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.