Discussion of

The Credit Channel of Fiscal Policy Transmission

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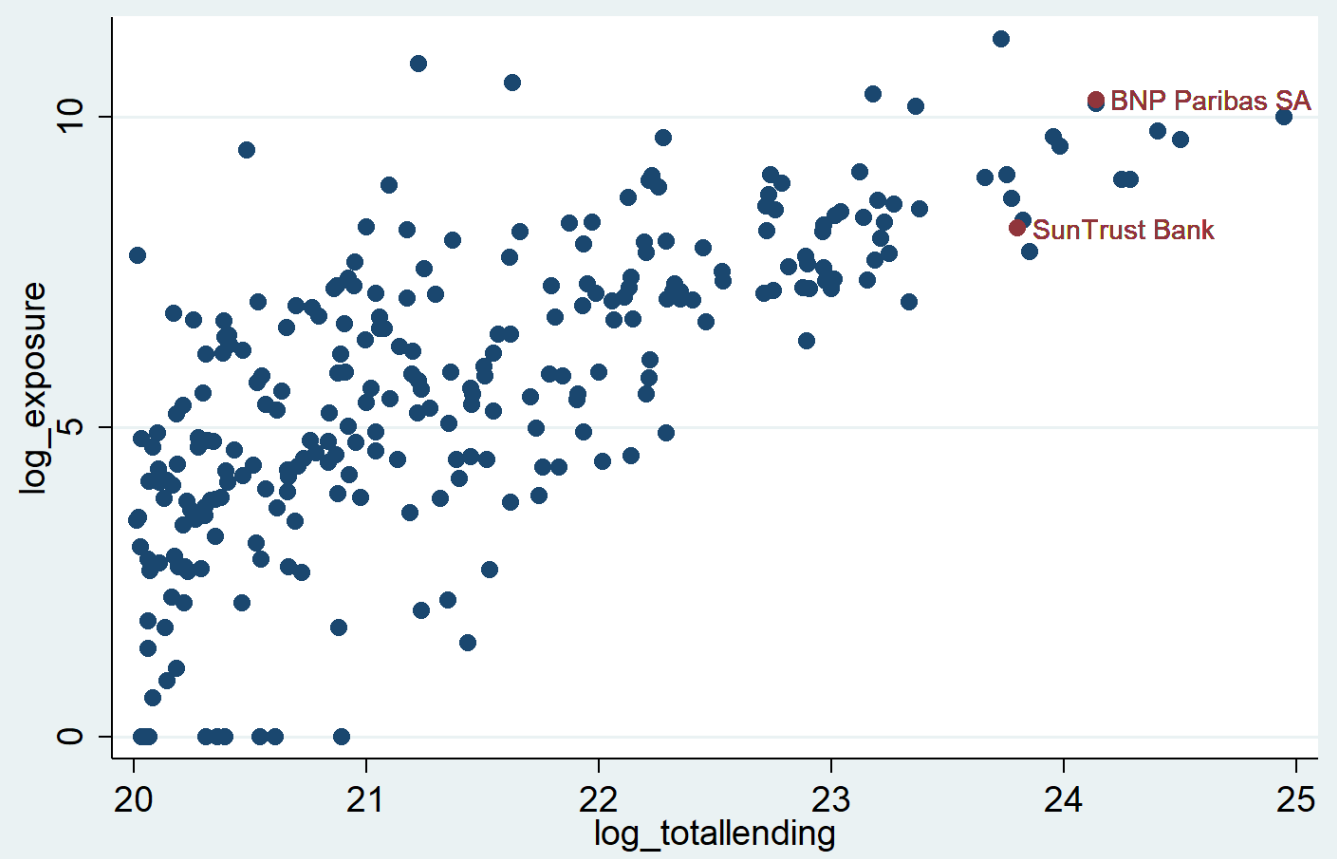
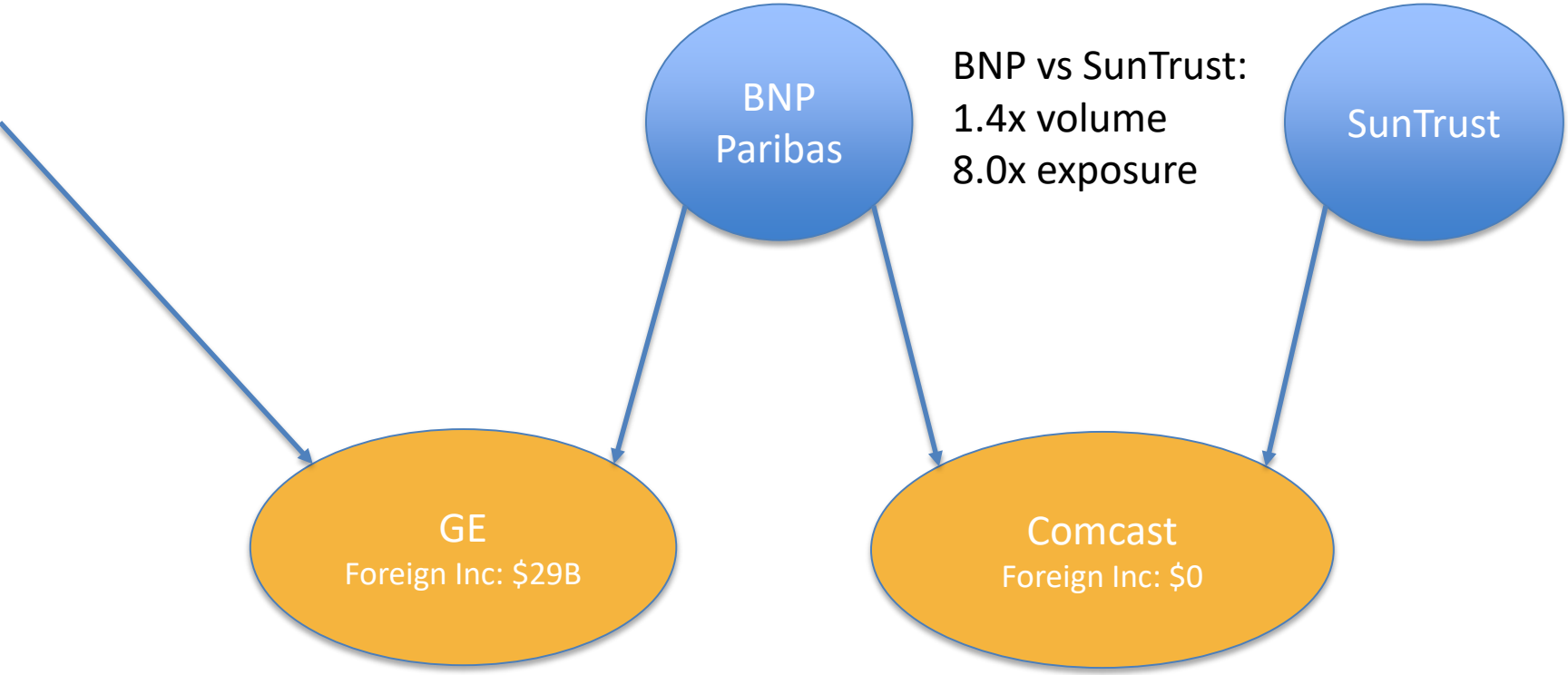
Overview

- Policy question: what are the GE effects of targeted fiscal policy?
  - Government decides to subsidize some firms once
  - Shock is transmitted
    - Horizontally: to competitors
    - Vertically: to suppliers and customers, and on through I-O network
    - Financially: through lenders (a particular kind of supplier?)
- Theory question: how do shocks to one part of a bank's portfolio affect its portfolio choices?
  - Non-financial firms: internal capital markets
  - Most banking papers: big negative shocks
  - This paper: moderate positive shock

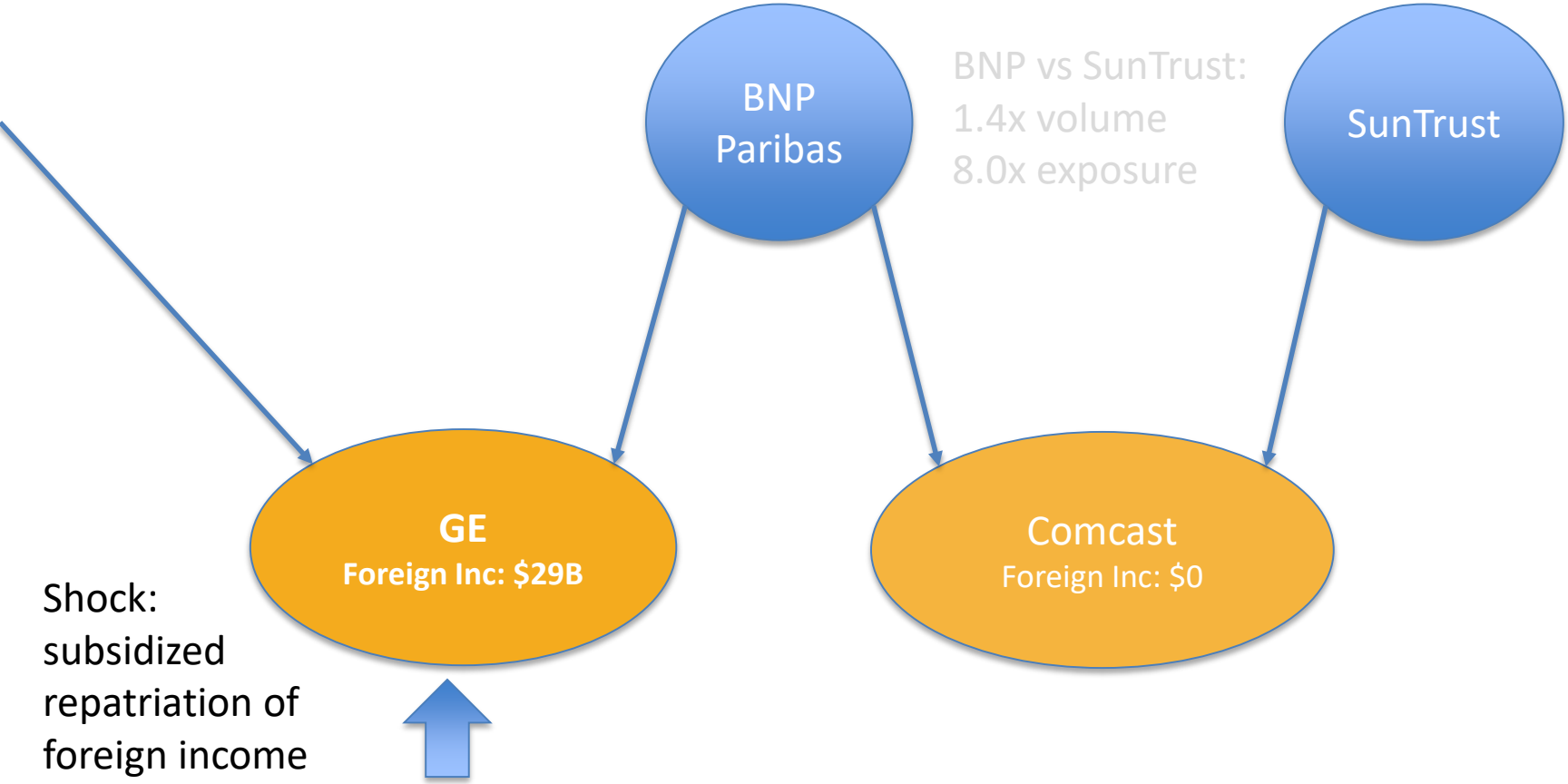
Example:
Pick 2 banks



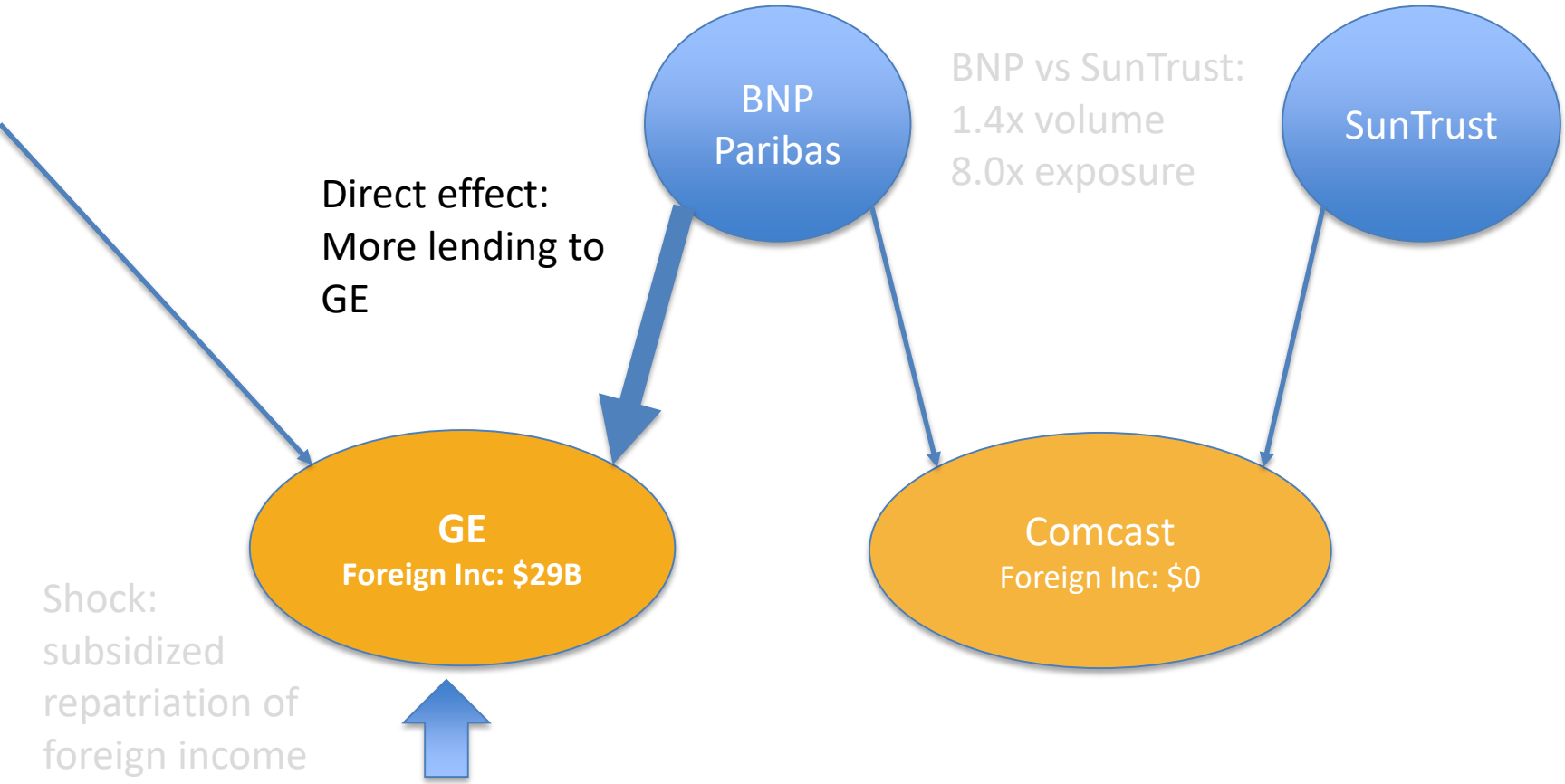
Example:
multi-national vs domestic borrowers



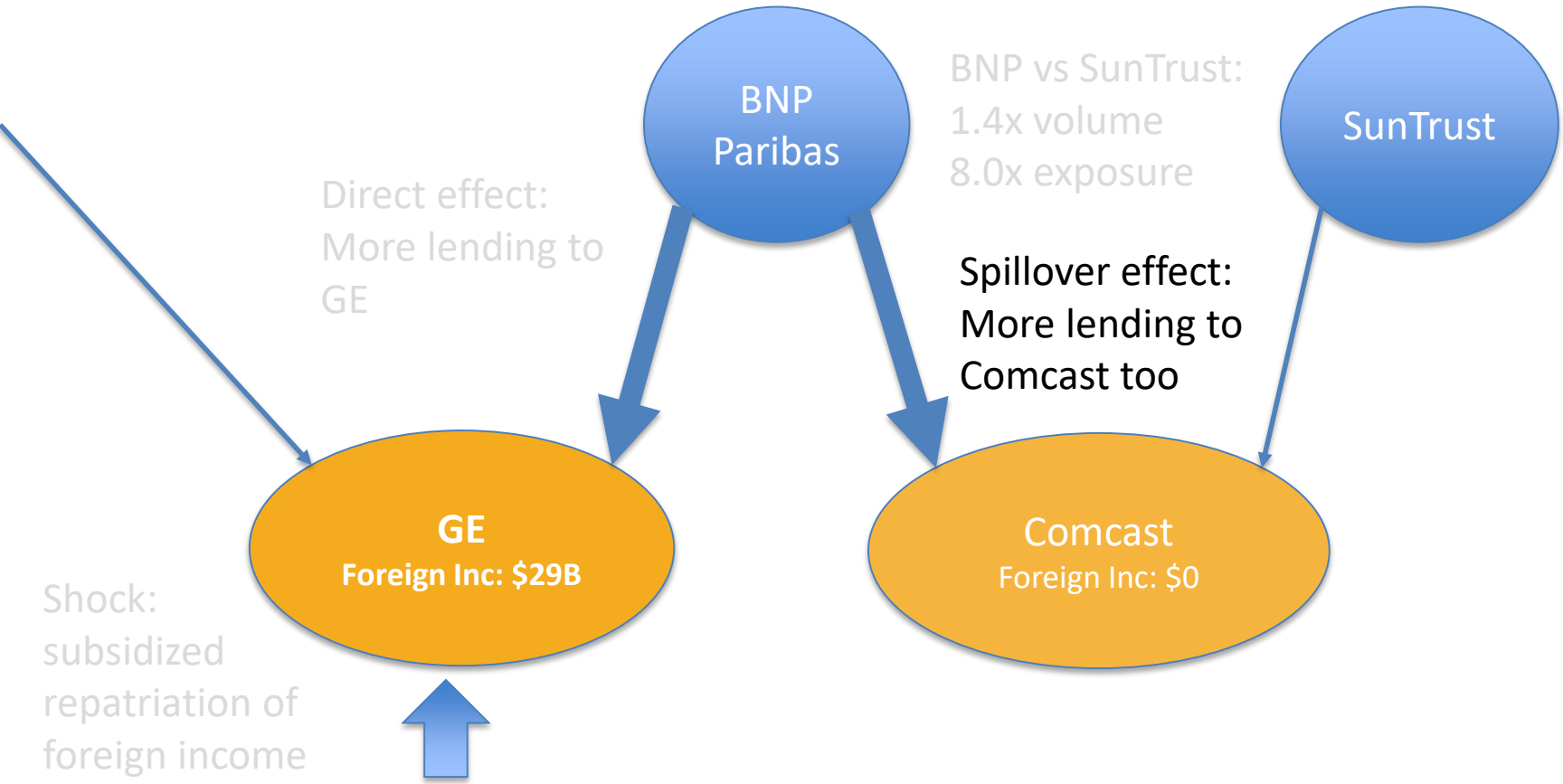
Example:
Shock to multinationals



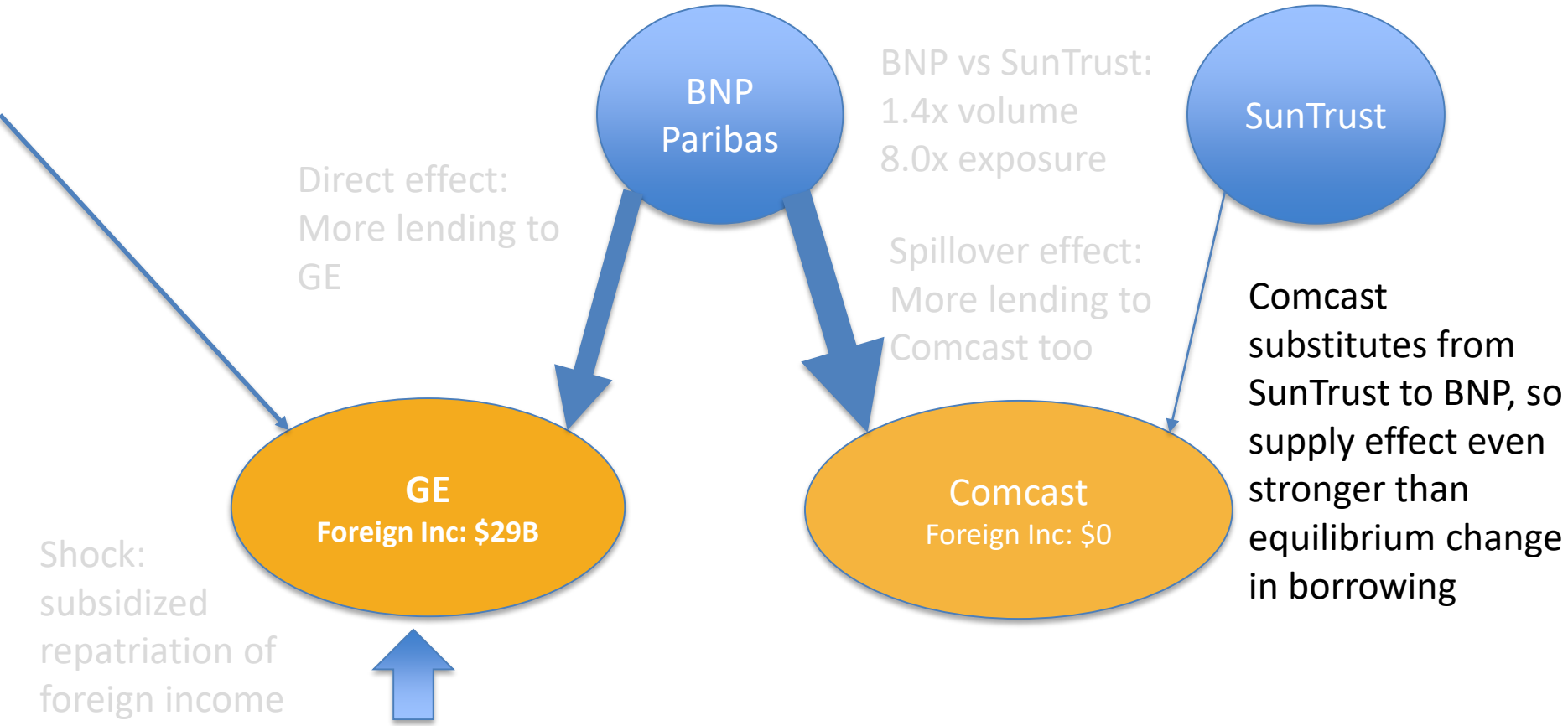
Example: Direct Effect



Example: Spillover

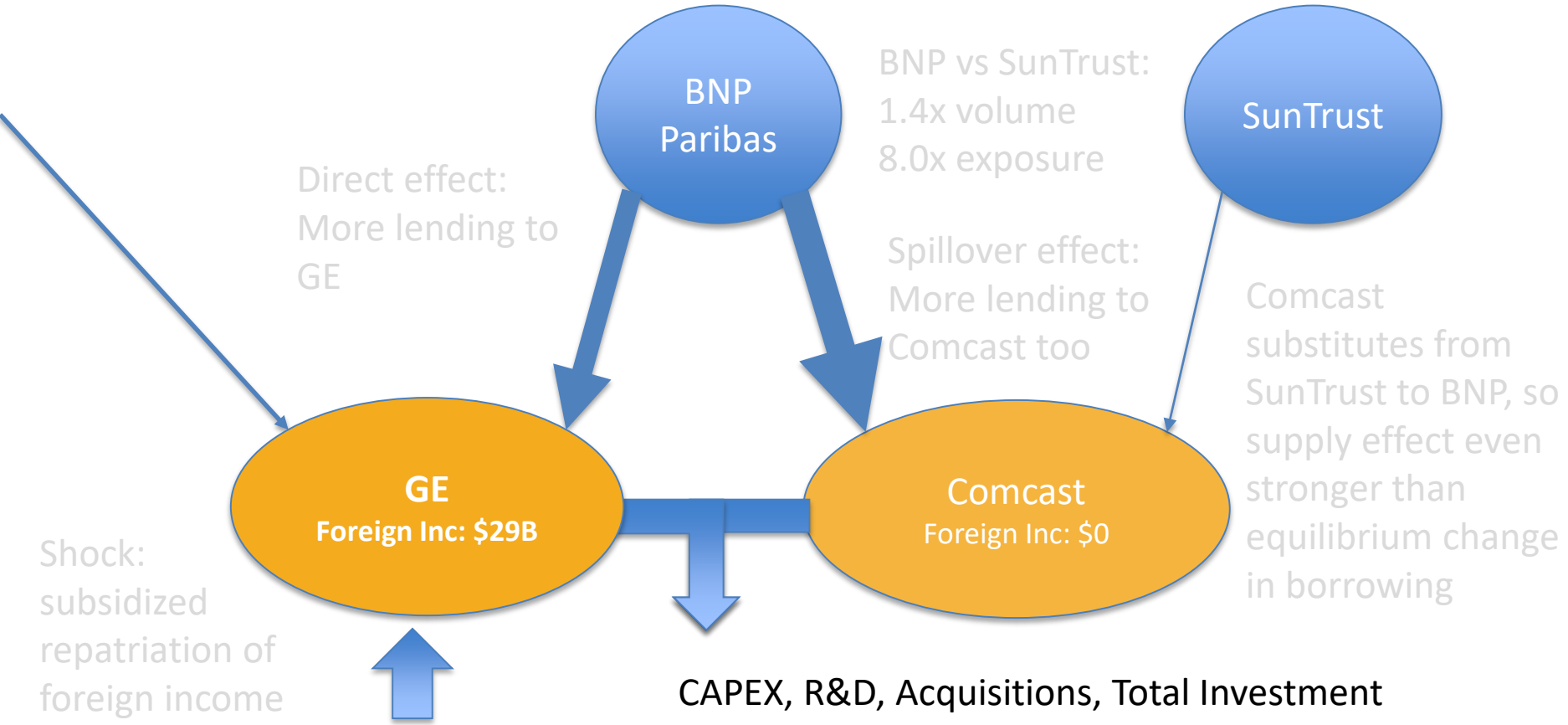


Example:
Khwaja-Mian approach to isolate supply



Comcast substitutes from SunTrust to BNP, so supply effect even stronger than equilibrium change in borrowing

Example:
Credit supply expansion has real effects



Comments Overview

- Very interesting paper
  - Huge effects: in my example, the average BNP Paribas borrower will increase her total investment by 29.8% x 2.07 = 61.8% more than the average SunTrust borrower!
  - Important to think about fiscal policy spillovers through the banking sector, not just through goods markets

What cancels out the huge effects in the aggregate?

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- Comments about identification
- Comments about the mechanism

High-exposure banks more likely to be U.S. branches of foreign institutions

Largest Lenders By Total Loan Volume in Increasing Order of Foreign Exposure

LaSalle Bank NA	Bank of New York
National City Bank	BANK ONE Corp
Wells Fargo Bank	Wachovia Bank
Fleet National Bank	Citibank
Bank of America NA	Barclays Bank Plc
General Electric Capital Corp	MUFG Bank Ltd [ex-Bank of Tokyo-Mitsubishi Ltd]
Bank of Nova Scotia	JP Morgan Chase Bank NA
SunTrust Bank	Credit Suisse First Boston
PNC Bank	ABN AMRO Bank NV [RBS]
US Bank NA	JP Morgan
Lehman Brothers Inc	Bank of America
Merrill Lynch & Co Inc	UBS AG
Comerica Bank	Deutsche Bank AG
Societe Generale SA	BNP Paribas SA
Royal Bank of Scotland Plc [RBS]	HSBC
Morgan Stanley	Citigroup

Foreign Banks Significantly Increased their (non-mtge) U.S. Presence after 2004

Flow of Funds: Share of Dep. Inst. Loans not elsewhere classified made by Foreign Banking Offices in U.S.

Trough-to-peak:
17% → 24%

2004 to 2005:
17% → 20%

Exclusion restriction: this is entirely due to the tax holiday. Is that true?

- Add parametric controls at the bank-time level (right now there are none)
  e.g. total foreign lending in the U.S. at time *t* x foreign dummy for bank *I*
- Or just drop the foreign banks…

Mechanism: why the spillover?

- Frictionless (and risk-neutral) benchmark: firms pursue every positive NPV project available regardless of returns on other projects
  - Should be no spillover to domestic borrowers
  - But we see not just spillovers, but **bigger effects on domestics** vs multi-nationals! Why?
- Constraints
  - Shock makes multinationals safer
    - Increases value of existing loans to them → relaxes capital constraint
    - Makes future returns less volatile – relaxes VaR constraint or lowers risk weights
  - Exposed financial institutions borrow more, have more capital to lend to everyone
  - Domestics were already the higher-NPV opportunity
    → now they get more of the extra lending
- Portfolio Choice
  - Shock changes the risk-return properties of loans to multinationals
  - New optimal portfolio involves relatively more loans to domestic firms
  - E.g. safer loans to multinationals → lower Sharpe ratios on such loans, domestics now become a more attractive investment

Mechanism: authors' story

- High-exposure banks have lower ex-post loan defaults
- Consistent with both channels
- Test for constraints directly:
  - Triple interaction with some measure of bank constraints/shadow cost of capital
  - E.g. capital ratio
  - E.g. revealed preference based measure e.g. ABCP use (see Kisin and Manela RFS 2016)
- Test for portfolio choice directly:
  - Combine ex-post default evidence with ex-ante pricing to construct returns, XS std. dev. for Sharpe ratios

Conclusion

- I liked the paper!
- Important theory and policy contribution with highly economically significant quantitative results
- Questions I still have:
  - Which firms are doing the extra investing?
  - How do such large effects cancel out in the aggregate?
  - Is the fiscal shock really driving the result or are foreign banks behaving differently for another reason?
  - What exactly is the spillover channel?