

Prudential policies and their impact on credit in the US

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Part I: stress tests

Tested banks' market shares of Jumbo mortgage

Table 4: State-level regressions of CCAR banks' jumbo loan origination shares on stress test episodes

	(1)	(2)	(3)	(4)
	1 quarter	2 quarters	3 quarters	4 quarters
SCAP 2009	0.905 (0.356)	2.908 (1.208)	4.816*** (2.997)	2.020 (0.705)
CCAR 2011	-4.874*** (-4.029)	-4.163*** (-2.809)	-3.372** (-2.111)	-4.392 (-1.556)
CCAR 2012	-0.880 (-0.741)	-0.609 (-0.439)	-0.192 (-0.145)	-3.319 (-1.217)
CCAR 2013	-1.230* (-1.819)	-0.576 (-0.531)	1.115 (0.704)	-2.951 (-0.713)
CCAR 2014	-0.095 (-0.094)	0.748 (0.509)	1.370 (1.541)	-3.940 (-0.753)
Growth in house prices	0.278* (1.692)	0.239 (1.261)	0.162 (1.300)	0.123 (0.574)
Unemployment rate	-1.186 (-1.316)	-1.221 (-1.369)	-1.530** (-2.449)	-2.027** (-2.506)
Growth in per capita GSP	-0.093 (-0.367)	0.017 (0.065)	0.143 (0.669)	-0.050 (-0.190)
Num. of observations	1200	1200	1200	1200
R-squared	0.78	0.79	0.79	0.78

Part I: stress tests (2)

- Plausible interpretation
 - ∨ CCAR 2011 caused a contraction in Jumbo mortgage
 - ∨ But why no effect for other stress tests?
- What is the right counterfactual?
- Are stress-tests comparable?
 - ∨ Scenario stringency
 - Current + future
 - Adjustment to Basel III
 - ∨ Market conditions (control group is quite different)

Part I: stress tests (3)

- Does it work in theory?
- Formalisation
 - ∨ What is it that we should expect?
 - ∨ Does a more stringent stress test decrease lending?
- Think of a stress test has a change in capital requirements
 - ∨ If regulator unhappy with capital position (and path)
 - ∨ Restrictions on future actions
 - Raise more capital (or cut dividend)
 - And/or cut lending

Part I: stress tests (4)

- Does an increase in requirements decrease lending?
- Bahaj et al. (2016)
 - ∨ It depends
 - ∨ Interaction between debt overhang and risk-shifting incentives
 - ∨ Three effects
 - Composition
 - Price
 - Internalisation
- Can the price effect dominate?
 - ∨ Economic conditions matter, initial requirement, etc.

Part I: stress tests (5)

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Part I: stress tests (6)

- Some, inconclusive effects in other years
 - ∨ For instance: reversed sign in 2012
 - ∨ Could reflect extent of balance sheet cleaning
 - ∨ Note that effect between groups could be masked by averaging positives and negatives.
- Final comment
 - ∨ Is it really the goal to curb lending?

Part II: Leveraged loans (1)

- Share of leveraged in bank syndicated loan portfolio
 - ✓ Went down after FAQ (looks permanent)
 - ✓ Went up after IGLL (but only for 1 quarter)

Table 12: Regressions of speculative-grade syndicated loan originations for most active lenders

	(1) 1 quarter	(2) 2 quarters	(3) 3 quarters	(4) 4 quarters
Bank × IGLL	22.981*** (3.566)	3.015 (0.364)	-9.116 (-1.516)	-6.921 (-1.162)
Nonbank × IGLL	2.971 (0.759)	3.587 (0.910)	7.392 (1.052)	13.557* (2.052)
Bank × FAQ	-15.476*** (-3.305)	-21.049*** (-3.668)	-19.528*** (-2.869)	-36.543*** (-4.335)
Nonbank × FAQ	3.236 (0.813)	3.427 (0.686)	2.968 (0.926)	-0.500 (-0.085)

Part II: Leveraged loans (2)

- Plausible interpretation
 - ∨ FAQ caused a decreasing for banks
 - Don't want to upset the regulator
 - Need to clarify difference between US and foreign
 - ∨ (In my view): IGLL triggered a correction
 - ∨ Identification
 - What determines the portfolio share?
 - Relationship lending versus OTD
- Macro-prudential considerations
 - ∨ What is the goal?
 - ∨ Pipeline risk: 2015 Q4, the market dries up

Conclusion

- Very interesting paper
- Identification is tricky
- Recent theory advances may be useful in framing the tests and interpreting the results

Thank you very much