Inflation and Disintermediation

Discussion by Yannick Timmer

Bank of Canada MacroFinance Conference

May 18, 2021

[1]Disclaimer: The views expressed in the paper are solely those of the authors and do not necessarily represent the views of the IMF, its Executive Board, or its Management

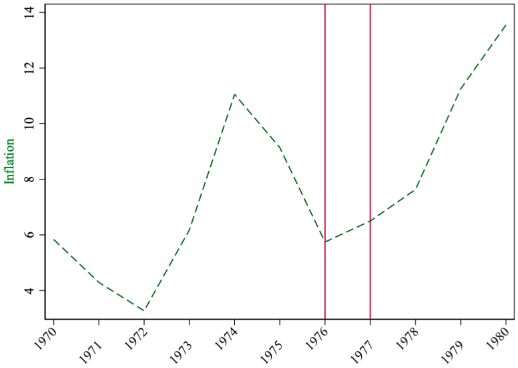
Summary

- Paper studies effect of inflation on bank-lending
- Uses cross-country panel and US bank-level data
- Inflation can lead to reduction in lending
- Banks have non-inflation protected assets (Reserves) $\Rightarrow$ Rise in inflation hurts banks $\Rightarrow$ Reduction in Lending
- Reallocation Channel
  - Banks reduce long-term loans (such as fixed-rate mortgages) which are more exposed to inflation
  - Increase corporate loans as lower maturity and therefore less inflation exposure

Identification

- Bank-lending and inflation can be related in many ways
- Cross-country panel regressions have their obvious problems
    - For example Crisis $\Rightarrow$ Depreciation $\Rightarrow$ Inflation
- Main identification strategy: Bank-level exposure to inflation in 1977
    - Instrumented by reserve requirements
    - Higher reserve requirements $\Rightarrow$ Higher exposure to inflation

Inflation during the 1970



- Several reasons why 1977 inflation, which was driven by an increase in energy prices that spilled over to other prices
  - One-time increase, after which inflation plateaued for the following year
  - No long-term interest rate movement

Issues with 1977 as Event study

- Large inflation before
  - Treated banks already treated before ⇒ Reallocation
    - Probably parallel-trend assumption does not hold: show graph
- Short-term rates went up ⇒ Flattening yield curve ⇒ Inflation exposed banks were investing short-run? Rates
- Why not panel regressions with a "high inflation" dummy? Table A9 goes in the direction ⇒ For US instrument with state-level reserve requirements (and their changes)
- Only IV estimate is shown: Show reduced-form. IV is on weak side ⇒ Blows up coefficient?

Reallocation Channel

- Banks reallocate from high inflation exposure assets to low inflation exposure
- $\Rightarrow$ If one-time increase in inflation, why reallocate?
- Reallocation channel more consistent with increase in inflation expectations and not with inflation itself?
- If inflation expectations were going up, why did interest rates not?
- Use increases in inflation expectations instead of realized inflation? $\Rightarrow$ better tell apart channels

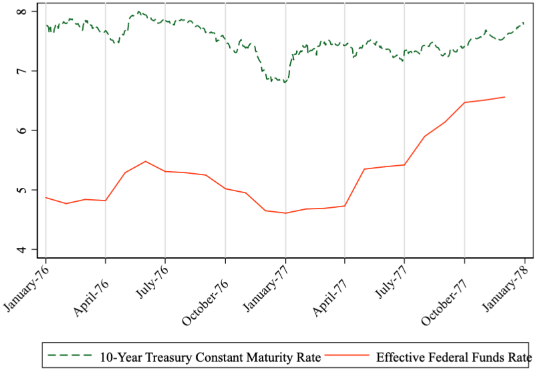
Minor Comments

- Disentangle credit demand and credit supply?
  - Can you get more disaggregated lending data? Syndicated loan data? Control for credit demand? Only outside-state lending?
- Differentiate exposure to interest rates and inflation (control for exposure to interest rates)
  - Inflation exposure “negatively" correlated with interest rate exposure
  - Lower bound estimate?
  - Medium-run higher inflation and higher interest rates benefits banks
- Can you look at bank-level stock prices? ⇒ Wealth channel
- Describe measure of mismatch earlier in the intro
- Within each loan category a lot of heterogeneity in terms of inflation exposure, e.g. fixed vs. floating rate mortgages, especially across countries
- Securities are classified as low inflation exposure
  - Banks mainly hold debt securities that are not inflation protected
- What about deflation? Asymmetry?
- Equation (3) and (4) should not have a s index

Conclusion

- A lot of empirical evidence showing higher inflation can reduce credit supply
- I'm overall convinced
  - But 1977 event study (main empirical strategy?) not entirely convincing
- I really really like the paper!
- Highlights an additional cost of inflation!
- Super relevant, especially these days
  - Conclusion mentions emerging markets, but now for US *super* relevant
- Highly recommend reading!
- Potential to become extremely impactful paper

Interest Rates



Back