The Risk-Taking Channel of Monetary Policy: A New Approach and Evidence from Peru

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Summary

- How financial-firms exposure to risk changes with monetary policy (MP) movements? Evidence based on a novel granular dataset from Peru.
- Parts of the analysis:
  - Motivating aggregate evidence.
  - Motivating theoretical model.
  - Panel data evidence.
- Main results: after controlling for several fixed effects, loans granted by the same financial firm in more risky provinces are more elastic to policy-rate changes than those in less risky provinces. Robustness to several specifications and relevant covariates.
- Main comments:
  - Importance of defining "excessive risk taking" conceptually: analysis of the assumptions in the theoretical model.
  - Interpretation of empirical results: latent/ex-ante vs. realized/ex-post risk, non-linearities, cyclical behavior of latent risk and monetary policy.

Theoretical Model

- Risk taking not bad per-se, only if "excessive." Relative to what? Model approach: frictions+externalities vs. constrained efficient optimum.
- Key components in the model:
  - 2 periods, 2 lending opportunities that differ on their ex-ante riskiness.
  - Banks limited-liability (LL) + Deposit insurance (DI): together they imply banks do not care about situations in which they default on depositors.
  - Under **un**limited liability, or under LL but No DI, banks will consider these other state, improving welfare ex-ante.
- But not obvious that results are as general:
  - Even under LL and DI, if banks live for more than 2 periods their default decision is less trivial $\Rightarrow$ they will indeed care for those bad states.
  - Why is there DI in the model? If it is in place to improve welfare (for a reason not modeled), there will be a trade-off.
- Still, the empirical strategy implemented can only talk about changes in risk exposure, but not excessive risk exposure.

Empirical approach

- Is Non-Performing Loans a good measure of **ex-ante** risk?
- NPL-Branch is a time invariant variable, thus it is a province fixed effect (interacted with the interest rate). You are assigning these differences to risk, could the they be reflecting other province related reasons?
- If the risk-taking channel is a phenomenon of low interest rate scenarios, should the analysis differentiate between low and high interest rates **levels**? e.g. below or above natural rate.
- Besides MP, a pro-cyclical latent risk is expected for other reasons (e.g. entry and exit during the cycle). If MP is trying to smooth the cycle, how can we be sure that the estimated effect is due to MP? Suggestion: use the shock inferred from the SVAR as the regressor.
- What estimation technique is used to account for the endogeneity in a dynamic panel model?