



INSTITUTE OF
INTERNATIONAL
FINANCE

Reza Siregar

Institute of
International Finance

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Singapore

Discussant on:
“Destabilizing effects of
bank overleveraging on
real activity – an
analysis based on
threshold MCS-GVAR”

Objectives

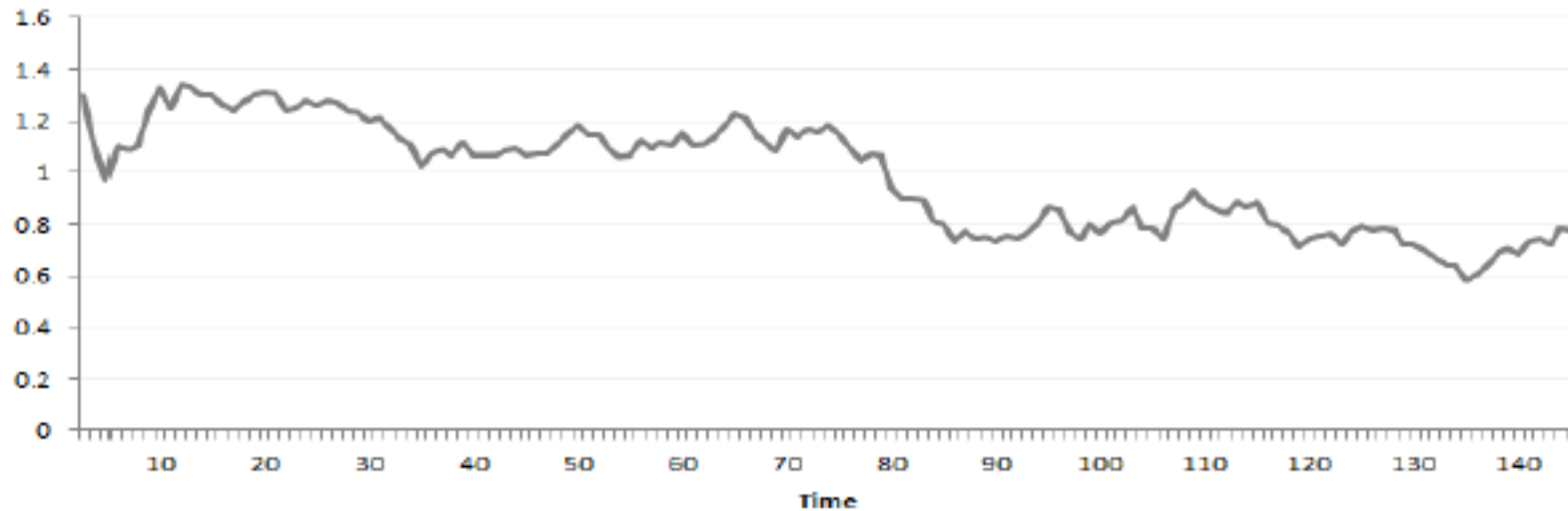
- Investigate the consequences of overleveraging and the potential for destabilizing effects from financial and real-sector interaction.
- Develop and empirically test how a highly leveraged banking system can lead to unstable dynamics and downward spirals
- Observations covering 40 banks of 14 banking systems of the EU-28 countries for the period of 1995:q1 – 2014:q4
- Key findings:
 - Leveraging state matters
 - Deleveraging strategy also matters

Theoretical and Empirical Approaches

- Extending the theoretical framework of Brunnermeier and Sannikov (2014) and Stein (2012), but this study applies a discrete time framework rather than the continuous time model. The finite time approach is a more realistic approach in capturing the deleveraging shocks.
- Overleveraging is defined as a positive gap between borrower's actual debt level and its debt capacity.
- Use the overleveraging variable as a transition variable in a Threshold Mixed-Cross Section GVAR.
- *The regime component aims to make the relationship between credit and real activity dependent on the extent to which the banking system is overleveraged.*

Comment: Banks tend to be slow to react. Does the period matter for path of optimal leverage?

Figure 2: Regime change in interest rates and shift in optimal leverage $1 + f_t$: upper line, up to period 73, leveraging for interest rate=0.02; lower line, from period 73, leveraging for interest rate 0.12



Comment (2): Measuring the overleveraging

- Total debt is measured by long-term debt, excluding the short-term debt
- The asset price is assumed to grow at a trend r and there is a deviation from the trend, y .

Comment (3): Banking systems

- Characteristics/categories of 14 banking system?
- How much does the type of banking system influence the impacts of the deleveraging shocks (Types 1 – 3)?

Comment (4): Cross-border exposures

- Cross border spill-over effects appear to be more pronounced when the capital ratio shocks hit the banking system during a period of overleveraging

Countries — Countries (W^{C-C}): A measure of *bilateral trade*

Banking systems — Countries (W^{B-C}):

Banking systems — Banking systems (W^{B-B})

- Weight of exposures: instead of cross-border loan exposure, we may want to consider (cross-border loans/domestic GDP)
- How about combining those exposures, such as bilateral trade and cross-border exposures?
- Are the impacts of the shocks sensitive to the types of exposure weight?

Comments (5): Final thoughts

- Does the origin of the leveraging matter?
- Does the size of the overleveraging matter?
- Does the duration of the overleveraging matter?
- On policy: the use of countercyclical capital buffer or the QE measure, have there been effective in managing the impacts of deleveraging?