

Discussion of
**“Monetary Policy, Inflation and Crises:
Evidence from History and Administrative Data”**
by G.Jiménez, D.Kuvshinov, J.L.Peydró and B.Richter

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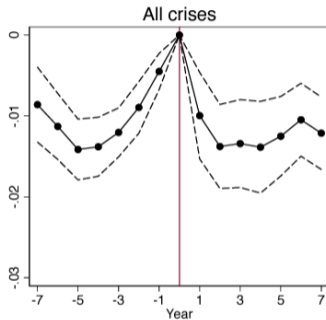
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This Paper

- **Research Question:** how does **monetary policy affect the probability of a banking crises?**
- **Analysis:**
 - Characterizes **monetary policy path before banking crises**
 - Uses credit registry and bank administrative data for Spain to analyze the **effects of monetary policy on loan default**
- **Data Set:**
 - Macrofinancial database (Jordá, Schularick and Taylor, 2016)
 - Covers 17 economies between 1870-2020
 - Historical series on interest rates, output, asset prices
 - Banking crises dataset of Baron, Verner and Xiong (2020)
 - Credit registry and bank administrative data for Spain (1995-2020)

This Paper: Main Findings

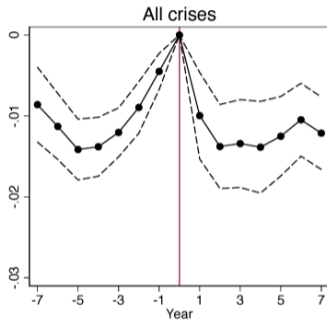
- **Main Fact #1:** banking crisis preceded by **U-shaped monetary policy path**



- Rate increases affect banking crisis if rates had been cut 5 years before

This Paper: Main Findings

- **Main Fact #1:** banking crisis preceded by **U-shaped monetary policy path**



- Rate increases affect banking crisis if rates had been cut 5 years before
- **Mechanism:**
 - **Low interest rates** induce an increase in credit and asset prices (**Red-zone**)
 - An **interest rate hike** in a Red-zone increases the **probability of a crisis**

This Paper: Main Findings

- Recessions are usually preceded by increases in the interest rate but not by the U-shaped monetary policy
- Not such systematic patterns for inflation and short term real interest rates

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- Not such systematic patterns for inflation and short term real interest rates
- **Main Fact #2: loans issued after period of low interest rates** are more **likely to default** in the following three years
- This probability is higher if there is a hike in the interest rate

This Paper: My Discussion

- Very interesting paper that tackles a **crucial question**
- Important contribution for understanding monetary policy and financial stability
- Careful implementation and well-written. Enjoyed reading it!

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- **My discussion:**
 1. Pattern of the real interest rate
 2. Capital flows and banking crises
 3. IV based on trilemma

1) Real Interest Rate Pattern

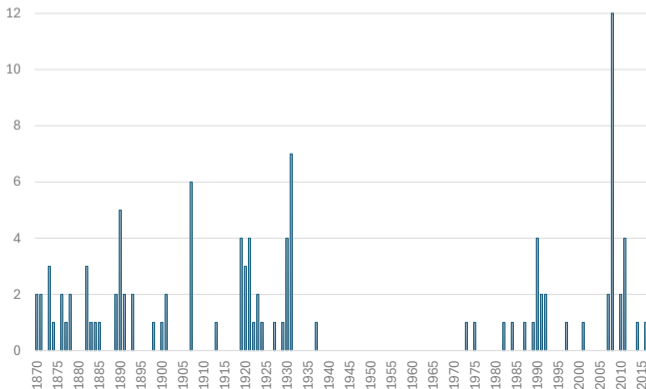
- The real interest rate should reflect stimulative monetary policy. However, it does not display a U-shaped pattern
- Two potential **explanations for low nominal interest rates**:
 1. The central bank lowers the interest rate to boost demand and keeps the rate too low for too long (**discretionary**)
 2. A positive productivity shock induces a fall in inflation which pushes the central bank to lower the policy rate. When the supply shock dissipates, the central bank increases the policy rate to tame inflation (**systematic**)

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- Current results are probably a mixture of these two explanations
- **Comment**: can these explanations help to account for the patterns of the real interest rate and inflation? **Are both explanations important for triggering banking crises?**
- **Suggestion**: disentangle the two cases exploiting the sign of the real interest rate response in each of the events

2) Capital Flows and Banking Crises

- Sustained surges of capital inflows (*Capital Flow Bonanza*) can lead to banking crises (Reinhart and Reinhart, 2008)
- Mendoza and Terrones (2012) show that credit booms are synchronized internationally
- In this dataset, **banking crises sometimes occur simultaneously**

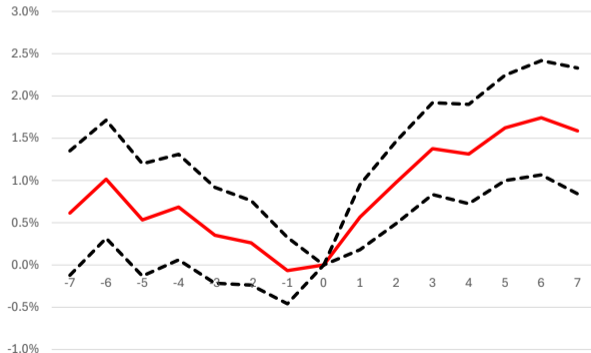


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- I've replicated short-term interest rate dynamics and checked **Current Account-to-GDP dynamics around banking crisis:**



- I have also tested that the **main estimations are not affected if we control for global factors**

3) IV based on Trilemma

- The authors use the **change in the interest rate in Home Country as an instrument** for the change in the domestic interest rate (Jordà et al, 2020)
- **Assumption:** changes in the foreign interest rate affect the probability of a banking crisis only through the domestic interest rate

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- The authors use the **change in the interest rate in Home Country as an instrument** for the change in the domestic interest rate (Jordà et al, 2020)
- **Assumption:** changes in the foreign interest rate affect the probability of a banking crisis only through the domestic interest rate
- **Potential problems:**
 - Home country may adjust the interest rate due to **global shocks**
 - The change in the foreign interest rate may affect **global financial conditions** (Gerko and Rey, 2017), having a direct effect on banks' balance sheets
- **Question:** are results robust to removing the main currencies from the IV?

Summary

- Very interesting paper that tackles a **crucial question**
- **U-shaped monetary policy** and **R-zones** are important for triggering banking crises
- Loans issued after period of low interest rates are more likely to default in the following three years
- **Open Question:** which is the optimal monetary and macroprudential policy design?