Discussion of:

Mending the link: heterogeneous bank lending and monetary policy pass-through

by Altavilla, Canova and Ciccarelli

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Unconventional monetary policy: effectiveness and risks

Banca d'Italia, October 2016

Very interesting paper

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I like the paper.

Food for thought.

The paper

- How does expansionary monetary policy affect lending rates and lending margins? The pass-through (PT).

- Rich dataset covering 260 banks in Europe

- Focus on the Great Recession and its aftermath

- First part on conventional measures ($\downarrow$ in the policy rate)

- Second part on unconventional measures (credit easing (CE) + quantitative easing (QE)).

Discussion

- Results

- The empirical model
  - Conventional
  - Unconventional

- Few comments/questions
  - Policy shocks with CE/QE
  - Non-linearities

Effects on the pass-through, PT

Conventional

- Stressed vs non-stressed countries is irrelevant

- Bank balance sheet relevant (low PT for 1. low capital, 2. exposed to domestic sovereign debt)

Unconventional

- ↓ cross-sectional dispersion of lending rates (uncertainty?)

- Larger pass-through than conventional measures

- Lending rates ↓ for banks 1. low capital 2. from stressed countries, 3. high share of non-performing loans, 4. high uptakes in the CE operations.

Unconventional on lending rates to households

- ↓ of lending margins (lending - deposit) for: 1. low capital, 2. exposed to domestic sovereign debt, 3. high share of non-performing loans.

- This made profitability lower. Hampers banks' profitability.

The model: conventional mon. policy 2007-14

VAR model for $X_t^{ij} = [\ \underbrace{y_{i,t}}_{bank\ i}\quad \underbrace{x_{j,t}}_{country\ j}\quad \underbrace{z_t}_{EONIA}\ ]$

z_t: EONIA

$x_{j,t}$: 10-yrs sovereign bond, E(default prob. non-fin. corp.), unempl. rate

$y_{i,t}$: lending rate, deposit rate, bond yield

$$
\begin{aligned}
z_t &= lags + v_t \\
x_{j,t} &= C_j z_t + lags + \varepsilon_{j,t} \\
y_{i,t} &= A_i x_{j,t} + B_i z_t + lags + u_{i,t}
\end{aligned}
$$

v_t: conventional monetary policy shock (temporary or persistent shock?)

VAR bank by bank, then slicing the distribution, conditional on few criteria.

The model: unconventional mon. policy 2014-15

Event-study approach:

$$\Delta Y_t = aD_t + bD_{t-1} + c(\text{macro news})_t + \varepsilon_t \tag{1}$$

3 lhs variables. EONIA: z_t; sovereign yields: $x_{1,t}$; bond yields: $y_{3,t}$.

D_t: dummy variable. $D_t = 1$ in the dates of the CE/QE announcements

3 forecasts: path under the assumption that the announcements were the only thing happening.

$$E(y^1_{i,t+h}|\Omega_t, z^*_{t+h}, x^*_{1,t+h}, y^*_{3,t+h}) = \alpha z^*_{t+h} + \beta x^*_{1,t+h} + \gamma y^*_{3,t+h} \qquad \text{(I think...)}$$

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Impulse responses of lending rates for bank i:

$$u_{i,t+h} = E(y^1_{i,t+h}|\Omega_t, z^*_{t+h}, x^*_{1,t+h}, y^*_{3,t+h}) - E(y^1_{i,t+h}|\Omega_t, z_{t+h}, x_{1,t+h}, y_{3,t+h})$$

Slicing the distribution, conditional on few criteria.

Comments: policy shocks

- Monetary policy shocks are deviations from the policy rule (CEE).

$$i_t = f(\Omega_{t-1}) + \epsilon_t$$

- This means that displacements of expectations are identifying policy shocks:

$$E(i_t|\Omega_t) - E(i_t|\Omega_{t-1}) = \epsilon_t$$

- But what if the policy rule is changing?

- What if markets expected some changes in the policy rule?

- Behavior of yields before the announcements?

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- "News shock/foresight" environment. Agents know about the shock in advance: $y_t = \epsilon_{t-1}$. Agents receive a signal on the shock: $s_t = \epsilon_t + v_t$

- Are Δ in expectations really identifying exogenous policy shocks?

- Isn't there a difference between: 1. the effect of the **announcement**/variations in expectations; 3. the effect of **policy** shocks?

Comments: policy shocks

If I wasn't the discussant, I would do what you did!!

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• If CB wants **mon. tightenings** to have an effect, it needs bad (small, illiquid and poorly capitalized) banks, that cannot shield increases in i.

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4) US: contractionary shocks have stronger effects than expansionary shocks (see figure).

• As far as I know, no study on this. Interesting to relate this to bank balance sheet/credit channel asymmetries.
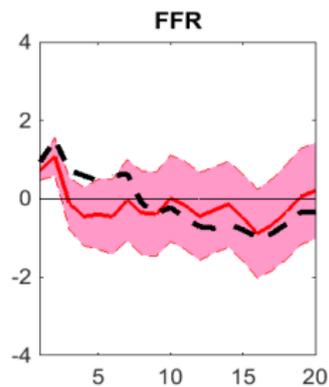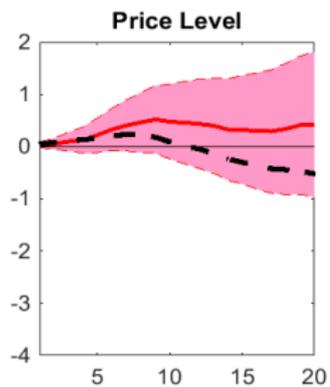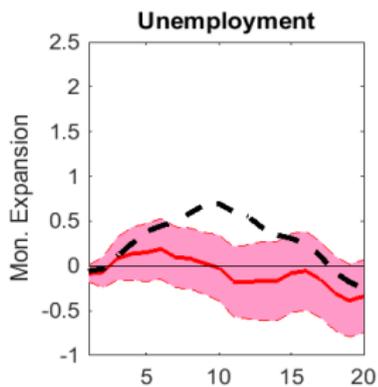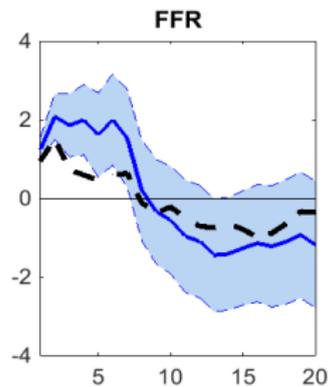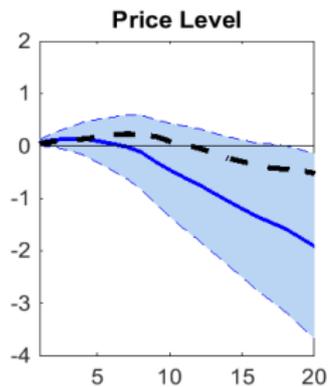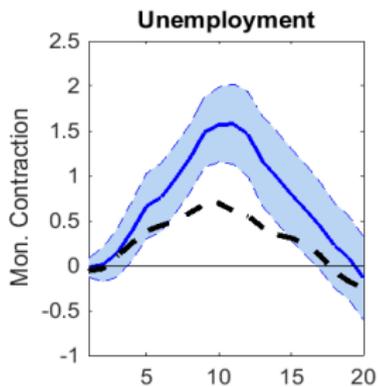
Comments (non-linearities 2)

5) Conditioning on uncertainty. Does it generate variations in the PT?

6) A source of non-linearity: downward rigidity of lending and deposit rates. Should them be negative? Strong non-linear effect at the ZLB?

7) What about quantities? Weak demand of loans in Europe? Does this come from banks' supply or from demand? Are lending rates low enough?