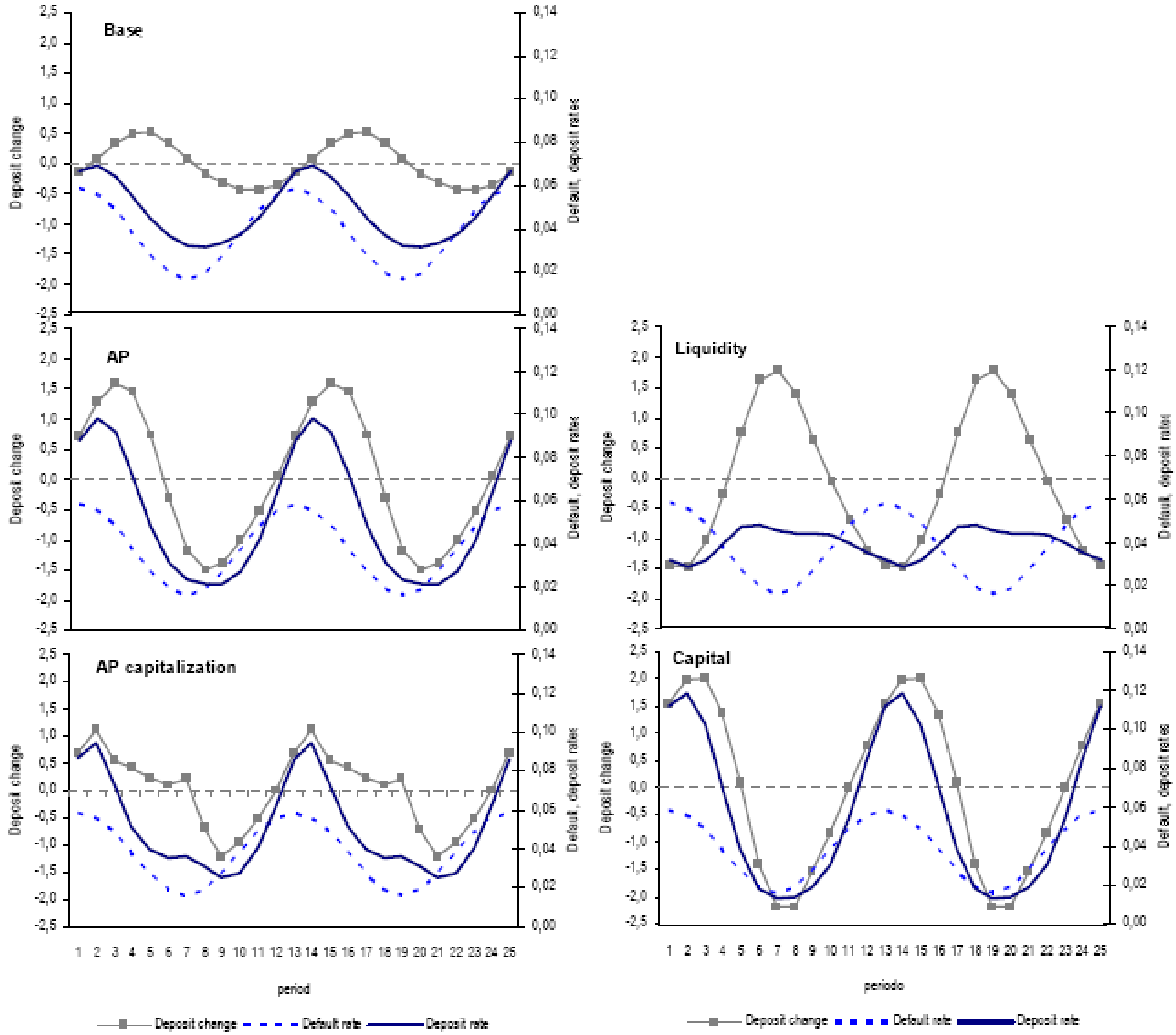


Figure 4.4.2: Funding with Deposits



I. Model: Deposit demand

- Demand for deposits is very “loaded”

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$$r_t^d = 0.005 + r^b + \sum_i \varepsilon^l ind_t^i + \eta \Delta D_t cycle$$

Where r_t^d is the rate on deposits and ε^l represents the different sensibilities applied on ind^i indicators, corresponding to:

- the difference between the observed capitalization ratio and the target capitalization ratio (tier 1);
- the difference between the observed liquidity ratio and the target ratio;
- the difference between the observed ROE and the target ROE;
- the phase of the business cycle, and
- the verification that the bank has had to raise capital at the previous year end to avoid regulatory breaches.

I. Model: Deposit demand

- Demand for deposits is very "loaded"
  - Should ROE be part of it?
    - Isn't capital enough?
    - How important is this factor should be part of the analysis provided.
  - Cyclical dummy in the elasticity of demand in addition to factors related to bank's quality.
  - No room for a positive role of dynamic provisions.
  - In general, factors included should be motivated with stylized facts

I. Model: Demand for loans

$$\ln(L_t) - \ln(L_{t-1}) = w\left[\ln(1 + r_t^l - r_t^b) - \ln(1 + r_{t-1}^l - r_{t-1}^b)\right]$$

$$\ln(L_t) = w\ln(1 + r_t^l - r_t^b)$$

$$\ln(L_{t-1}) = w\ln(1 + r_{t-1}^l - r_{t-1}^b)$$

- Stock of loans in *t* (includes loans from t-1), a function of rate at *t*
- Alternative – Demand for New loans a function of rates at t:

$$\ln(L_t) - \ln(L_{t-1}) = w\ln(1 + r_t^l - r_t^b)$$

I. Model: General

- Two-year loans: Adapt to lenght of the cycle.
- Constraint of fixed ROE? (annex 2) → Discuss relevance of this.
- Possible extension: Interaction with monetary policy (Base rate to follow a Taylor Rule).

II. General

- Signaling problems in dynamic provisioning: Seems to be possible to circumvent via communication.

- Model should incorporate facts (or hypothesis) that give rise to procyclicality
  - View of fall in standards in boom periods → If policy can prevent this, then Default rate should react to this.

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