Comment on "Evaluating the Impact of MP Policies in Colombia"

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Colombia Example

- *EMs have greater need for MP policy*
  - Capital flows can drive huge credit shifts
  - Foreign currency mismatches
- *Colombia's strong evidence on MP tools*
  - Many tools used proactively after failure of monetary policy (400 bps) with success
- *Its environment is not representative of EMs*
  - Cooperative, credible institutional environment
  - Uribe's leadership, lessons of 1990s crisis
  - Inflation targeting/flexible exchange rate
  - Disciplined banks, limited insurance and LOLR
  - Fragile five is about weak institutions, forward looking uncertainty. Easier to do MP here.

Colombia Example (Cont'd)

- May and July 2007 action responded to inflation acceleration, current account deficit doubling, ~30% loan growth, asset price appreciation
- Provisioning, reserve req., capital flows (huge rise in capital ratios)
- 2008 room to move, soft landing
- Successful loan growth slowdown

This Study

- This study uses micro data to gauge relative importance of each MP tool.
- Focus on responses in credit growth, pricing, and risk (loans and borrowers) using panel loan-level data approach.
- Findings are mixed, somewhat inconsistent, and sometimes puzzling.

Mixed and Puzzling Results

- Provisioning affects credit growth and price
- Reserve requirement affects credit growth and price, but not price in sub-sample
- Foreign capital flow limits don't affect credit growth but do affect price
- Provisioning reduces risk, reserve requirement increases risk, neither is visible in sub-sample

Right Specifications?

Several challenges

- Endogeneity of policy actions, one experiment, policy actions overlap in time
- Results are depending too much on simultaneous, one-time, endogenous aggregate annual variation which is hard to interpret. (Average price effects may be swallowed up by macro controls.)
- This is not similar to Jimenez et al. or Aiyar et al. which exploited cross-sectional variation.

Alternative Approaches

- Panel VARs to rule out or try to model endogeneity (not very promising approach given one time shocks with overlapping policies).
  - Incidentally, lag specifications may be too short
- Exploit cross-sectional interactions (India project) with fixed year effects (give up on time series identification)
  - Not much discussion of provisioning variation from across the board change
  - Foreign capital flows and reserve requirements operate differentially on banks through wholesale funding market; banks vary in funding mix and costs of access
  - Monetary policy similarly works off dependence on wholesale market and access costs (large vs. small banks)
- Same approach applies to monetary policy interaction (define complementarity and test whether the effectiveness of MP depends on monetary policy).

Forward-Looking Objective

- This last boom cycle may be different from next one with respect to which constraint will bind.
- Perhaps binding provisioning prevented foreign capital growth limit from being the binding source on loan expansion for many banks. But this may not be true next time.
- Interactions are helpful because they can identify which banks are subject to which influence, and therefore, likely to be responsive to a particular intervention.
- So interaction approach may be helpful for crafting policy in future.

Other Questions

- Is tightening differential across sectors?
- Individuals vs. corporate borrowers?
- Large vs. small firms?
- Evidence of regulatory effects in responses?
- Buffer effects (can go either way)?

Conclusions

- Colombia is an important example.
- Offers an opportunity to sort among tools.
- Evidence so far is promising, but also puzzling and mixed. This is going to be very hard to clarify using time series variation (endogeneity, overlap, one episode).
- Desirable to focus more on interaction effects to improve identification, which may create more useful forward-looking information, too.
- Monetary policy interaction effects on strength of MP effects will be challenging but may also work via interaction effects.