

*Comment on Peydró, et al.*

# **Reach-for-Yield and Monetary Policy: Security and Credit Registers Evidence**

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*ECB workshop on non-standard monetary policy measures*

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# Outline

- Breadth of the conclusions drawn
- Specific comments on mechanics of exercise
- Broader comments on impact of (non-standard) monetary policy measures on financial stability

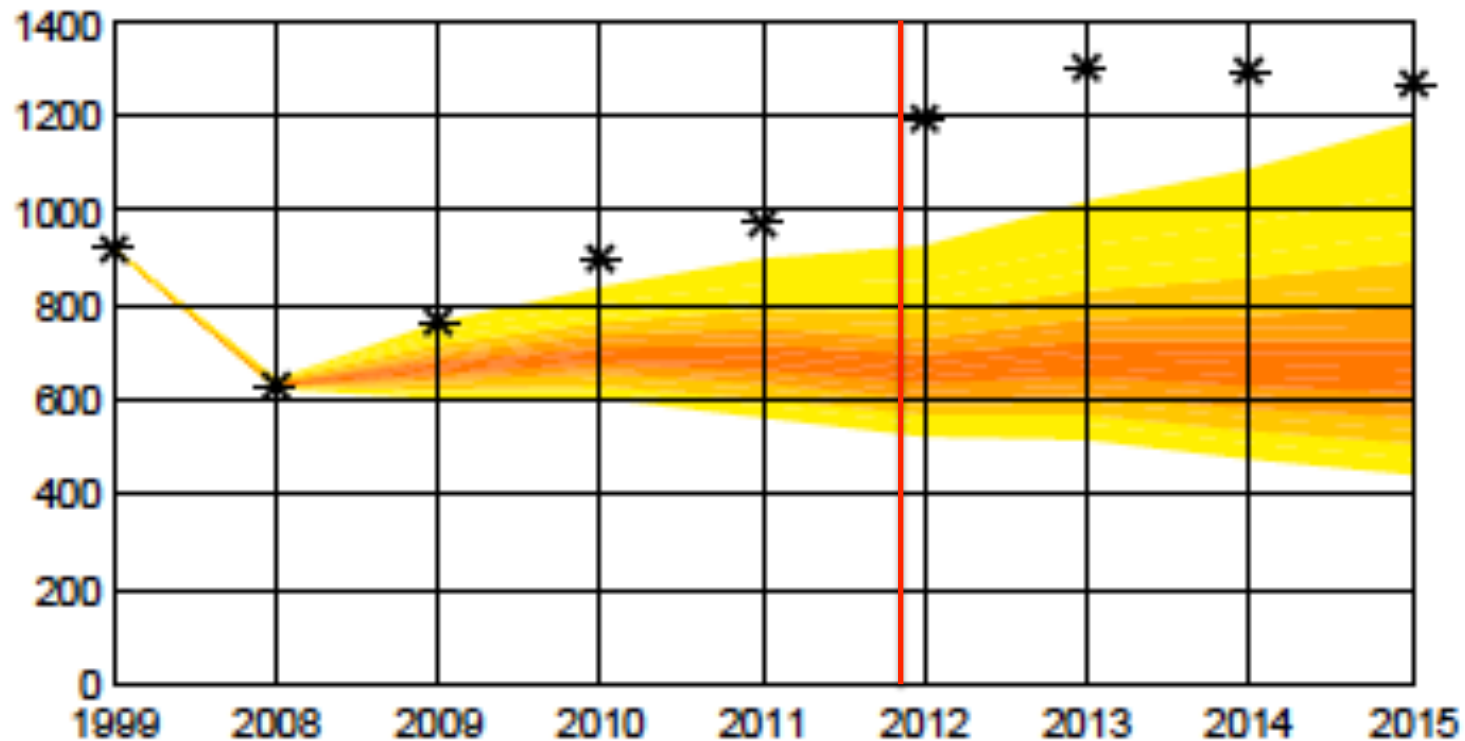
# V-LTRO episode

## 'Folk history'

- Concerns about bank funding and capital
- Sovereign market stress
- V-LTRO:
  - Provides funding at favourable rates
  - 'Sarkozy carry trade' – *V-LTRO funding used by peripheral banks to buy domestic sovereign debt*
    - Capital gains serve to recapitalise banks
    - Deepens market for sovereign debt

# Bank holdings of domestic sovereign debt

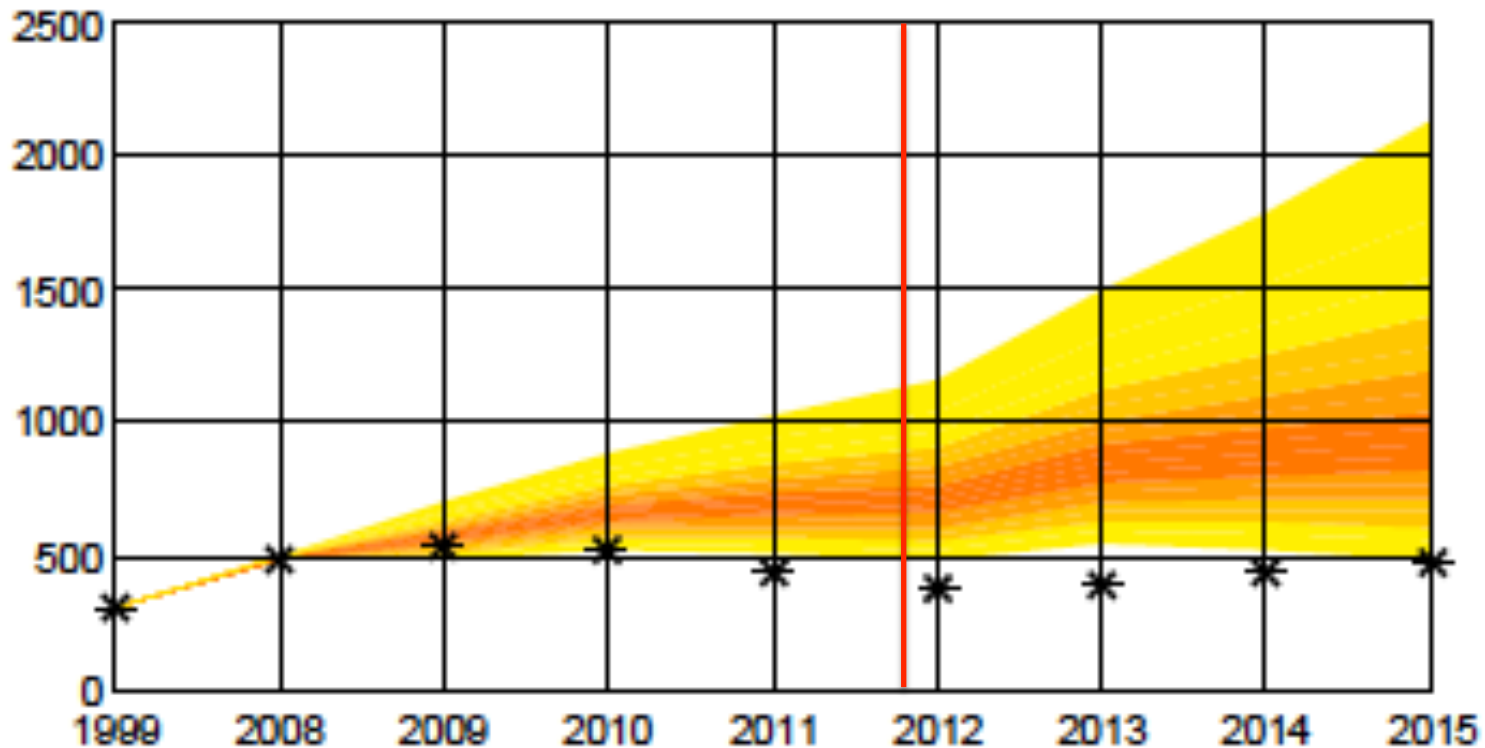
EUR mn



Source: Colangelo, A. et al. (2016).

# Bank holdings of other Euro area sovereign debt

EUR mn



Source: Colangelo, A. et al. (2016).

# Issue 1 – V-LTRO conclusion

*“Banks with higher risk-bearing capacity (larger capitalization) buy riskier securities. Risk-shifting or regulatory arbitrage do not appear to be important drivers of bank trading.”*

- Teufelskreis (‘diabolic loop’) between sovereign and bank risk is not really addressed in this exercise ...
- ... but this is the key issue in considering implications from risk-shifting / regulatory arbitrage considerations

# Mechanics of exercise

- Characterisation of risk

$$risk = (yield - EONIA)$$

- Distinguishing credit risk from interest rate risk  
(slope of yield curve)

# Mechanics of exercise

- Identification §1

Include control for ...

*security x time*

... so as to *control for time variant unobserved characteristics of individual securities* [so as to] *examine changes in holdings of the same security by different banks.*

- Makes sense for analysing bank loans, where idiosyncratic credit risk of loan is key ...
- ... but less clear cut for securities when portfolio considerations may dominate.



# Mechanics of exercise

- Identification §2

Monetary policy is exogenous because oriented to area-wide objectives rather than Italian objectives.

- For non-standard measures (e.g. V-LTRO), this is a more questionable assumption ...
- ... especially when (1) Balkanisation of Euro markets is taken into account; and (2) coincident country-specific measures (such as changes in collateral framework).

## Issue 2 – Securities ≠ Loans

- Are the (very convincing) methods developed for analysing loan supply decisions appropriate for analysis of bank securities holdings?
- By nature, biggest risk with loans is idiosyncratic credit risk (that is why we need banks to monitor, etc.) ...
- ... but with (tradable) securities portfolio considerations and systemic issues more likely to matter.

# Implications for financial stability

- Paper aims to inform debate on:
  - role financial stability considerations should play in monetary policy decisions;
  - how best to integrate macro-prudential and monetary policy frameworks.
- Recognises that not all monetary policy is the same.
  - Split sample, with different results in two sub-samples;
  - Different characterisation of monetary policy (Taylor rule residuals vs. balance sheet size).

# Balance sheet expansions

- Not all central bank balance sheet expansions are the same.
- Using central bank intermediation as a substitute for private intermediation when markets 'seize up':
  - euro area money market and FRFA;
  - euro area bank funding market and V-LTRO, etc.
- Using portfolio balance channels to transmit QE.
  - More expensive to hold safe assets (flat sovereign yield curve, negative rate on deposit facility);
  - Weighs on earnings of financial institutions (that are reluctant to shift into riskier assets); *and / or ...*
  - Pushes financial institutions into riskier assets through 'search-for-yield'

## Issue 3 – Risk and stability

- Both channels imply a similar positive relationship between size and central bank balance sheet and bank risk taking ...
- ... but arguably have different impact on financial stability.