Discussion of

The Macroeconomic Effects of Bank Capital Regulation

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Introduction

- Empirical analysis of effects of bank capital requirements

  → Focusing on macro variables

  → Creating new **qualitative** indicator of cap req

- Data from US 1980-2009 (monthly obs.)

  → Local projection regressions (Jorda, 2005)

- Main message(s)

  → Tighter CR result in lower credit only short term

  → Tighter CR result in lower economic activity in short term

  → Taking into account anticipation matters

Overall view

- Interesting paper with interesting and useful facts

  → I like the “macro” focus of the paper

  → Important to understand short and long run effects

- Two types of comments

  → Regarding the index

  → Regarding the facts

Capital Req in Macro models

- Two main assumptions

  → Capital (equity) is costly to raise externally

    → But not so costly to accumulate via retained earnings

  → Bank lending is relevant for production (no perfect subst)

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  → Reduction in loans to comply (recall E is fixed in ST)

  → Less loans lead to less production (employment etc)

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  - → Bank lending is relevant for production (no perfect subst)
- Tighter capital requirements (E/A)
  - → Reduction in loans to comply (recall E is fixed in ST)
  - → Less loans lead to less production (employment etc)
  - → Capital is accumulated internally E grows
  - → More loans are granted as constrained is less binding

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- Tighter capital requirements (E/A)

Short Term
- → Reduction in loans to comply (recall E is fixed in ST)
- → Less loans lead to less production (employment etc)

Long Term
- → Capital is accumulated internally E grows
- → More loans are granted as constrained is less binding

Capital Req in Macro models

- Prediction from those models

  → Negative ST impact of CR in the economy

  → Transitional period where impact is reduced

  → Lower impact in the LT (as equity is replenished)

  → **But what about new "steady state" in LT?**

    → This paper helps answering this question

- Please remember

  → Equity must be costly to raise in the short run

  → But not (so) costly to accumulate through retained earnings

Narrative Index

- The index builds on 6 (8) events

Change	Proposed rule	Final rule	Effective date
num. CRs	Jun. 23, 1981	Jun. 23, 1981	Dec. 17, 1981
ILSA	Mar. 7, 1983	Apr. 21, 1983	Nov. 30, 1983
com. CRs	Jul. 20, 1984	Mar. 19, 1985	Apr. 18, 1985
Basel I	Mar. 27, 1986	Jan. 18, 1989	Dec. 31, 1990
FDICIA	Mar. 5, 1991	Aug. 2, 1991	Dec. 19, 1991
PCA	Jul. 7, 1992	Sep. 29, 1992	Dec. 19, 1992

- Are all of this events equally important?

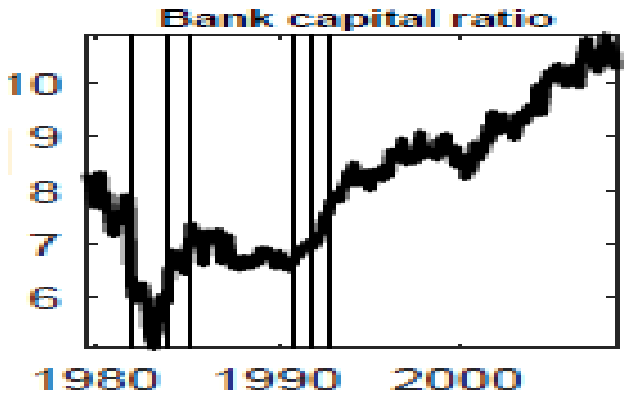
  → From 6 months (num. CRs) to 4 years

  → Do they all propose similar increase in cap ratios?

  → Some quantification of how binding each was could help

Narrative Index – binding regulations?

- Where all this events equally important/binding?



- Could it be that the first event(s) where not binding/relaxation?

  → Some comment/quantification would help

  → Not clear to me that the first (and third) had same effects…

  → … But this is only "eyeballnometrics"

Narrative Index – exogenous?

- We care about what regulators say or when & how they act?

	Change	Proposed rule	Final rule	Effective date	
	num. CRs	Jun. 23, 1981	Jun. 23, 1981	Dec. 17, 1981	→ 81/82 Recesion
	ILSA	Mar. 7, 1983	Apr. 21, 1983	Nov. 30, 1983	
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S&L Crisis	Basel I	Mar. 27, 1986	Jan. 18, 1989	Dec. 31, 1990	→ 90/91 Recesion
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- I understand we don't have random experiments

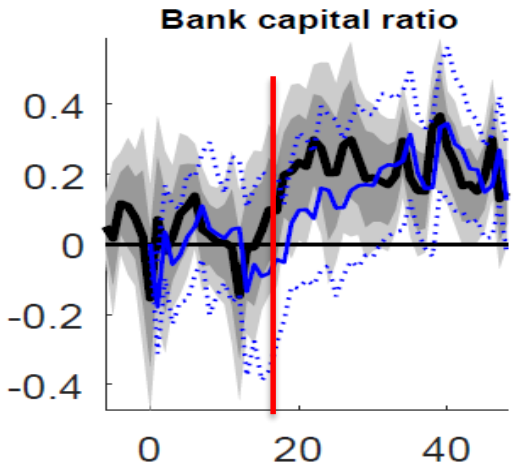
  → The paper runs a regression but … still not fully convinced

  → Could they help me out a bit?

  → On top of this we have branch deregulation (post 1985)

Effects of CRI on Equity ratio

- Why is the results on E/A lagged?



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  → Why? are they using their buffers?

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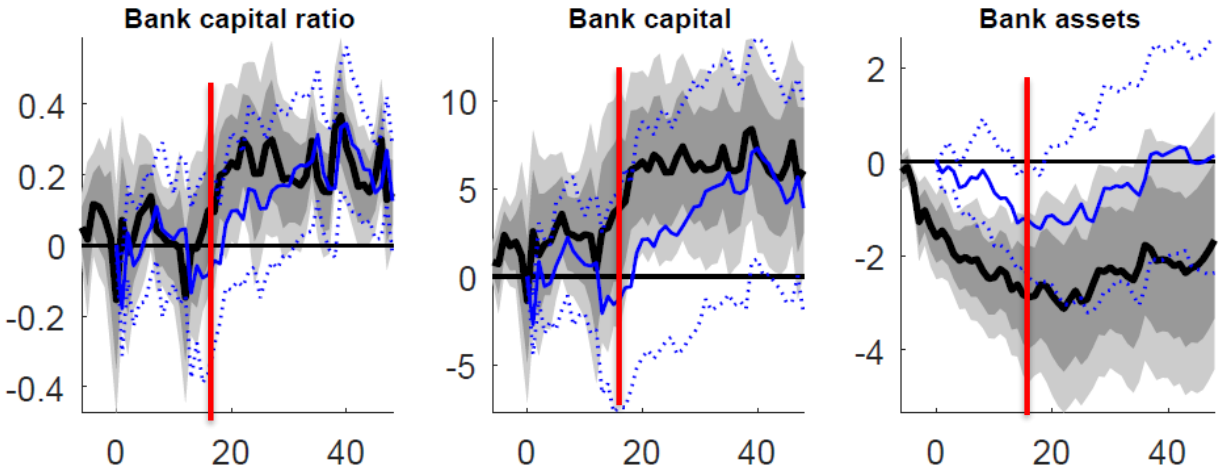


- Takes around 1.5 to 2 years to see an effect

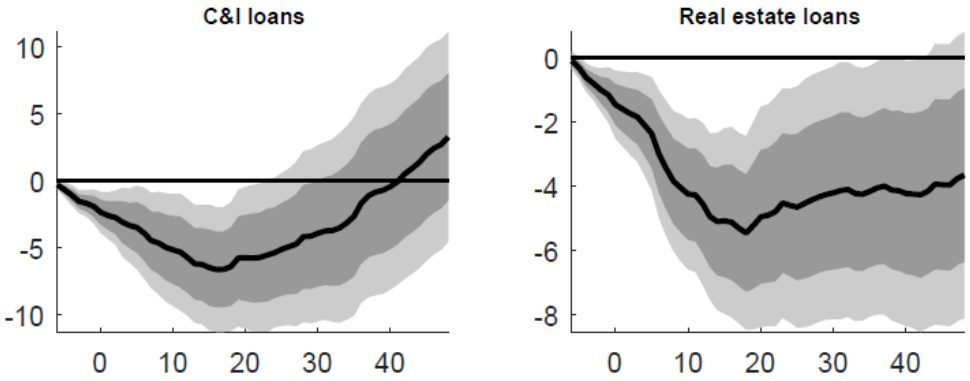
  → Why? are they using their buffers?

  → Assets react downwards + Equity does not diminish

  → What am I missing? (Accounting of loses?)

Effects of CRI on types of loans (risk)

- C&I loans recover but Real state loans do not recover



- The paper argues that it is because of lower risk taking

Effects of CRI on types of loans (risk)

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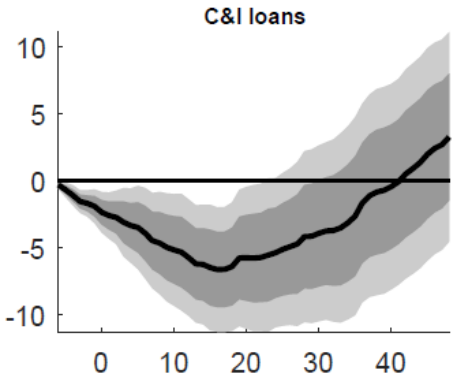
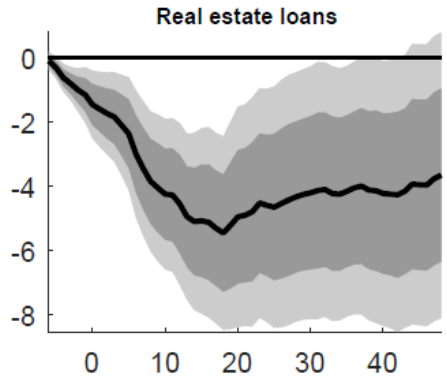
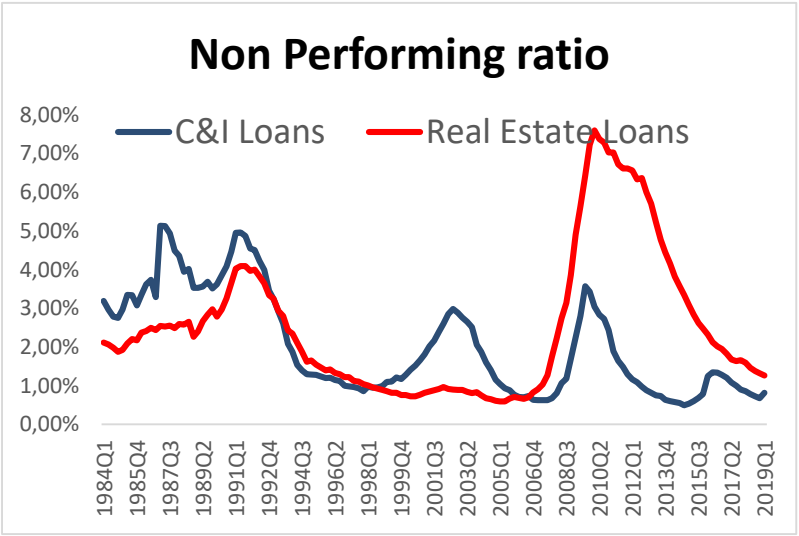






- The paper argues that it is because of lower risk taking

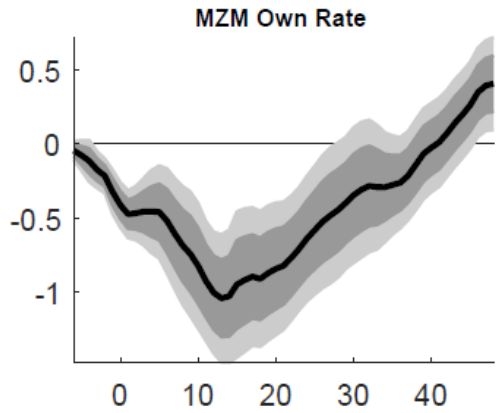
→ But NPL of Real estate loans where lower in that period

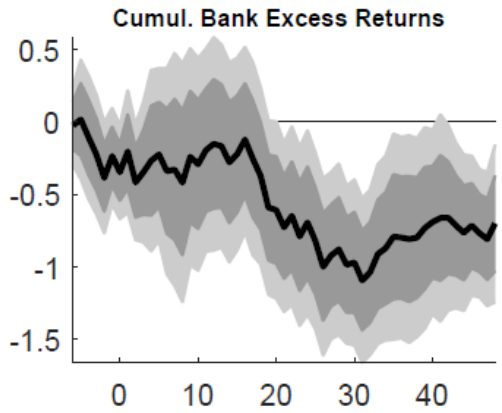
→ What is happening? Why don't RE and Assets recover?

→ For risk … can they run NPL (quarterly) regressions?

Effects of CRI on cost of funding

- Lower cost of debt and lower cost of equity





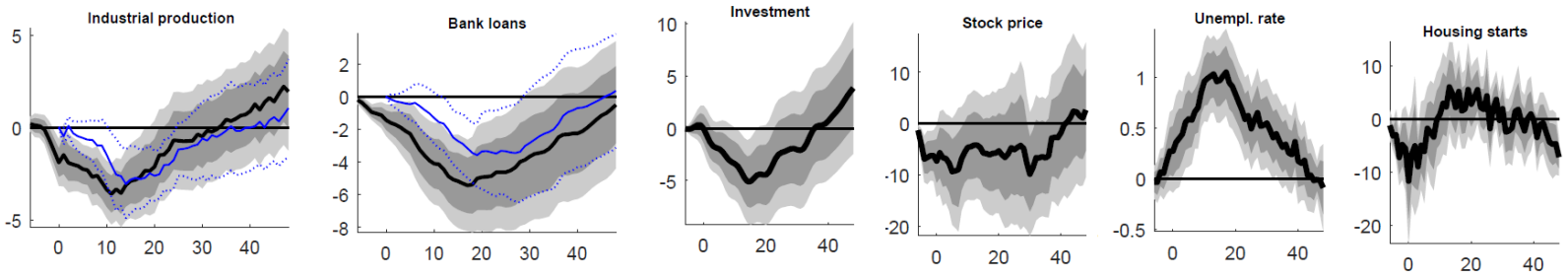
- But leverage (E/A) also chages (MM) (Back of envelope?)

$$WACC = r_d \frac{D}{A} + r_e \frac{E}{A}$$

- Should we worry about LT debt cost increasing?

Effects of CRI on bank size

- Only ST effects on multiple relevant variables



- But loans / industrial production or loans/ investment decrease

  → Transition out of bank funding? Looks like its good

  → Bank loans / total funding?

  → Where is this extra funding coming from?

Effects of CRI on housing related variables

- Only LT effects on housing related variables + Bank assets

- Where regulations aimed at real state loans? (Less profitable?)

  → Looks like lower house prices reduce consumption

  → But this should be true only for house owners no?

  → Any evidence on this effects? Maybe not for this paper…

  → What bank assets are being reduced? Banks shrink

Conclusion

- Interesting paper with relevant facts

  → Improve exogeneity and “quantitative” of Index

  → Clarify some of the facts

  → What is happening 18 months after?

- Looking forward to the next version