

Discussion of U.S. Monetary Policy and Emerging Markets Credit Cycles

by

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The Disclaimer - Very Important

The views stated herein are those of the author and are not necessarily the views of the Federal Reserve Board or the Federal Reserve System.

The Paper

Links lending to EME borrowers to U.S. monetary policy.

- 1 The authors document considerable spillovers from U.S. monetary policy to lending to EME borrowers.
- 2 They find that EME borrower experience a 32 percentage point greater increase in lending over a typical U.S. monetary policy easing cycle than their DME counterparts.
- 3 The results suggest potentially large vulnerabilities of EME borrowers to change in U.S. monetary policy.

What exactly is the channel?

- Banks' balance sheet condition and dollar funding affected by monetary policy stance.
- Borrower's credit demand depends on U.S. business cycle.
- Violation of covered interest parity - EME borrowers may not be able to hedge exchange rate risk and/or interest rate risk.
- Sovereign risk - Deteriorating in EME economic condition increases its vulnerability to changes in U.S. interest rates (Bowman, Londono and Saprizza, 2015).

The Empirics:

$$L_{ijt} = \beta \text{ U.S. Interest Rate}_t \times \text{EME} + D_i + D_j + D_t + \epsilon_{ijt}$$

- L_{ijt} is the log loan amount originated to borrower i by bank j in quarter t .
- D_i is a borrower fixed effect.
- D_j is a bank fixed effect.
- D_t is a quarter fixed effect.

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Identification: Compare the difference between the loan amounts (measured relative to the banks' average) of two loans taken out by the one firm in EME at different levels of U.S. interest rates with the difference between the loan amounts (measured relative to the banks' average) of loans taken out by the one firm in DME at the same different levels of U.S. interest rates.

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- Including a borrower fixed effect (D_i) only controls for time-invariant firm characteristics.
- It does not control for changes in the firm's credit demand or credit risk, which could be correlated with U.S. monetary policy, over the cycle.
- Within firm variation with few observations in the panel is tricky: Consider a firm with a loan in 1991 and a second loan in 2011. Is this the right comparison?

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→ The interpretation of the coefficient as percent increases in loan amounts should be clarified: From the same banks needs of bank-firm FE. If loan is originated by other banks with different values for FE then the interpretation is not as straight-forward.

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- It does not control for changes in the home country over the cycle (e.g. sovereign risk, vulnerability)..
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→ include more country-level macro controls, e.g. GDP growth, domestic monetary policy etc.

Empirics cont.

- The level of U.S. interest rate is one measure for monetary policy.

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- The authors use later bank-quarter FE, killing the credit supply story.

→ Why not interacting U.S. monetary policy with bank balance sheets, allowing for country-quarter FE and identifying a supply channel.

Measuring Loan Amounts

.. we consider only lenders with relatively large commitments. [footnote: we exclude...participants.] The loan amount for a given bank is computed on a pro-rata basis...[p. 7]

- Heroic assumption: Needed because shares are missing in Dealscan?
- Lead share varies because of monitoring incentives (Sufi, 2007), over the credit cycle (Ivashina and Scharfstein, 2010) and with syndication success (Bruche, Malherbe, and Meisenzahl, 2017).
- Large banks, those in the league tables, originate to distribute and may sell loan shares after origination (Bord and Santos, 2012; Irani and Meisenzahl, 2017).
- Unclear whether reduction comes from large banks or smaller participants. Similar for substitution.

Measuring Loan Amounts

Paper does not have any summary statistics.

Lender Shares in the Shared National Credit Program (EME loans only)

	Number of Lenders	Shares		Agent Shares	
		unweighted	weighted	unweighted	weighted
Mean	11	21%	6%	44%	21%
25p	3	0.1%	0.02%	6%	15%
Median	5	7%	0.06%	14%	33%
75p	10	27%	6%	25%	75%

Lending from Where?

Authors assign loan amount to ultimate top holder/parent company.
Lending to EME borrowers in the SNC:

Top Holder (share weighted)

US Banks: 16%

Foreign Banks: 64%

Non - Banks: 20%

Actual Lender (share weighted)

US-based: 60%

other: 40%

Actual Lender - Foreign Top Holder (share weighted)

US-based: 56%

other: 44%

Nit-Picks

- Table IV - high yield dummy is identified by status switchers (otherwise the dummy would be multi-collinear with borrower FE).
- BIS claims data have breaks (especially during the financial crisis when investment banks became BHCs).
- Do the EME borrowers lever up more or do DME borrowers start to issue relatively more bonds—that is, become less bank-dependent—over the credit cycle (Becker and Ivashina, 2014)?
- Cluster 2-ways by country-quarter and firm.

Conclusion

- This paper documents interesting new facts about lending the EME and U.S. monetary policy.
- I encourage the authors to clarify which channels are at work here.
- Tie the empirical specification and in the interpretation of the results to the specific channel(s).