

Discussion of Steven Ongena and Jose-
Luis Peydro's life time (?) work on
Monetary policy and bank risk taking

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Message

- Low policy rates induce excessive risk-taking
- More importantly, the real contribution of the paper is to isolate supply effect: banks go for more risk in low yield environment, more specifically when monetary policy rates are lowered
- In several of their (life-time) papers they provide empirical evidence

Complicating issues

- Endogeneity/causality – policy rates are set conditional on economic conditions...
 - Bolivia paper... nice way of getting around this
- Separate out demand effects from supply effects... → authors show that extra risk is underpriced

Key issue and contribution

- Why do banks increase risk when interest rates are lower?
 - Not obvious!!!
 - What this means is that the present paper has dual contribution: identifies this risk taking and could shed light on why banks behave like this
- And this helps assess side effects of monetary policy

Why do banks increase risk when yields are low?

- Obvious? Going for yield??
- We do not understand much about how banks operate and behave....
- What is explaining why they go for yield, ignoring risk, or alternatively, why are they willing to take risk with lower return per unit of risk in low yield environment?

Explanations...

- See authors – nominal rewards, etc.
- Same applies to cost of equity... in bankers mind...
- Myers-Rajan – agency problems worse in more liquid setting

Yes, but can we say that agency problems are in general worse in low yield environment?

→ Bankers argue that margins easier to get in higher yield environment

Difficulty for authors...

- Can empirical work help us learn how bankers behave? Yes... but...
- If we do not really understand what is driving behavior of bankers, difficult to come up with appropriate empirical controls and tests.....
 - Back to criticism of corporate finance... too little guidance...