Discussant comments on
Regulatory solutions for bank loans pro-cyclicality
Is the cure worse than the illness?
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* These comments reflect the views of the author and not necessarily those of the BIS or of central banks participating in the meeting.
Comments to:
Regulatory Solutions to Bank Loans Pro-Cyclicality
Is the cure worse than the illness?

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▪ Innovative: Explores a different channel to procyclicality, the “cost of funds” channel.
▪ The paper has a good discussion of the context.
▪ Presentation of the exercise is a bit cryptical, more should be explained about the drivers of the results.
Comments

- I. Model
- II. General
Figure 4.4.1: Credit Pro-cyclicality
Figure 4.4.2: Funding with Deposits
I. Model: Deposit demand

- Demand for deposits is very “loaded”
I. Model: Deposit demand

\[ r_t^d = 0.005 + r^b + \sum_i \varepsilon^l ind_t^i + \eta \Delta D_t \text{cycle} \]

Where \( r_t^d \) is the rate on deposits and \( \varepsilon^l \) represents the different sensibilities applied on \( ind^i \) indicators, corresponding to:

- the difference between the observed capitalization ratio and the target capitalization ratio (tier 1);
- the difference between the observed liquidity ratio and the target ratio;
- the difference between the observed ROE and the target ROE;
- the phase of the business cycle, and
- the verification that the bank has had to raise capital at the previous year end to avoid regulatory breaches.
I. Model: Deposit demand

- Demand for deposits is very "loaded"
  - Should ROE be part of it?
    - Isn’t capital enough?
    - How important is this factor should be part of the analysis provided.
  - Cyclical dummy in the elasticity of demand in addition to factors related to bank’s quality.
  - No room for a positive role of dynamic provisions.
  - In general, factors included should be motivated with stylized facts
I. Model: Demand for loans

\[
\ln(L_t) - \ln(L_{t-1}) = w\left[\ln(1 + r^l_t - r^b_t) - \ln(1 + r^l_{t-1} - r^b_{t-1})\right]
\]

\[
\ln(L_t) = w\ln(1 + r^l_t - r^b_t)
\]

\[
\ln(L_{t-1}) = w\ln(1 + r^l_{t-1} - r^b_{t-1})
\]

- Stock of loans in \( t \) (includes loans from \( t-1 \)), a function of rate at \( t \)
- Alternative – Demand for New loans a function of rates at \( t \):

\[
\ln(L_t) - \ln(L_{t-1}) = w\ln(1 + r^l_t - r^b_t)
\]
I. Model: General

- Two-year loans: Adapt to length of the cycle.
- Constraint of fixed ROE? (annex 2) → Discuss relevance of this.
- Possible extension: Interaction with monetary policy (Base rate to follow a Taylor Rule).
II. General

- Signaling problems in dynamic provisioning: Seems to be possible to circumvent via communication.

- Model should incorporate facts (or hypothesis) that give rise to procyclicality
  - View of fall in standards in boom periods → If policy can prevent this, then Default rate should react to this.
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