Discussion of “Global Banks and International Business Cycles” by Enders, Kollman and Müller

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The usual disclaimer applies
Under which circumstances country-specific events (increase in loan defaults) can trigger a sharp and highly synchronized international downturn?
When “financial” shocks are large, although not necessarily synchronized, and when it is costly to adjust bank capital.
The model

Symmetric two country-one good RBC model (BKK type) with:

- a “global” bank (varying capital is costly)
- a representative households
- a representative entrepreneur
Comments

1. Correlation among default rates and TFP shocks
2. Adjustment costs for bank capital
3. Other sources of synchronization in recent financial crisis
4. Other comments
Correlation among default rates and TFP shocks

\[
\begin{bmatrix}
\theta_t \\
\theta_t^* \\
\delta_t \\
\delta_t^*
\end{bmatrix} = 
\begin{bmatrix}
\rho_\theta & 0 & 0 & 0 \\
0 & \rho_\theta & 0 & 0 \\
0 & 0 & \rho_\delta & 0 \\
0 & 0 & 0 & \rho_\delta
\end{bmatrix}
\begin{bmatrix}
\theta_{t-1} \\
\theta_{t-1}^* \\
\delta_{t-1} \\
\delta_{t-1}^*
\end{bmatrix} + \text{Chol} 
\begin{bmatrix}
1 & 0.82 & -0.63 & -0.63 \\
0.82 & 1 & -0.63 & -0.63 \\
-0.63 & -0.63 & 1 & 0.76 \\
-0.63 & -0.63 & 0.76 & 1
\end{bmatrix}
\begin{bmatrix}
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How are IRFs and moments affected by cross-correlations of innovations? Is this structure really needed? Not clear how exercises are conducted. Needs be clarified in text
Adjustment costs for bank capital

- Link between costs related to bank capital and spreads

\[ R^L_{t+1} - R^D_{t+1} = mc_t - \gamma \phi' \left[ L^W_{t+1} (1 - \gamma) - D^W_{t+1} \right] \]

- Same idea in GNSS (2010)

\[ R^b_t - r_t = -\phi_{Kb} \left( \frac{K^b_t}{L_t} - \nu \right) \left( \frac{K^b_t}{L_t} \right)^2 \]

- Symmetric/asymmetric costs. How realistic is it?
Costs related to your bank's capital position

Bank's margin on average loans
Other sources of synchronization

- Oil, and more generally, commodity prices, may have played an important role in 2008 recession
Both Hamilton and Kilian agree that oil shocks have played an important role in the 2008 recession.

From Lutz Kilian’s comment on “Causes and Consequences of the Oil Shock of 2007-08” by James D. Hamilton.
From James D. Hamilton’s testimony before the Joint Economic Committee of the United States Congress on May 20, 2009

Both Hamilton and Kilian agree that oil shocks have played an important role in the 2008 recession.
Other sources of synchronization

• Oil, and more generally, commodity prices, may have played an important role in 2008 recession
• Part of synchronization of downturn may be caused by oil shock
• In this sense, positive correlation between TFP innovations captures the global dimension of 2008 oil price shock
Other comments

• Financial crisis started in sub-prime segment of residential mortgage market
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- Financial crisis started in sub-prime segment of residential mortgage market
Other comments (cont’d)

• Crucial role played by monetary policy…
• …both with conventional and unconventional measures
Other comments (cont’d)

• Right to say that model does not need collateral constraints or heterogeneity in discount factors (as in Iacoviello, 2005 and 2010)
• But it is crucial to assume that deposits provide liquidity services
• Otherwise model would not have a well-defined steady state for loans and deposits
• Crucial assumption is global dimension of bank: effective loan rates are equalized across countries.

• Size of adj. costs for bank capital is not crucial, as long as it is not exactly zero, in which case balance sheet does not matter.
To sum up

• Interesting paper, very simple model
• Too simple to capture complexity of 2008 financial crisis:
  – Funding liquidity and money markets tensions
  – Its origins in housing markets
  – Role of risk taking by financial institutions, poor risk management
  – Loose monetary policy between 2003-2005