Risk Taking and Interest Rates: Evidence from Decades in the Global Syndicated Loan Market

Discussion by Şebnem Kalemli-Özcan

What does the paper do?

- Show evidence for corporate risk taking in the rest of the world as a response to low US rates
- Before crisis, ex-ante riskier loans to non-US borrowers as a response to decline in short-term rates
- After crisis, ex-ante riskier loans to non-US borrower as a response to a decline in long-term rates
- No role for risk appetite and exchange rate

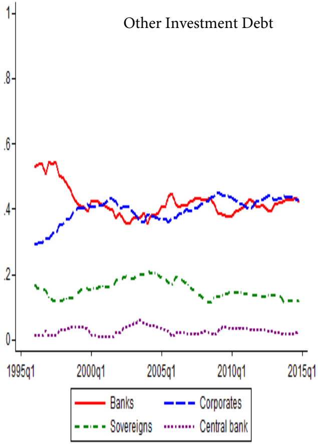
General Impression

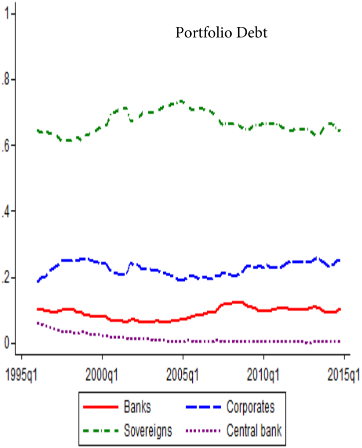
- I liked the paper a lot.
- Risky loan measure is spread fixed at origination; use confidential US data to link to defaults and to secondary markets for systemic risk
- Right focus on cross border loans
- Strong identification from specifications with no US borrower and US lender

International Transmission via Global Banks

- We know **global banks and capital flows** into banks are very important for the transmission
- We still need more empirical work on mechanisms and specific role of **bank heterogeneity** and bank balance sheet management (and effect of lending and borrowing in FX)
- Important to understand if transmission via banks work through **prices** (interest rates and spreads) and/or **quantities** or both
- Important to separate **credit supply** shocks via banks versus other sources and also from **credit demand** shocks

Importance of banking flows in EMs: Loans 50-60% of external debt; bonds 30-40%





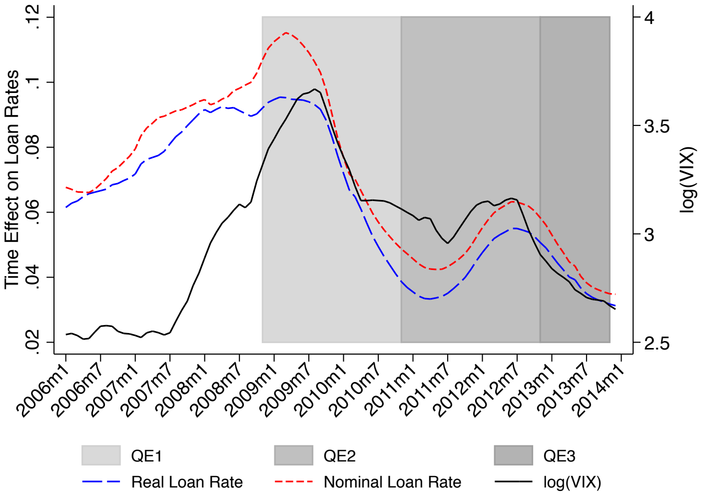
Identification

- **Credit demand** may not be fully controlled since firm$\times$quarter effects cannot be used not to absorb the US interest rates (only firm$\times$year)
- How much quarterly variation in US rates?
- Is firm credit demand slow moving?

Interpretation

- How do we know this is **risk taking** without full balance sheet of firm and bank (need firm and bank characteristics)?
- Conventional policy works via lowering short term rates however unconventional policy works via lowering risk spreads and might encourage risky loans/investment at a <u>lower</u> cost
- What is the **exact mechanism**?
  - Lowering rates/spreads in US can lead to portfolio balance channel overseas (for cross-border loans?)
  - Global banks fund themselves cheaply so lower rates on customers (as in Baskaya et al., 2016) (means lower spreads?)
  - For loan portfolio regressions; post crisis long-term result is stronger and short term result is weaker

Lower funding costs for global banks, lower funding costs for domestic banks, lower loan rates



Conclusion

- Great paper!
- Focusing on banking flows is the first step in understanding US monetary policy spillovers across borders
- Innovative way of measuring risk!
- Food for thought: Policy implications—How to regulate cross-border loans when foreign banks involved?