Cross Border Banking and International Transmission of Financial Distress

Discussion by:

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Broad Questions

- Does bank distress reduce credit supply?
- Do small, risky firms suffer more in face of credit crunch?
- Does financial integration propogate shocks internationally?
- Do foreign banks cut lending more than domestic banks?

Specific questions

- Do SMEs report being more constrained if local banks are more distressed?
  - Paper removes banks reporting no need for a loan.
- Are effects larger when foreign banks have more market share?
- Do smaller and riskier firms report greater sensitivity to distress of local banks?

Identification

- Basic model:

  $Borrower\ Constrained_{i,j,k} = \beta^2 * Bank\ Capital_{j,k} + \ldots$

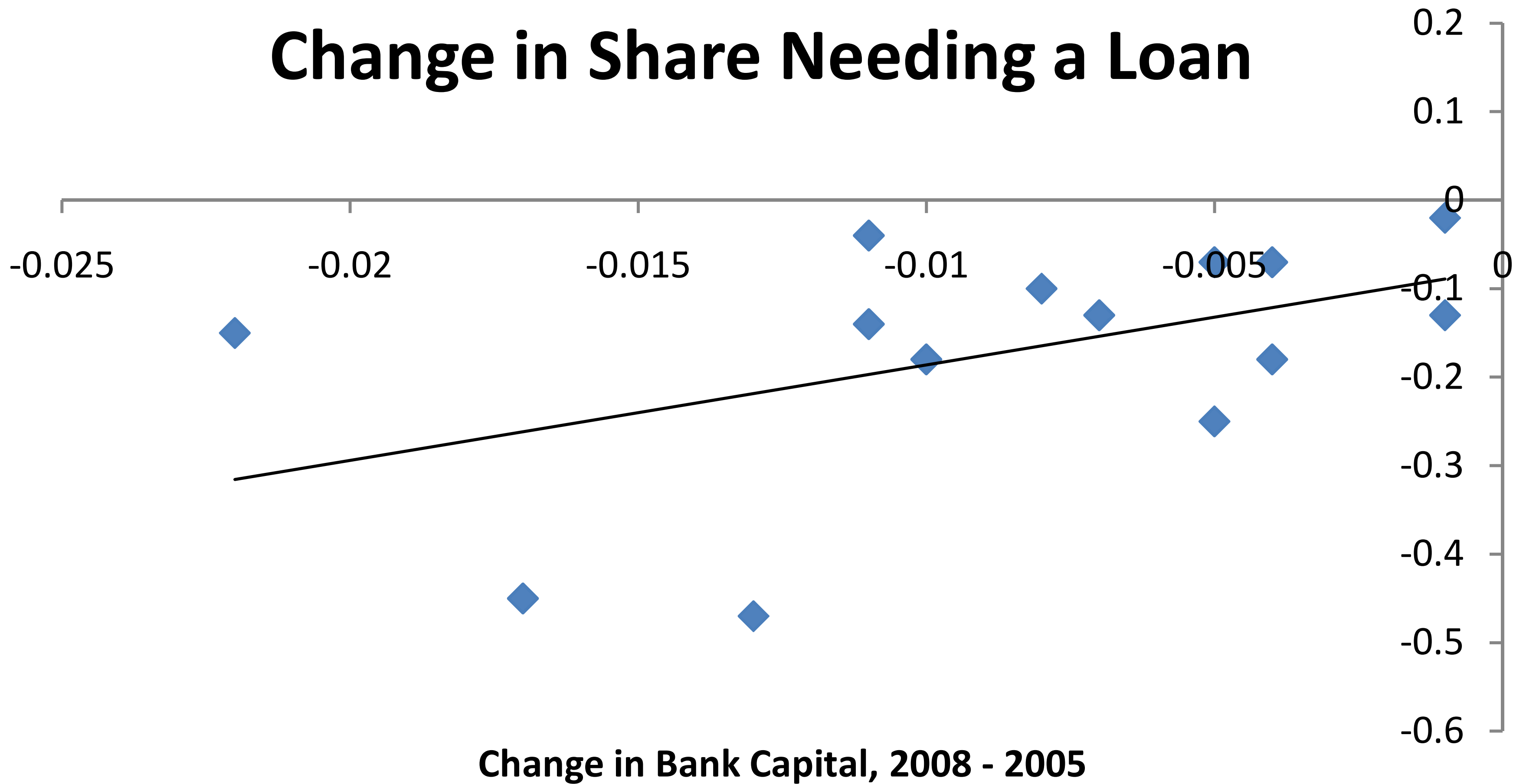
- What generates β^2 ?
  - Credit supply reduced when bank capital is low (desired effect)
  - Composition of credit demand may be weak where capital is impaired
  - Reverse causality: Bank capital may be low when borrowers are distressed

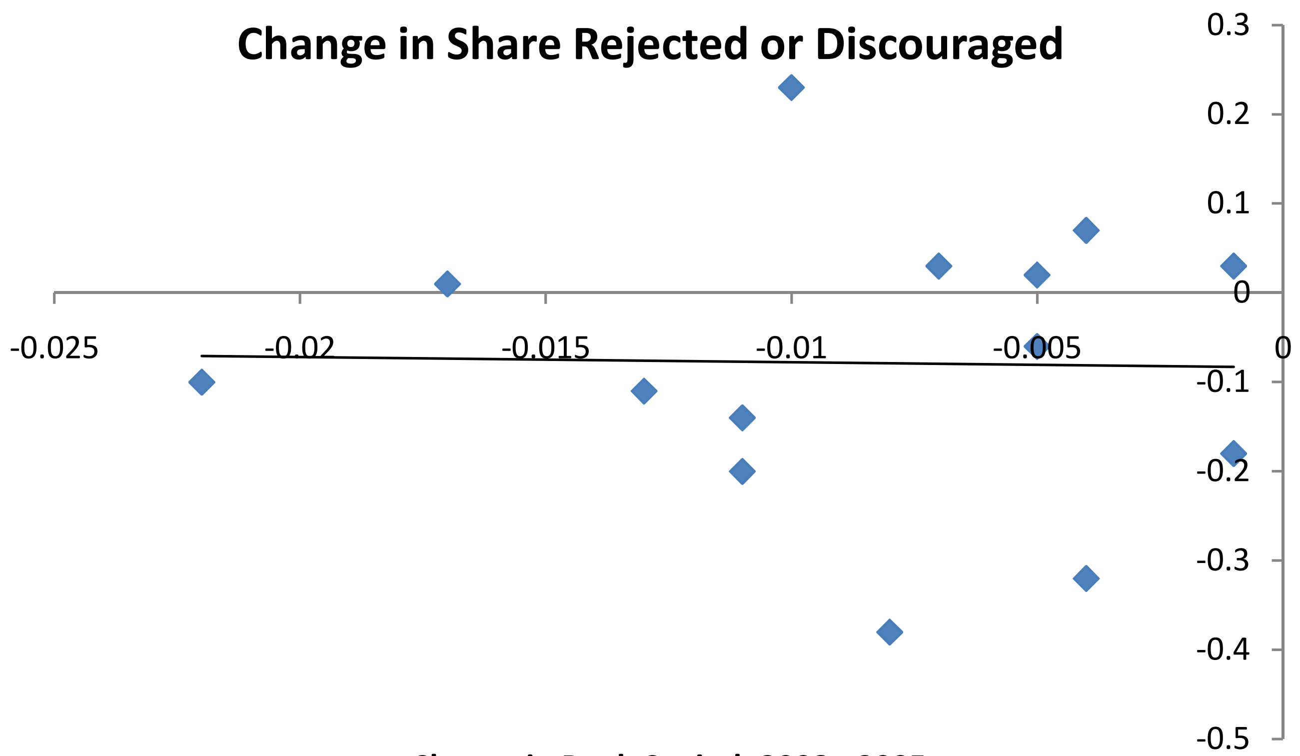
Identification

- Remove demand bias using Heckman style correction
  - What are the identifying instruments?
- Use of small countries with large foreign bank presence helps with reverse causality
  - But complicates tests of the impact of foreign banks…

What is being measured?

- Between 2005 to 2008 (Table 3)
  - Fraction reporting a need for credit falls by 17% on average, and it falls in all 14 countries
  - Fraction reporting being constrained FALLS by 7.9% (8 fell, 6 increased)
- Correlations (Table 3)
  - Change in capital v. Change in credit demand = 0.48
  - Change in capital v. change in share constrained = -0.02


Change in Share Needing a Loan
0.2
0.1
0
-0.1
-0.2
-0.3
-0.4
-0.5
-0.6
-0.025
-0.02
-0.015
-0.01
-0.005
0
Change in Bank Capital, 2008 - 2005


Change in Share Rejected or Discouraged
0.3
0.2
0.1
0
-0.1
-0.2
-0.3
-0.4
-0.5
-0.025
-0.02
-0.015
-0.01
-0.005
0
Change in Bank Capital, 2008 - 2005

Across v. within country

- All regressions are generated by within country variation
  - How local are banking market across small countries like Bulgaria, Slovenia, Slovakia, etc?
  - How much variation is left after removing the country effects?
  - Do standard errors account for within-country clustering?

Summary

- Paper emphasizes tradeoffs of financial integration
  - Benefits: more competition, more capital, faster growth
  - Costs: financial instability from abroad
- Empirical extensions
  - More analysis of demand
  - More details on nature of local banking is Eastern European economies