# Cross-border bank flows and monetary policy

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The views expressed here are those of the presenter and do not represent those of the IMF, its Executive Board, or its policies.

# What the paper does

- Explores the impact of large countries on smaller countries' business cycles, focusing on a particular push factor – monetary policy (MP) in BIS reporting countries
- Finds that a monetary tightening at home leads to an increase in the amount of lending abroad
- Interpreted as a "portfolio rebalancing channel" underpinned by domestic firms becoming **riskier** (net worth effect) than foreign firms

# My comments

1. Relation to the literature
2. Contribution to the literature
3. Results
4. Suggestions
5. Wrap-up

# #1 – Relation to the literature

- Related to earlier literature on capital flows
    - Calvo, Leiderman, and Reinhart (1993 and 1996)
- But also to relatively more recent papers
    - Shambaugh and di Giovanni 2006 JIE
    - Laeven and Tong 2012 JFI
    - Di Giovanni, McCrary, and von Wachter's 2009 ReStat
- And finally the latest-generation papers
    - Baskaya, di Giovanni, Kalemli-Ozcan, Peydro and Ulu (2016) - Turkey
    - Morais, Peydro and Ruiz (2016) – Mexico

# #2 – Contribution to the literature

- This is a **great use of BIS data** - to ask a very **important** and **timely policy-relevant question**

- <u>**Suggestion**</u>: **Better emphasize** that **cross-country data** comes with limitations but also with opportunities to study cross-border propagation of different shocks (financial, monetary, macroprudential, real)
  - Exploit the cross country (dyadic) nature of the data more
    - Through interactions of MP at home and abroad
    - Explore the role of exchange rates - Shed any light on the trilemma vs. the dilemma (Rey, 2015)?

# #3 Results

- Main results: When there is a monetary **tightening** in a large economy, international banks **increase** the amount (and share?) of lending abroad
  - Somewhat counterintuitive and different from earlier studies
    - Gianneti and Laeven (2011 AER P&P) (“**GL**”) show the opposite with micro data;  Cetorelli and Goldberg (2012) find muted effects
  - For internationally-active banks, after a tightening domestic credit remains flat
  - **Paper’s explanation**: portfolio reallocation effect away from the home market to foreign markets (“anti-home bias”)

# #3 Results

- GL show that that monetary/funding conditions in the countries of origin of international banks affect the relative amount of domestic vs. foreign lending
  - A **loosening** at home **raises the share of foreign loans**, essentially because banks have access to cheaper cost of funds which increases their lending capacity
    - Banks have higher market valuations at home
    - The cost of interbank funds at home is also low
  - There is **time-varying home-bias** – the bias towards extending loans at home is **weaker** during expansions, and **stronger** during contractions.

# #3 Results--Why this difference?

- Similar methodology (both paprs control for host country credit demand using host country*year Fes)
- Different data granularity: measurement, sample issues?
- Is this a "micro-macro paradox"? Neither study takes into account "adding-up constraints":
  - Disconnect between micro estimates and the growth rate in aggregate claims, see Amiti and Weinstein (2015), Amiti, McGuire, Weinstein (2016)
- **Do funding vs. lending currencies play a role?**
  - At home banks are funded in <u>local currency</u>, abroad they tend to lend in foreign (major) currencies – How do international banks hedge their foreign exposures, and what are the implications of a tightening at home for lending in <u>foreign currencies</u>?

# #4 Suggestions

- Document impact on the **real economy** – quarterly GDP/industrial production data for recipient countries
- Provide more evidence for the "**portfolio rebalancing**" channel explanation:
  - Foreign borrowers are **safer** than domestic borrowers so there's substitution from risky domestic borrowers to safe foreign borrowers
    - Denhaan Sumner and Yamashiro 2007 JME paper, based on VARs, not particularly convincing; it's also the only piece of evidence on this, not an established fact
    - The relative level of firm risk at home vs. abroad is pinned down based on the AE-EME designation of recipient countries – perhaps too crude? -- how about country's sovereign ratings, or a more precise measures of riskiness?
- Reconsider the **risk-taking channel** explanation
- Alternative explanations? (see comment on funding vs. lending currencies)

# Wrap-up

- Very clear, well-written, interesting, and thought-provoking paper
- Suggestions:
  - Better integrate in the existing literature, emphasize the costs/benefits of the cross-country data
  - Explain what drives the difference between the paper's results and most of the literature
  - Results even more convincing with evidence of real effects in recipient countries and the underlying channel
- Look fwd to reading future versions of the paper!