Discussion by Catherine Casanova (BIS)

Xiaoming Li, Zheng Liu, Yuchao Peng, and Zhiwei Xu:

"Bank risk-taking and monetary policy transmission: evidence from China"

ABFER, June 2, 2021

The views expressed in this presentation are those of the discussant and not necessarily those of the Bank for International Settlements.

Research Question

What is the effect of Basel III regulation on bank risk taking, also in response to MP shocks?

Approach

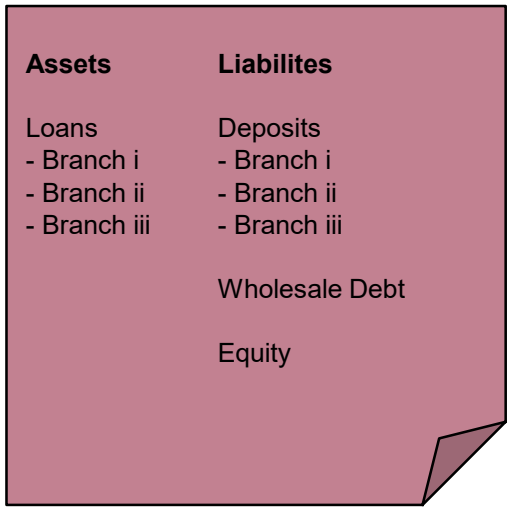
- Based on a theoretical model: bank optimize portfolio, subject to CAR constraint
- Data on branches of ***one*** Chinese bank, 2008Q1-2017Q4
- Firm data: SOE (0/1)
- 400'000 unique firm-branch pairs

Findings

- Yes, there is an effect on risk taking.

My Overall Impression

- Very nice paper
- Based on
  - theoretical model
  - on microdata
- Highly relevant, inform policy discussions.



But, some comments on

- Branches are not independent!
- Assets and liabilities are disconnected

⇒ Identification?

⇒ Regulation and monetary policy have an impact at the consolidated level.

Linking theory and empirical evidence

Assets and liabilities seem disconnected

«A bank can boost it's effective CAR by either raising its capitalization level or by reducing loan risks.»

- Not possible here. The liability side is fixed.
- If you looked at *individual* banks, their «riskiness» is based on assets and liabilities (eg by choosing higher buffers).

Risk-weighting sensitivity

«sensitivity of risk-weighted assets to loan risks …captures the regulations on risk-weighting»

- Should be the same across all branches.

Measures of risk

*«We measure **branch-specific risks** by the share of NPL before the Basel III regulations were put in place.»*

*«we measure **loan risks** by a dummy variable that equals one if the loan is extended to an SOE.»*

- Rollovers? New loans?
- Are all SOEs riskless? All loans are the same? How about collateral?

Findings

I. *High risk* branches *reduced* risk-taking relative to low-risk branches by increasing the share of lending to SOEs.
Decline in risk-taking on average, and during MP expansions.
   - Share of lending or using a dummy?

II. Decline in bank risk-taking driven by changes in the *sensitivity* to risk weighting, not by changes in capitalization.
   - Capitalization can only happen at the aggregate level.
   - Risk weights under IRB are at the bank level. So taking the entire bank ptf into account?

III. Expansionary MP post-2013 leads to a significant *reduction* in loan rates to SOEs by high-risk branches, but to an *increase* to non-SOEs
   - High-risk and low-risk branches are not independent. Parent might set targets, not each firm can ask for a loan at each branch.

IV. At the province level, a positive MP shock significantly reduces productivity after regulation is in place.

Other issues

- CAR as the **only** binding constraint? Liquidity regulation?
- **Entry** and **exit** of firms and branches => selection bias?
- **Announcement** in June 2012, implemented in 2013.
- How many firms with **multiple** branch relationships do you have? Typically branches in **neighbouring** areas?
- Literature is well explained at the beginning. But then, not picked up later.
- Language: banks vs branches; firm-loan vs firm-branch relationships.

Conclusions

What is the effect of Basel III regulation on bank risk taking, also in response to MP shocks?

Findings

- Yes, there is an effect on risk taking.

Nice paper with theoretical model and microdata evidence.

But, some comments on

- Branches are not independent!
- Assets and liabilities are disconnected

⇒ Identification?

⇒ Regulation and monetary policy have an impact at the consolidated level.

Thank you

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