The Cross-Market Spillover of Economic Shocks through Multi-Market Banks

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Overview

- The paper investigates the (de)stabilizing role of geographic diversification of banking during the recent crisis.

- Main motivation:
  - The significant increase in multi-market banks.
  - Affect on vulnerability to local economic shocks.
    - Multi-market banks remain less affected during local loan supply shocks.
    - BUT they reduce lending more during local demand shocks – shifting lending to other markets.
  - What about in case of shocks to other markets?
  - Recent studies document the cross-country transmission of shocks.
What the paper does

• Explores the way multi-market banks transmit shocks.
• Analyze at sub-national level in the U.S.
• Focus on home mortgage lending behavior where some regions experienced larger declines in home prices.
• Which effect dominates?
  heavy exposure to high-delinquency markets leads to
  – Spillover effect: reduced lending in less affected regions
  – or substitution effect: increased lending in local markets.
• Importance of local market, does it play a role?
• Ability of securitized lending in mitigating the shock.
Findings

• They find that spillover effect from loan supply shocks outweighs substitution effect from loan demand shocks: multi-market banks reduced lending in low-delinquency markets.

• The effect is stronger in peripheral markets.

• The decline in lending was mitigated to some extent by securitized lending.

• Contribution: First to distinguish between spillovers to markets based on share in lending.
Main comments

- Credit supply vs. demand
- Sample selection
- Measurement of certain variables
  - LHS variable
  - Peripheral
- Cross-section regressions
- Pooled regressions
  - Need for some robustness analysis
- Missing controls
- Is there room to exploit the data more?
Supply vs. demand

• A change in credit volume does not necessarily imply a change in credit supply.
• We observe equilibrium levels.
• Major problem in banking studies as long as one does not have access to loan applications/rejections data
  – Popov and Udell (2010) and Puri, Rocholl and Steffen (2011 JFE)
• The authors do a good job in controlling for demand effects.
  – Market*year effects
• Still concerned if that would work well within the same country during the crisis.
Sample selection & Measurement

• Only bank/market observations with positive mortgage originations in both pre-crisis and crisis periods are included in the sample.
  – Selection based on LHS variable ???

• I can see that it was necessary due to the definition of dependent variable, LNGROWTH (log growth in bank $i$’s mortgage originations):
  – Not possible to compute if there is no origination in one of the periods.
  – BUT not having the observations with no originations in time $t$ and positive originations in $t+1$ would bias the results.

• Alternative measurement for the dependent variable.

• At least, we should know how many observations are left out.

• The descriptive section uses same data too...

• What happens to banks that went bankrupt?
Measurement of Peripheral

• 1 to 50 percent of the bank’s total originations referred as “peripheral”

• Choice of 50 percent? Arbitrary.

• Why prefer dummies instead of actual shares?

• Can you observe shares at borrower level too?
• Location of the borrower only or lending at branch level?
  – Can you distinguish cross-regional lending? Or is it always the corresponding branch?
Empirical approach

• Cross-section regressions use aggregated data over two years.
  – Impact of 2006-2007 variables on changes over four years.
  – Still able to find a significant impact though.

• Why exploit time dimension only in robustness?
  – Results are parallel.
  – Is it possible to observe quarterly data?

• Main concern with panel data:
  – Why only pooled regressions?
    • treating banks as homogeneous entities
  – What about (unobservable) factors that influence individual bank behavior?
    • Are we confident that the included bank specific variables control for all factors?
Empirical approach-2

• My preferred specification is a panel estimation that includes bank fixed effects
• You may argue that
  – You do not want to remove the cross-sectional variation.
  – You are not interested in the value of the unobserved bank-specific effect, but rather in making inferences with respect to population characteristics.
  – However you need to show first that individual effects are not correlated with the explanatory variables.

• Also clustering at bank level is needed.
• It would be nice to see those results as robustness.
Securitized Lending

• The authors compare portfolio lending with total lending (portfolio+securitized).
• The effects are (mostly) mitigated for total lending estimations.
• Did you check with securitized only?
  – No effect or much smaller effect?
• How to interpret the larger effect with non-residential NPL? (Table5)
• Differences not very large in pooled regressions (Table6)
  – Coefficient in (2) larger for highly peripheral (important variable)
Extensions

- The importance of markets works in the same direction with relationship lending.
  - Share of financing at borrower level.
  - Cost of relationship lending to the banks
- Possible to explore this?
- Use distance across regions.
Minor Comments

• Empirical model includes peripheral where the estimations start with the ‘multi-market’ dummy.
• Estimate for Portfolio lending by excluding loans sold to an affiliate.
  – Any changes?
• Role of different loan types?
Summing up

• Very interesting and well written paper.

• Very important question with interesting results and policy implications.

• It would be nice to see some alternative specifications too.

• Looking forward to reading the next version.