Procyclicality of loan-loss provisioning and systemic risk in the Hong Kong banking system

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Paper overview:

- Comprehensive assessment of the systemic risk from two perspectives:
  - Cross-sectional dimension
    - The authors calculate CoVaR, which is a systemic risk indicator, using data of listed banks in Hong Kong
  - Time-series dimension
    - The authors examine the cyclical pattern of loan-loss provisioning (LLP) and loan supply using data from Asian countries.
- Conclusion:
  - LLP is an important determinant of the systemic risk from both perspectives of cross-section and time-series.

- Very good paper!
- Comprehensive assessment of systemic risk with Hong Kong and Asian countries data
- Important findings that LLP is an important variable for the systemic risk

Comment and question 1: CoVaR (just for clarification)

- Recent crisis has shown that margin/haircut spiral on banks' balance sheets is important for creating the systemic risk.
  - For example, in the fall of 2008, financial system was in danger of collapsing as a result of the liquidity shortage through the margin/haircut spirals.
- Since CoVaR takes the current structure of banks' portfolio as given, I am not sure whether CoVaR is capable of capturing the interactive (spiral) aspect of the crisis.
- Am I right? What is the limitation of CoVaR when we use it as a systemic risk measure?

Comment and question 2: On the importance of LLP

- This paper shows that LLP is an important determinant of the systemic risk.
- However, if both systemic risk and LLP are determined by other but same fundamental variables (such as land price), then, stabilization of the LLP doesn't necessarily result in the reduction of the systemic risk.
- Explain the mechanism through which LLP becomes a source of systemic risk.
  - In a conventional view, LLP is important in the sense of microprudence because it affects the financial condition of individual institutions.
  - Comovements of bank's LLP may not necessarily mean the existence of the systemic risk. Externality is needed for the source of the systemic risk.

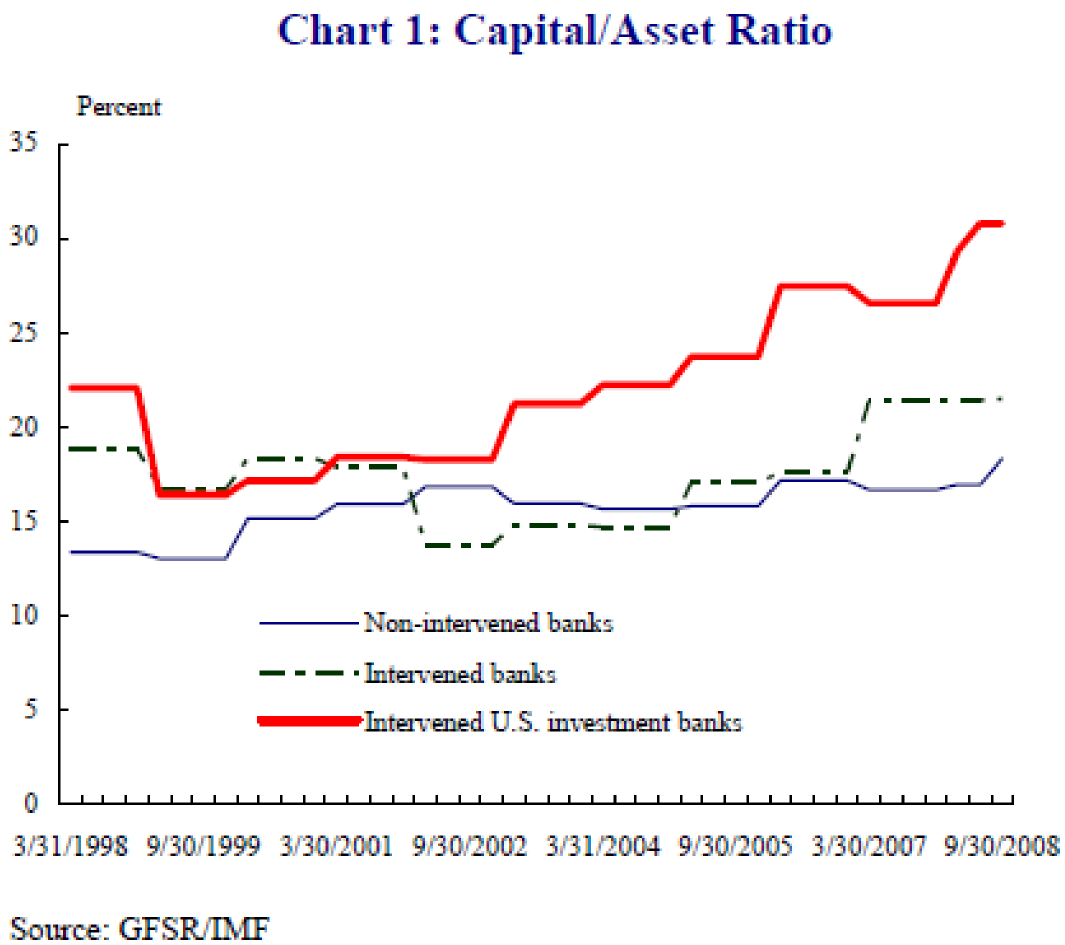
Comment and question 3: Policy prescription

- I agree that the dynamic provisioning helps to mitigate the procyclicality of the capital ratio regulation.

- However, dynamic provisioning (and hence the sufficient capital buffer at a time of crisis) may not be a perfect solution to eliminate the financial crisis (Chart1).

- Should we think that the crisis of 2008 could have been prevented if dynamic provisioning had been implemented?

Intervened banks had enough capital at the crisis.

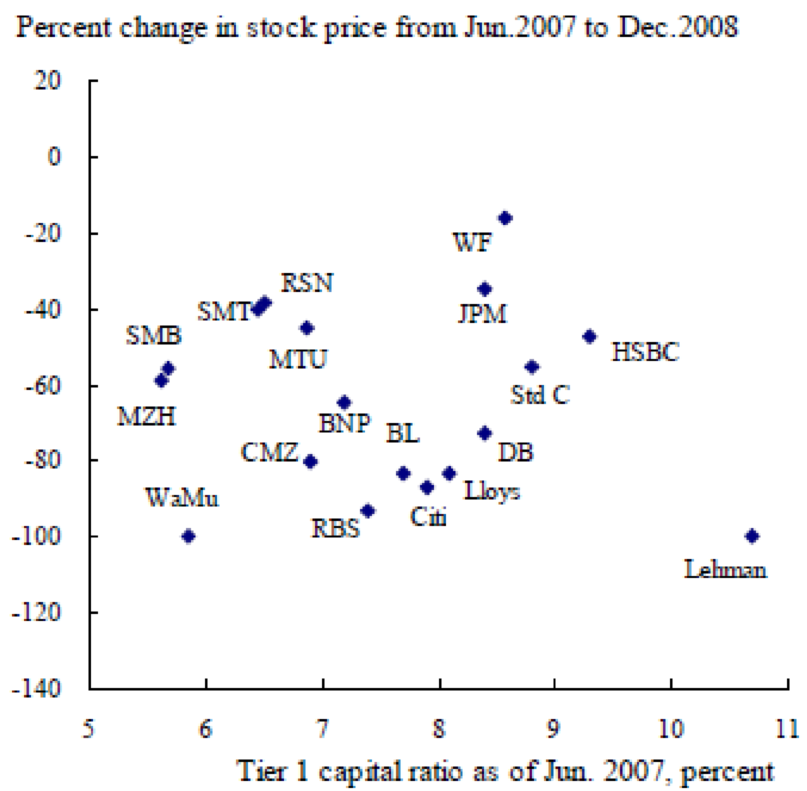


Thank you!

Supplement:
No correlation between bank value and capital ratio

Chart 2: Changes in Stock Price

and Tier 1 Capital Ratio



Source: Bloomberg