

Discussion of:

“Public guarantees and credit additionality during the Covid-19 pandemic” by Giuseppe Cascarino, Raffaele Gallo, Francesco Palazzo and Enrico Sette

10-11 May 2022 BCBS-CGFS Conference

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Any views expressed are solely mine and should not be taken to represent those of the Bank of England.





Overview/Summary

Overview

- Great work on public loan guarantees following Covid
 - Detailed dataset (covering all loans originated with public guarantees in Italy). Granular data on individual loans.
 - **Main focus:** how much additional (new) credit was created across programs with different coverage ratio and across different phases of the pandemic?
 - Contribution
 - Study carefully the role played by the coverage ratio (share of loan covered by the guarantee). Italy an ideal case study for this.
 - Authors consider both firm (risk factors) and bank heterogeneity (e.g. capital)
 - Data on interest rate differentials between programmes to examine bank and firm incentives
 - Comments including on measures of firm characteristics, the role of bank capital and development of multipliers over time.
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Method

- Theoretical framework of bank-firm relationships
 - Examines key tradeoffs
 - Testable predictions on (i) the relation between coverage ratios and multipliers, (ii) the role of bank capital and (iii) the role of firm leverage and liquidity needs
 - Empirical analysis
 - Based on granular micro data
 - Panel regressions with rich set of fixed effects
 - Consideration of key threats to identification from self-selection of firms/banks and characteristics of the bank-firm lending relationship (determining which banks firms get loans from).
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Results and policy conclusions

- Coverage ratio is a key determinant of additionality: additionality is higher for 100% vs 90% guaranteed loans in the first phase (Q2-2020), but similar in the second phase → High coverage key to generate new credit in an environment of uncertainty
- Bank heterogeneity: Higher capital banks generated more additional loans (if coverage smaller than 100%). → Importance of well capitalised banking system
- Firm heterogeneity: Credit multipliers do not vary much across firms' observable characteristics. → Remarkably (!): no shifting of riskier borrowers to guaranteed borrowing
- IR differentials: higher differentials lower the multiplier (as firm incentives to substitute increase).



Comments

Bank characteristics/capital

- Finding is that higher capital banks generated more additional loans (if coverage smaller than 100%). Specifications include bank fixed effects.
 - Could capital proxy something else?
 - Possible alternatives:
 - IT capabilities
 - Overall degree of relationship based lending (correlated with bank size and capitalisation?)
 - Funding profile (e.g. maturity or types of lenders). For example: if higher capital banks have safer (less short-term) funding profiles they might have been less affected by the dash for cash episode.
 - LCR/NSFR liquidity ratios
 - Include more stats to check if high vs low capital banks differ in other dimensions as well as a correlation table between bank characteristics
 - Measure of capital: double-check with regulatory capital and distance to minimum capital required?
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Firm characteristics

- Finding that observable characteristics do not matter for additionality is quite remarkable
 - Firm characteristics considered: firm size, liquid assets, leverage, new firm (younger than 3 years), sales growth (*All measured pre-pandemic, as of 2019*).
- Does the finding hold also ex-post?
 - Plausibility check: could look with available 2021 data at how the health of firms balance sheets evolved and if the banks appear to have taken this into account ex ante
 - Relatedly, might the analysis miss firm characteristics that the banks might have looked at?
 - E.g. forward-looking measures: firms' sectors (exposure to the pandemic) or their funding exposures to lenders most affected by the dash for cash episode? (e.g. banks/firms relying heavily on NBFIs for funding).

Multipliers in the 2nd phase (Q3-2020)

- Findings:
 - Multipliers lower in the 2nd phase compared to the 1st phase.
 - Similar multipliers in the 2nd phase between 100% and 90% coverage
 - Paper: pick up in GDP, reduced uncertainty and higher availability of internal finance drive fall in multipliers (across programmes, and potentially making them more similar).
- Might the increased ability of banks to screen borrowers (related to the easing of uncertainty in the 2nd phase) be a driving factor?
 - Measures of screening technologies employed to test for this?
 - Multipliers similar for banks focused on relationship-based lending even in the 1st phase?
- How likely is that banks/firms made increased use of loopholes (related to debt payments and adjustment to credit lines) in the 2nd phase?
 - Is there data to check? And do the mechanics of loopholes suggest they become stronger over time?

NBFIs

- Finding that substitution is mostly within-lenders – i.e. firms are not switching to other banks.
 - Are there other significant - i.e. non-bank - lenders in Italy which lend to firms?
 - Would they be in the data sets and also eligible to lend under guarantee schemes?
 - Or any reason why they might become more active in granting new credit especially in the 2nd phase?
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Thank you