


FREE LUNCH OR NOT FREE LUNCH?

DISCUSSION OF

***BEGGAR-THY-NEIGHBOR IN MACROPRUDENTIAL POLICY?
CROSS-BORDER IMPACT OF THE
AUSTRIAN SYSTEMIC RISK BUFFER***

BY EIDENBERG, SCHMITZ, STEINER AND UBL

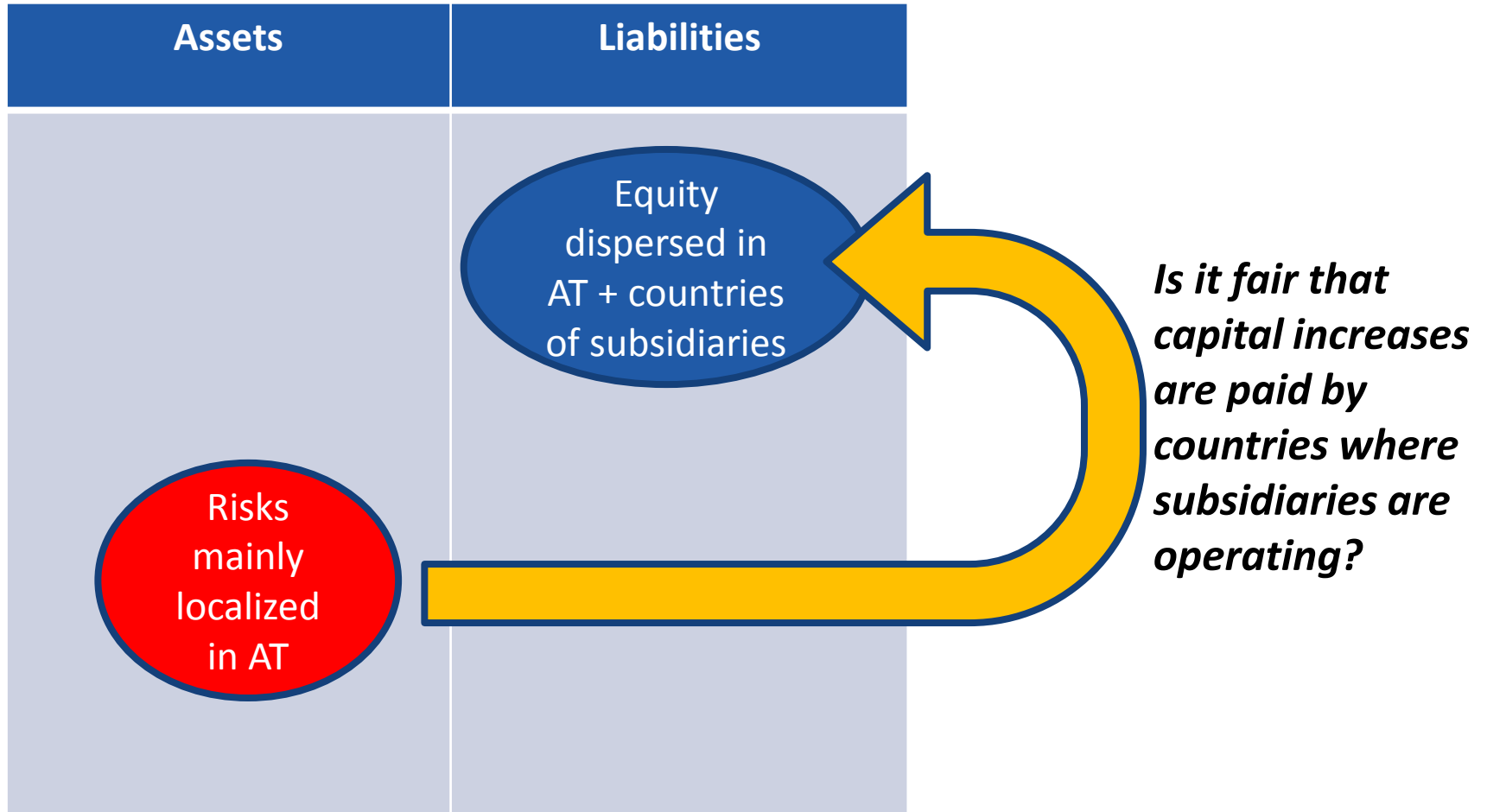
***J. IDIER - DISCUSSION
PERSONAL VIEWS - USUAL DISCLAIMERS APPLY***

- 
1. Summary
 2. Remarks on the model/ results
 3. Policy discussion on structural buffers and the fact that increases in bank capital look like « free lunch »



AN INSPIRING PAPER

WITH A LEGITIMATE QUESTION ON MAP ACTION: ARE WE DOING THE BEST?
ARE THERE ANY SIDE EFFECTS?



- SyRB implementation in Austria...
 - Between 1% and 2% in 2019
 - For most banks holding an additional macroprudential buffer did not cause any capital shortage
- ... Does not have any impact in loans dynamic/ GDP in Austria
- ... Does not have any impact on CESEE countries
- ... **But is it really a free lunch? Will we reach one day the turning point?**



MODELLING APPROACH

Capital gap estimation

- Contribution in the group capital: foreign subsidiaries provide capital (% of their BS or % based on their revenue contribution to the group)
- Capital strategy: maintain or not the management buffer

Opportunity cost per unit of capital

- Koop et al. (2017) paper
- Cost of loans should cover the expected cost of the balance sheet (taking into account taxes, debt/equity mix, administrative cost, debt funding costs)
- Translated into a lending spread shock

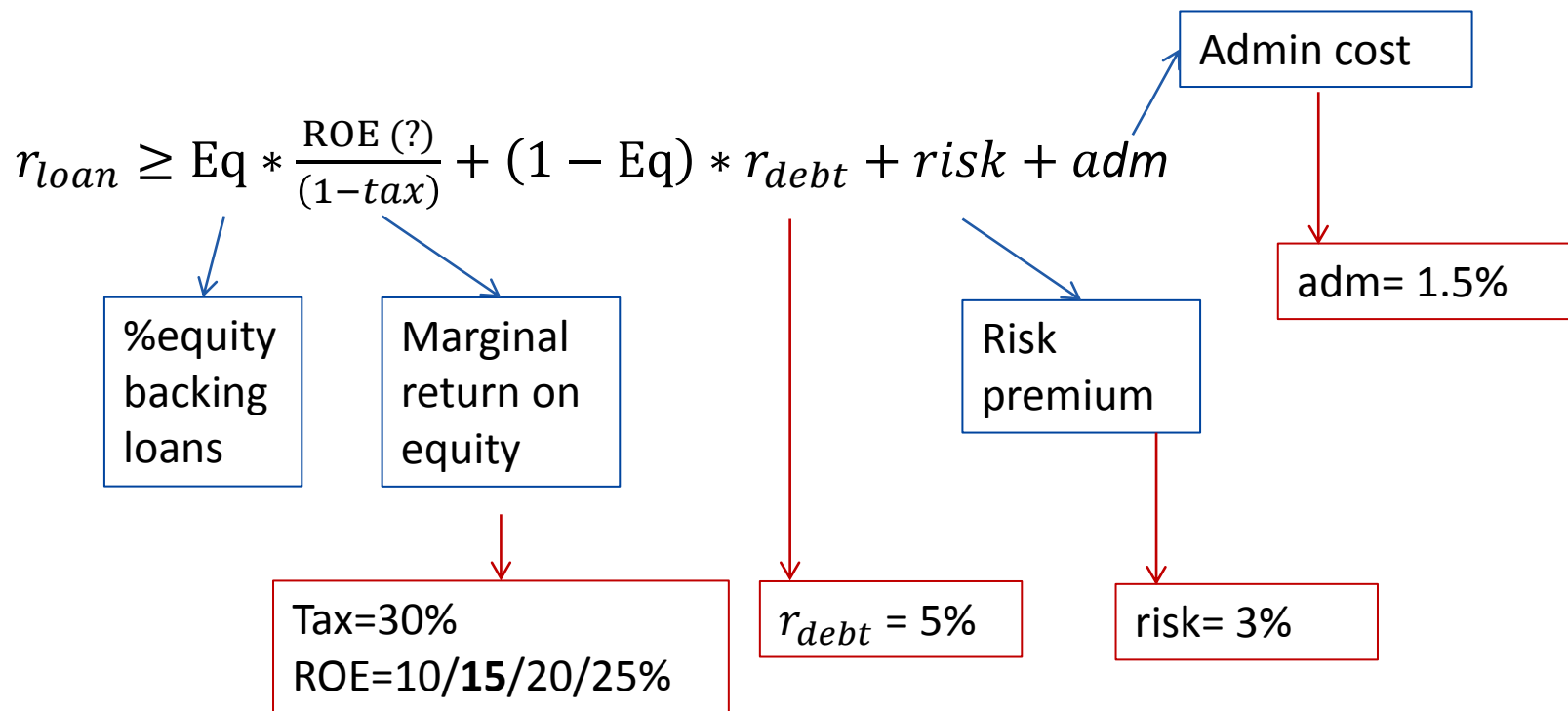
Macroeconomic impact

- Using the macroeconomic model of Austria (BMPE)

REMARK 1

MORE DETAILS ARE NEEDED IN THE PAPER TO UNDERSTAND HOW IS APPLIED THE OPPORTUNITY COST EQUATION OF ELIOTT (2009) – KOPP ET AL. (2017)

To come back on the model and the need for clarification



-> Calibration by Kopp (2017) – **what is yours?**

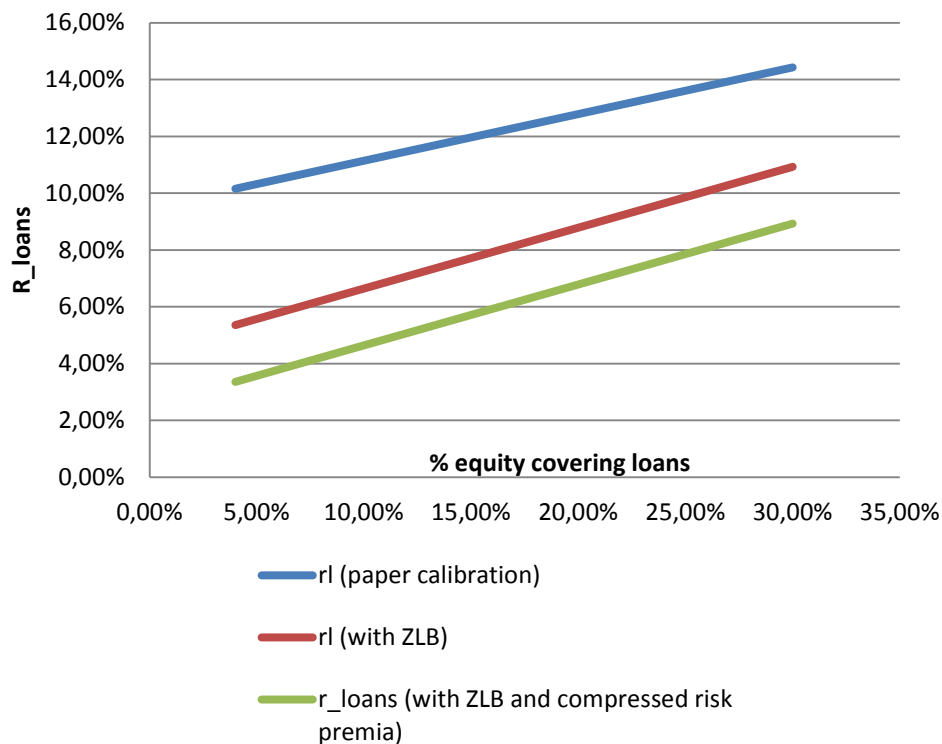
-> some clarification needed in terms of amount of equity needed to cover SyRB

-> If no need of additional capital, no opportunity cost

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Simulations of R_loans



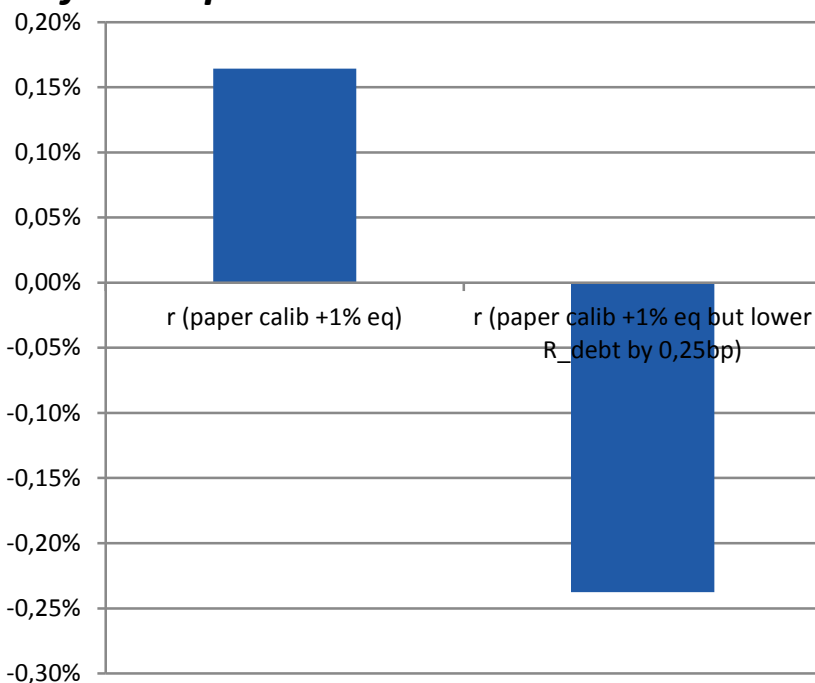
Behind « no impact » there could be different reasons as shown on the graph for two examples:

- Compensation in terms of cost of equity by decreasing cost of debt
- Compensation by a compression of risk premia

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A decrease by 0,25bp on r_{debt} compensates even more the increase of 1% capital



Do you econometrically see a free-lunch of capital increase?

... or do we forget some compensating factors as the cost of debt or the compression of risk premia

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Table 1: Cross border effects of the Austrian's SyRB

	Dependent variable: growth_loans_non_MFIs
GDP	1.254*** (0.370)
unemployment_rate	-0.530 (0.332)
National_credit_growth_lag2	0.440*** (0.144)
CET1_ratio	0.029 (0.027)
impairment_ratio	-1.326** (0.603)
period_result_ratio	1.402*** (0.511)
interbank_liabilities_ratio	0.004 (0.067)
growth_deposits_non_MFIs	0.450*** (0.041)
TotalAssets_bn	-0.003** (0.001)
SyRB_AT	1.134 (1.876)
Buffer_National	0.602 (0.939)
country dummies	...
Number of Observations	3645
Number of Groups	81
Obs per group: min	45
Obs per group: avg	45
Obs per group: max	45

Note: *p<0.1; **p<0.05; ***p<0.01

Source: OeNB, own calculation

No control for the funding cost of banks?

Or for the cost of equity?

MODEL: QUESTION 2

COMPARISON OF MAGNITUDE WITH OTHERS

Study	Lending reduction (%)	Impact on lending spreads (bp)	GDP reduction (%)
This paper		15bp	
Angelini and Gerali (2012)			0.05 [0-0.36]
Baker and Wurgler (2015)		6-9	
Bridges et al. (2014)	3.5		
Cosimano and Hakura (2011)		9-13	
De-Ramon et al. (2012)	1.6	9.4 [6.7-19]	0.3*
Fraisse et al. (2015)	1-8		
Gerba and Mencia (2017)	1.1-1.5		0.2-0.4
Kashyap et al. (2010)		2.5-4.5	
King (2010)		15	
LEI (2010)		9-19	0.09
MAG (2010)	1.4	12.2	0.1 [?-0.15]
Meeks (2014)	0.2 (mortgage) 0.5 (corporate)		
Miles et al. (2013)			0.25**
Noss and Toffano (2014)	1.4		
Roger and Vitek (2012)			0.11 [0.09-0.24]
Slovik and Cournède (2011)		16	0.2
Suturova and Teplý (2013)	1.4-3.5		
Yan et al. (2012)			



In the range of other papers

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Step 2: Macro impact of a lending spread shock using the model of AT or BMEs of CESEE country?

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Very small compared to others

How to explain that the AT model for forecasting has so low elasticities to interest rate shock?

POLICY REMARKS

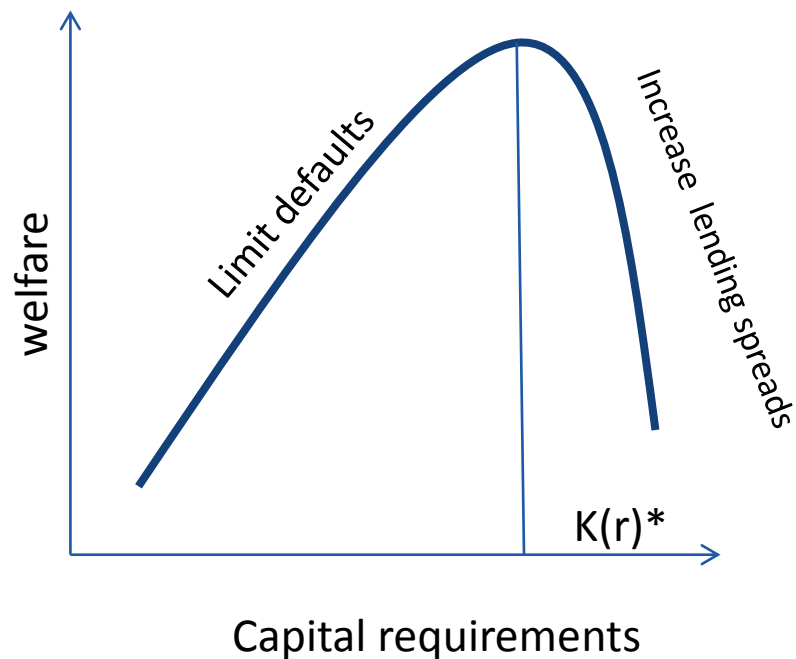
FREE LUNCH OR NOT FREE LUNCH?

- More generally models should better consider:
 - The very specific environnement of overall declining debt-funding cost over the last 30 years
 - We need to assess if the statement « *better capitalized banks, lend more* » is true or is just a twist of another statement « *increasing capital constraints and thus the cost of banking activities has been compensated by decreasing debt funding cost* ».
- **Is it really free lunch even if banks can comply without raising capital?**
 - At least we reduce the distance to MDA which can increase the perception of « risk » vis-à-vis investors which could ask for higher returns ?
 - The low level of pass-through in lending rates may give you right... depending on which factors are behind

POLICY REMARKS

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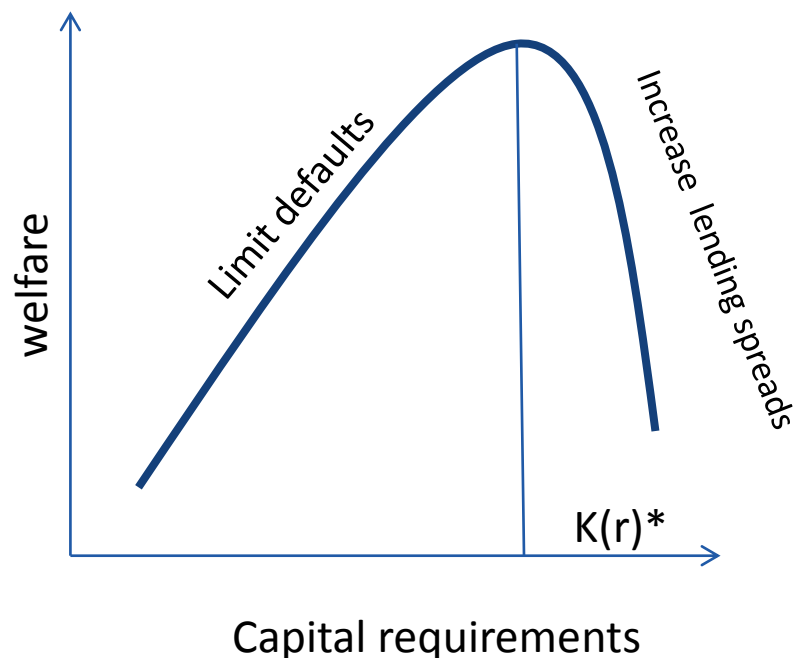
- U-inverted curve of capital constraints



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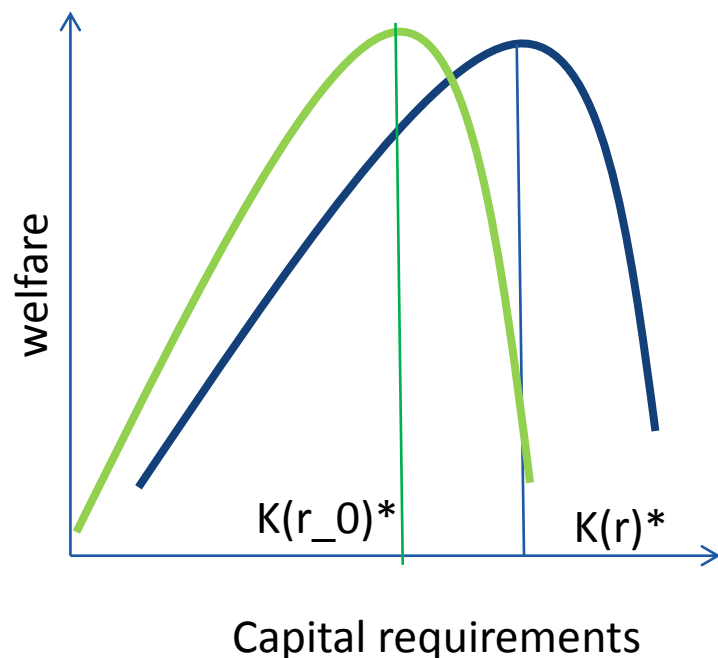
- Intuition: the turning point of the U inverted curve of capital regulation moves with interest rates/ cost of funding



POLICY REMARKS

FREE LUNCH OR NOT FREE LUNCH?

- Over the last 10 years: Capital constraints have increased and funding cost has decreased



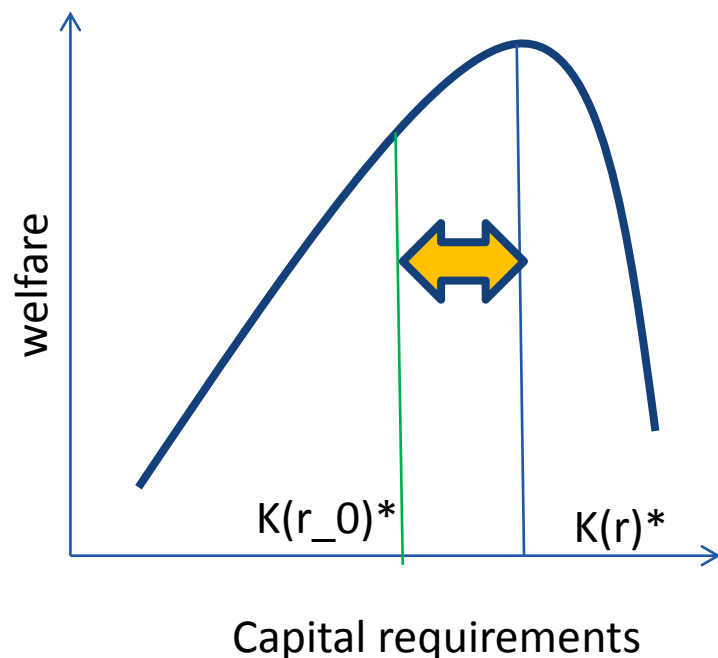
Observation 1:
We were able to increase K without reaching the « dangerous » zone.

« unexpected complementarity » benefit of MoP and MaP

POLICY REMARKS

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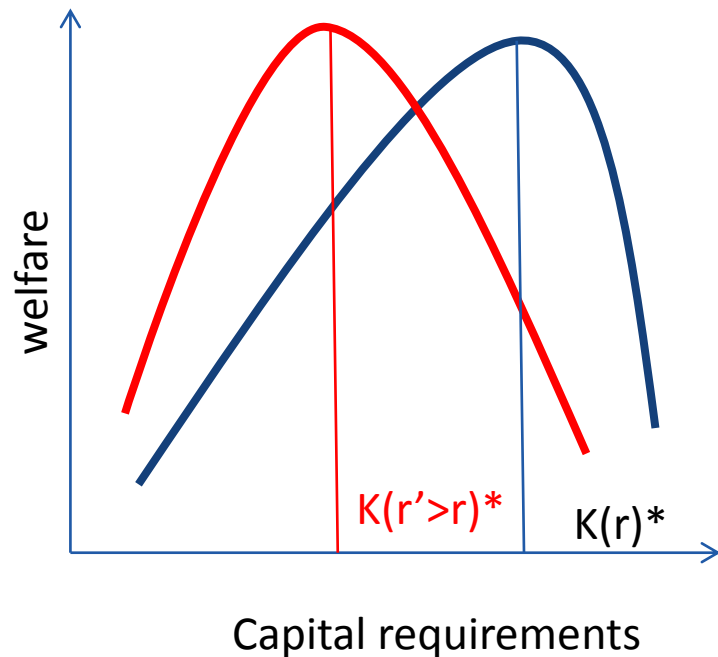
We were able to increase K without reaching the « dangerous » zone.

Loosening of monetary policy creates a space that should/could be occupied by more macroprudential buffers

POLICY REMARKS

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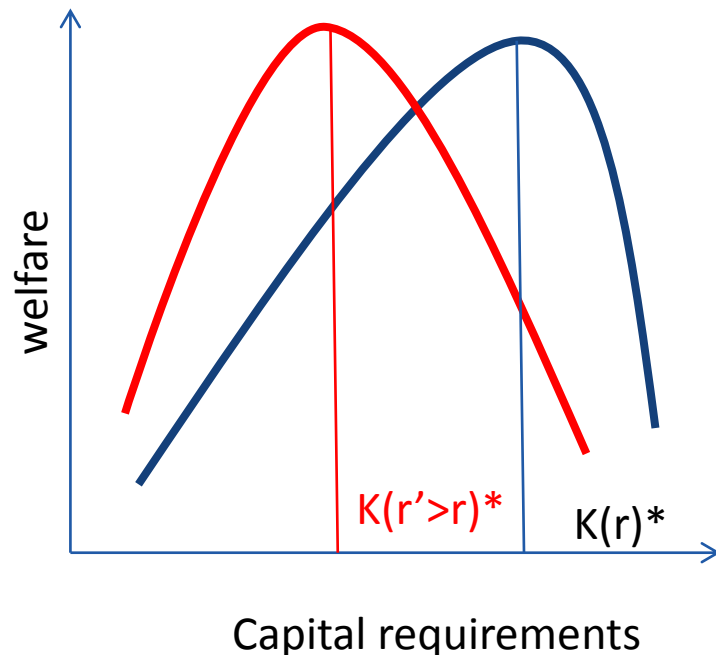
- What's happening if we see a reversal of the cost of funding?



POLICY REMARKS

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- What's happening if we see a reversal of the cost of funding?

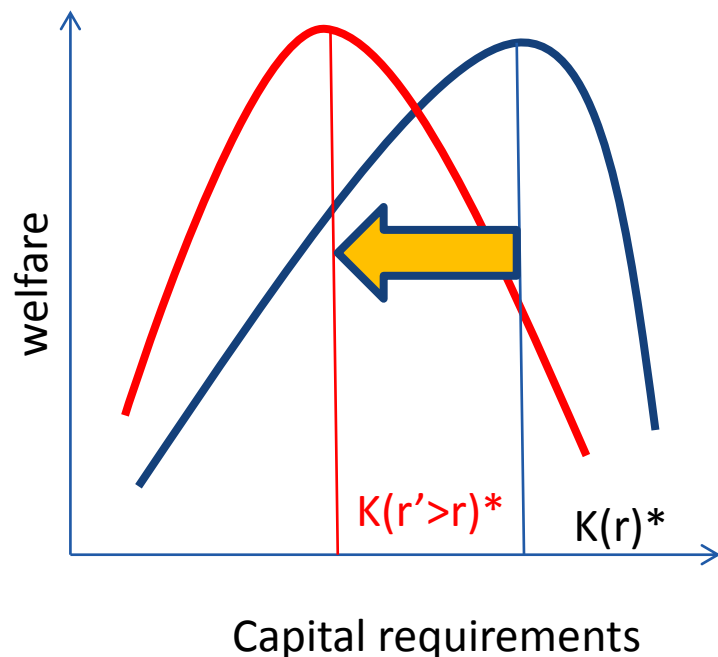


Observation 2:
Higher cost of funding may lower K^* such that
MaP authorities should be able to release the
macroprudential buffers

POLICY REMARKS

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- What's happening with the reversal of the cost of funding?



Observation 2:

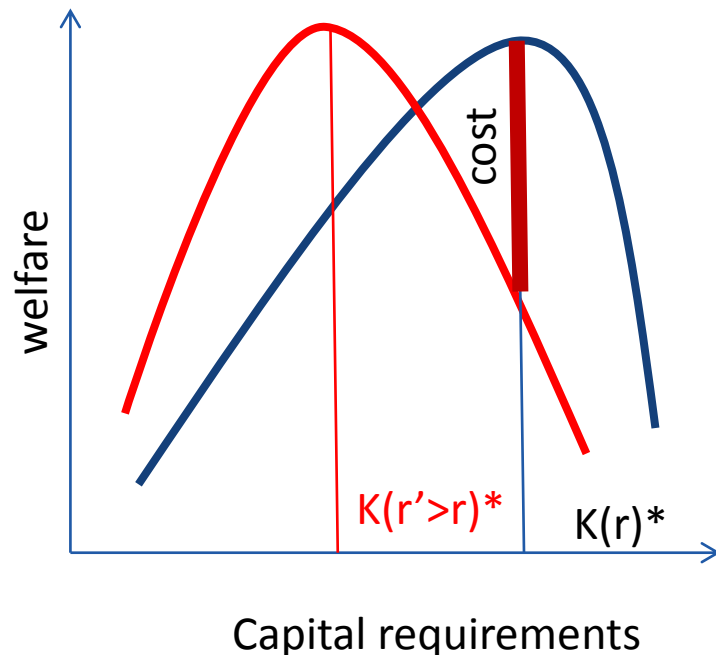
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BUT is the « share of releasable buffers » high enough? NO

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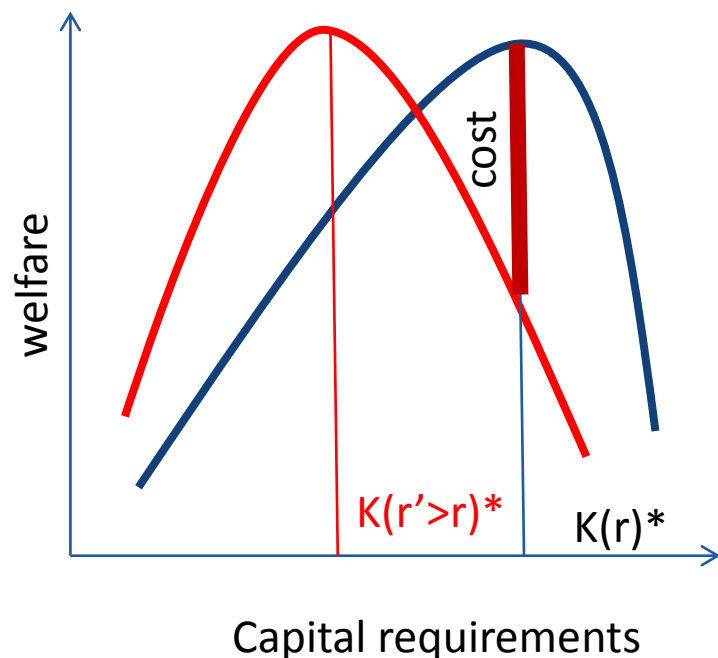
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Observation 3:

By filling this Macropru gap with structural buffers, we increase the **expected cost** of the NEXT shock in bank funding

Conclusion:

Free lunch? So far yes... but tomorrow a diet will not be enough!

Are structural buffers the best to fill-in the MaP gap? Potentially not

■ Model discussion

- Details needed on the calibrations of the opportunity cost?
- What about compensating factors?
- Why so little elasticity between lending spread and the macroeconomy

■ Policy discussion

- Should we really believe that increases in capital are free lunch? (whatever says econometrics 😊)
- Are structural buffers the best tools right now? Are you ready to release it as a CCyB in case of risk reversal?