Discussion: Banks’ Price Setting and Lending Maturity: Evidence from an Inflation-Targeting Economy

Ferre De Graeve

BIS conference - April 2015
Relevance

- Suffices to look at the data
- Informative for micro banking: marginal costs and price setting (competition)
- Informative for central banking: MTM: CB affects both real and nominal rates
- Parallel: These rates arguably more relevant (in coverage terms) for Chile than Gilchrist-Zakrajsek data is to US
Panel A: interest rates (%).

(c) Consumption.

(d) Real commercial.

Panel B: interest rate changes (% -points).

(h) Consumption.

(i) Real commercial.
The theory

- Paper argument:
  - Bank rate is function of MPR from now to horizon $x$
  - Taylor type rule contains inflation and autoregressive part
  - MPR forecast is function of inflation and lagged MPR
  - Therefore, bank rate responds to both inflation and lagged MPR

1. While true, the sole reason inflation matters remains that it forecasts future MPR
2. The marginal cost that matters is arguably the long rate
   ⇒ It is not obvious that inflation has a role to play other than through the long rate
Why is this long rate argument relevant?

- Pass-through of MP on bank rates combines two distinct effects:
  1) MP on LT rate (maturity transmission of policy)
  2) LT rate on the bank rate (of equal maturity, or pass-through of marginal cost)

- Because 1) is not one-for-one, can find that MPR pass-through is low for long term bank rates. Even if 2) is 100%!
- Paper’s finding that LT bank rates respond more to inflation may simply pick up that
- Put differently: Long term rate is arguably more relevant for long term products. Inflation may be a better forecaster of future policy than lagged policy (and thus of long rates). Inflation’s role may derive from that. Or not (!), but hard to judge from the results as they are.
Balance sheet characteristics and pass-through

1) Is asking a lot from the data: Lots of interaction terms.
   - May get clearer results if focus lies on fewer, but more "telling" coefficients (e.g. spread, immediate PT, ...)

2) There is a lot going on; perhaps too many results to see through clearly. IRF help: look at 1 balance sheet characteristic at the time
   - Disadvantage: ignores correlation with other characteristics (not in estimation)
   - Is possibly relevant: a bank business model is a joint decision on an entire balance sheet composition
   - Could contemplate plotting IRF per bank. Market is concentrated enough to possibly lay bare visual patterns
In sum

- Essential part of policy transmission
- Paper clearly measures that
- Understanding cross-sectional patterns difficult (e.g. cross-subsidization)
- All the more reason to continue this line of research