EUROPEAN CENTRAL BANK

EUROSYSTEM

Discussion of “The Secular Decline of Bank Balance Sheet Lending”

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Disclaimer: The views expressed are my own and not those of the Eurosystem

The Paper

Argues that information-based lending by banks has declined since 1970s

Presents a structural model to identify key drivers of this decline and finds that the key drivers are (a) improvements in securitization technology, (b) shifts in saver preferences away from deposits to debt securities, and (c) reduction in “subsidies” for bank intermediation, with securitization being the most important driver since the 1990s

Counterfactual analysis shows that increasing capital requirements would not drastically reduce lending today, in part because of the reduced role of banks

First impression

Fascinating question

Heroic task to explain changes in bank balance sheets over past 50 years into one structural model

Model can be used to generate important policy insights

Three sets of comments

1. Trends in the data: Decline of banks or rise of agency/GSE debt?

2. Model: Some limitations or possible extensions

3. External validity: Is the US special?

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Trends in the data

Decline of informationally sensitive lending?

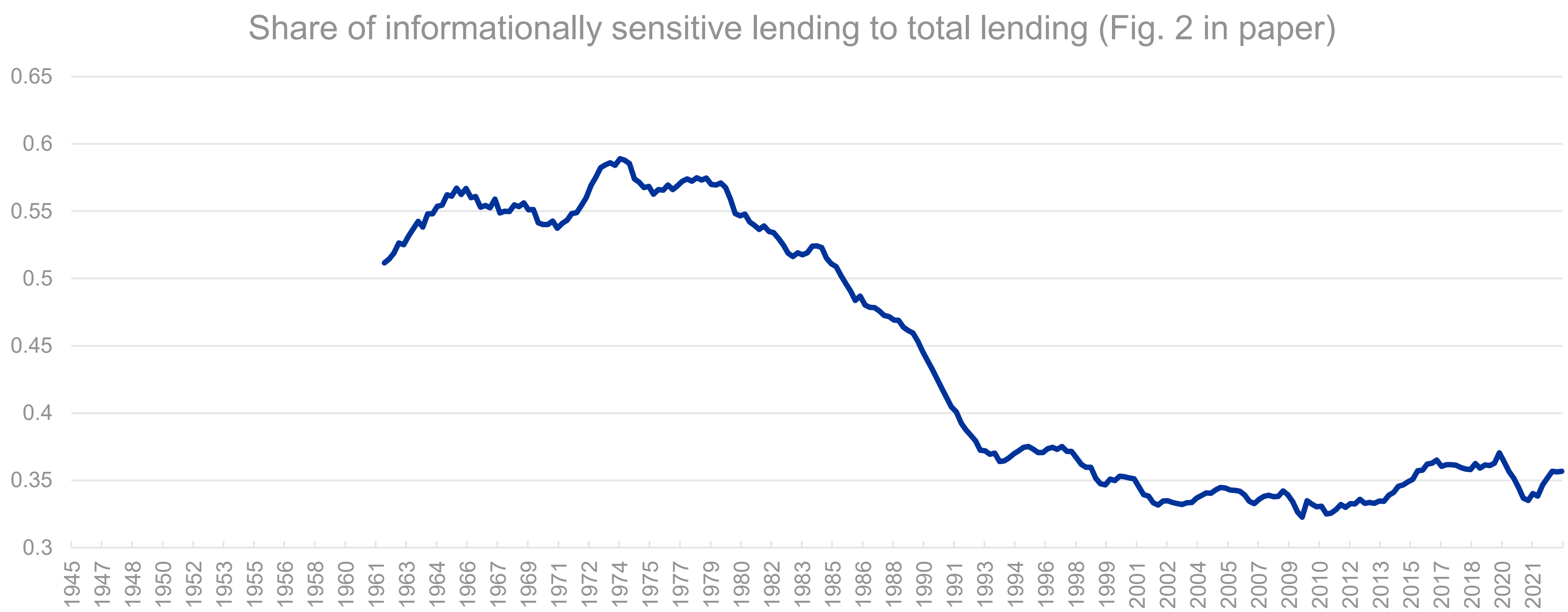
Total lending = Bank loans + Agency/GSE debt + Private debt

Bank loans = Informationally-sensitive lending

Decline of banks or rise of agency/GSE debt?

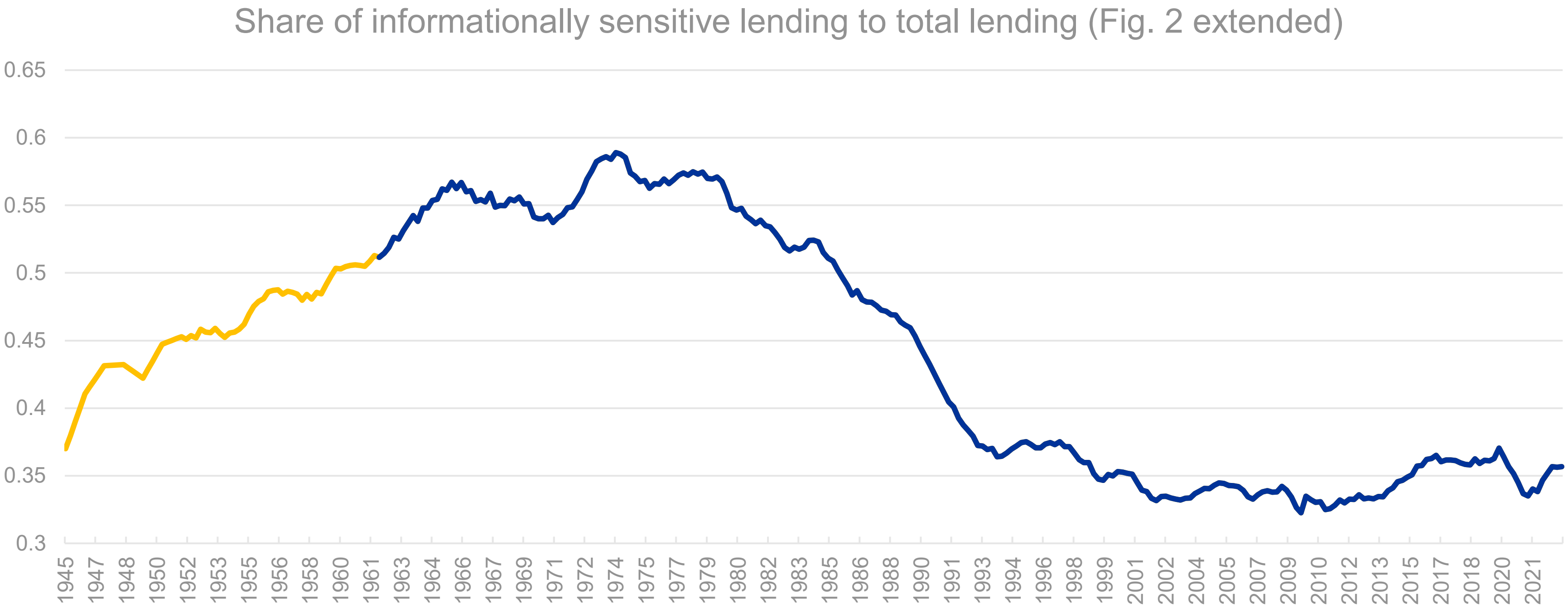
- Lending by banks declined since 1980s but has now reached 1945 levels
- Compositional effect mainly due to rise in agency/GSE debt
- Unique feature of US financial system where such debt enjoys implicit government guarantee (and bipartisan housing policies)

Share of informationally-sensitive lending declined …



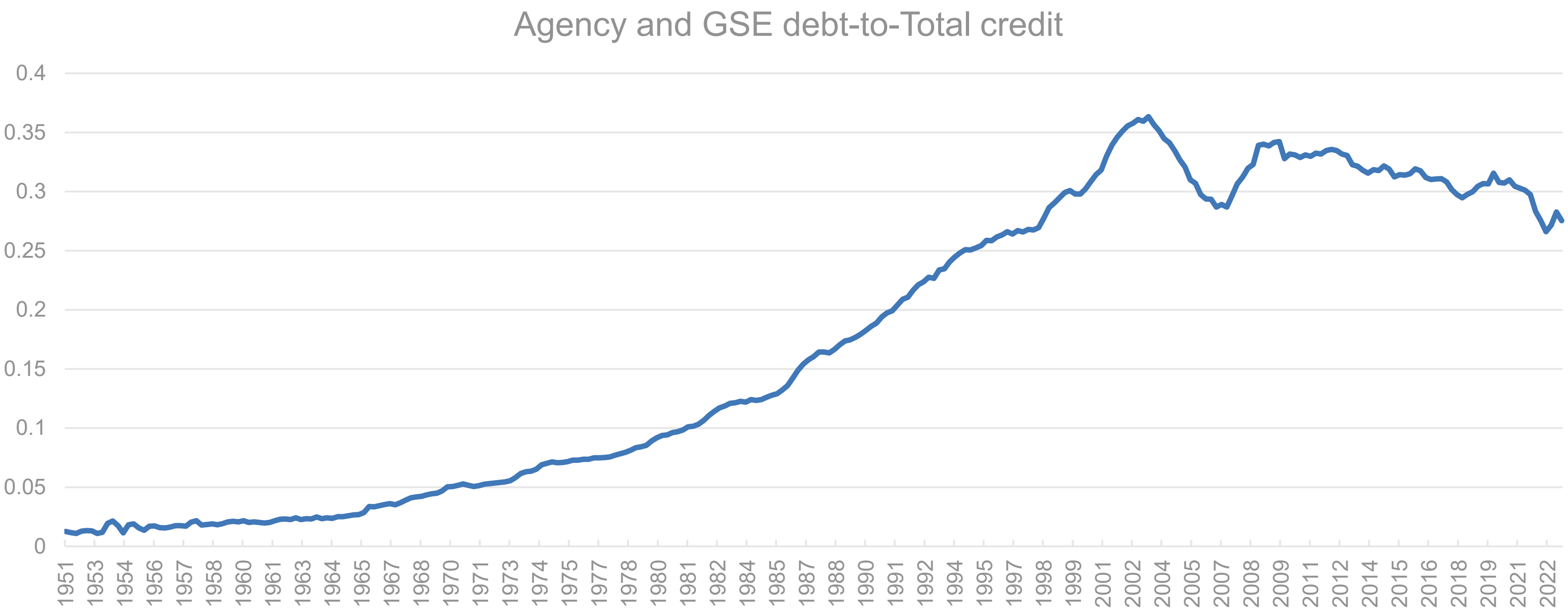
Source: US financial accounts;
obtained from FRED

Share of informationally-sensitive lending declined … but only since 1980, and has now reached 1945 levels



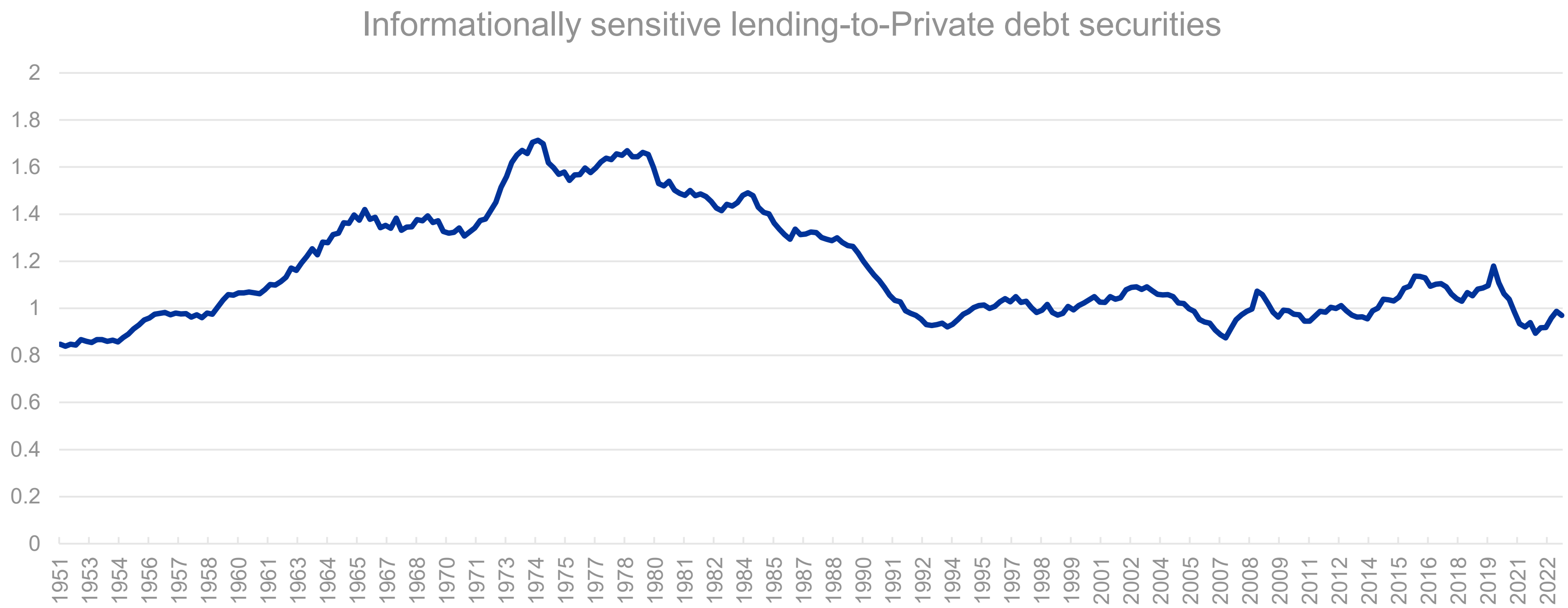
Source: US financial accounts; obtained from FRED

Rise of agency/GSE debt



Source: US financial accounts; obtained from FRED

No decline in information-based lending relative to private debt…except for boom during 1960-1980



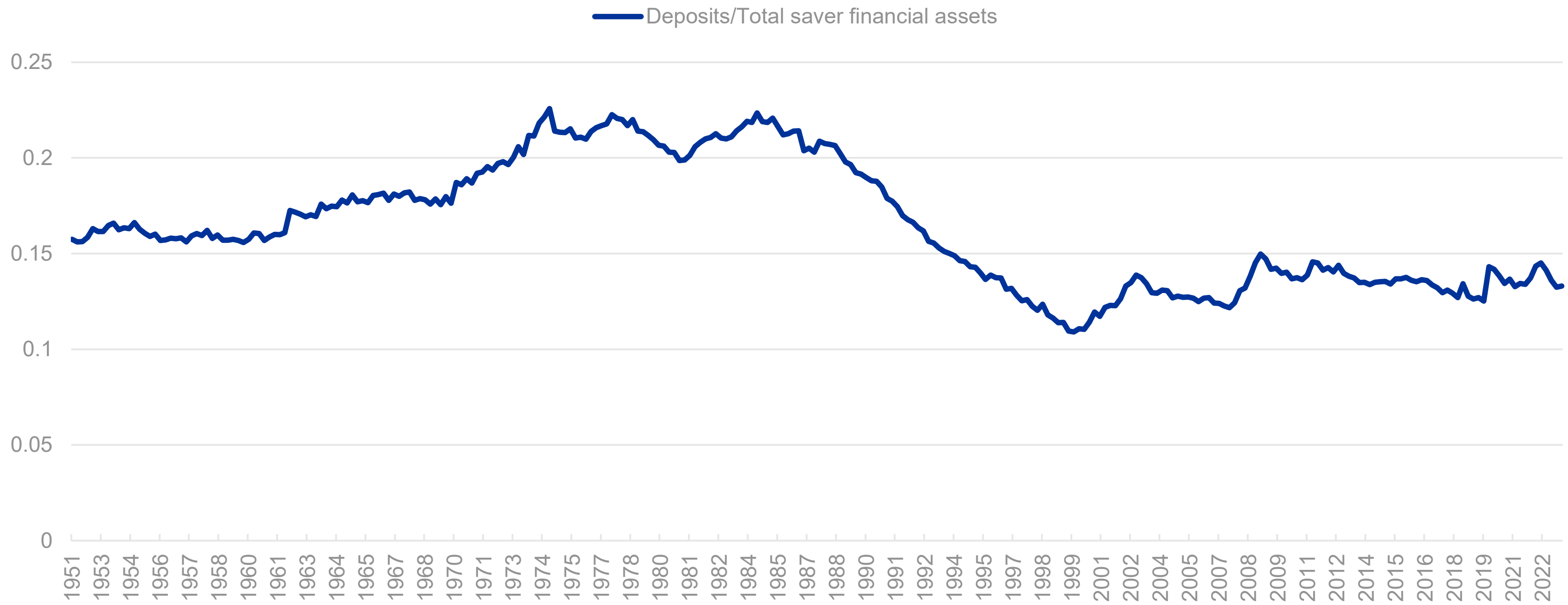
Source: US financial accounts; obtained from FRED

Shift away from bank deposits?

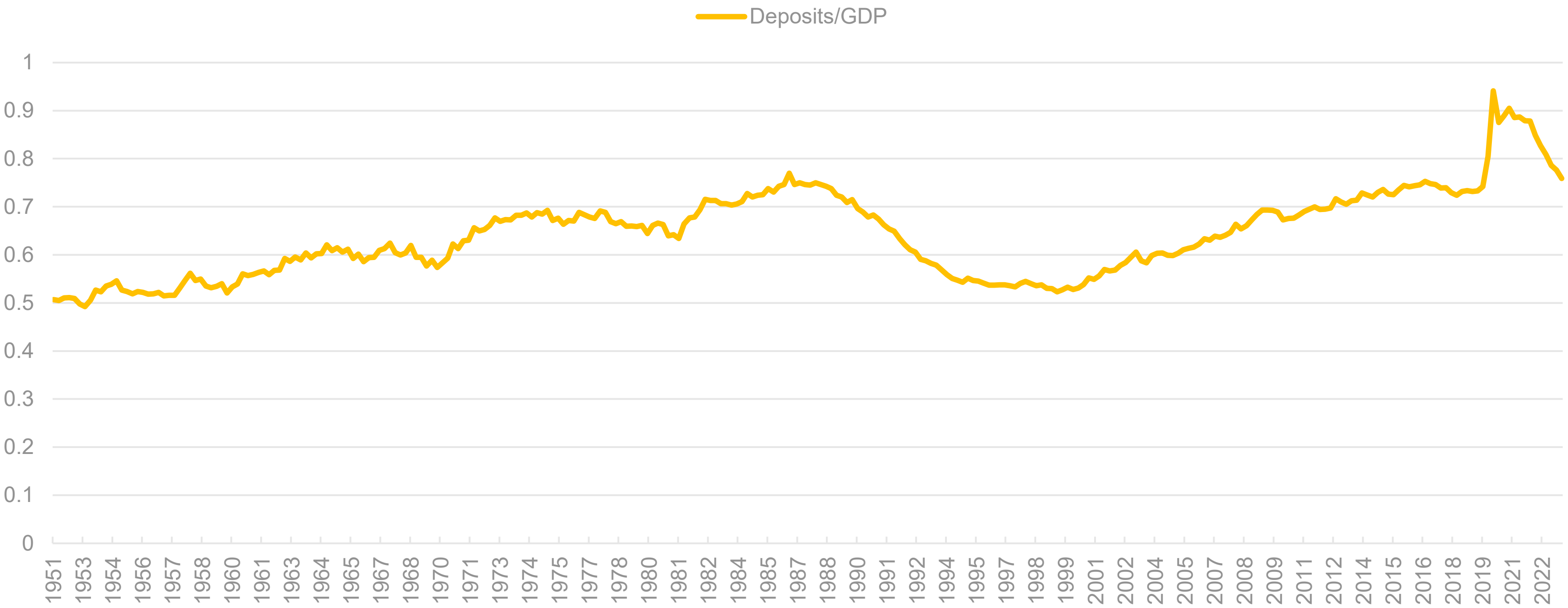
Not clear

- Deposit-taking by banks declined since 1980s but has now reached 1950 levels
- Deposit-taking by banks has if anything outpaced GDP growth

Shift away from bank deposits?



Shift away from bank deposits?



Source: US financial accounts; obtained from FRED

Are banks still special?

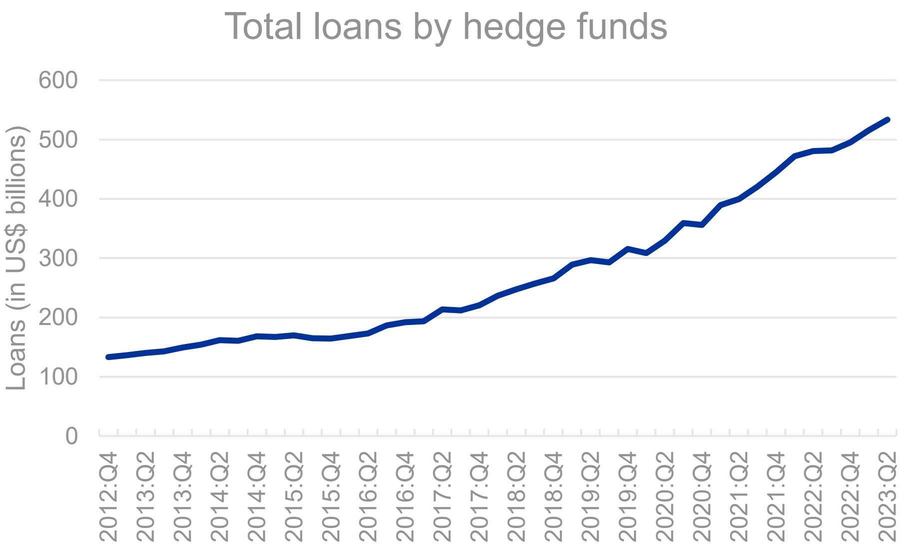
Loans by nonbanks treated as debt securities

- But such loans are also informationally-sensitive
- For instance, loans by hedge funds or syndicated loans by NBFIs

Have banks lost their edge in lending to firms?

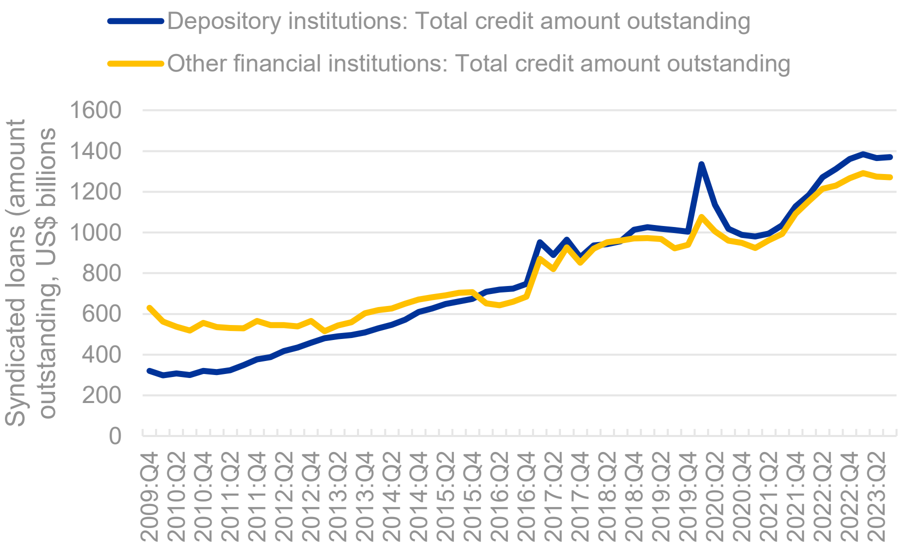
- Does not seem to be the case in syndicated loan market
- Bank lending has grown in tandem with GDP growth
- Net interest margins have been under pressure

Loans by hedge funds



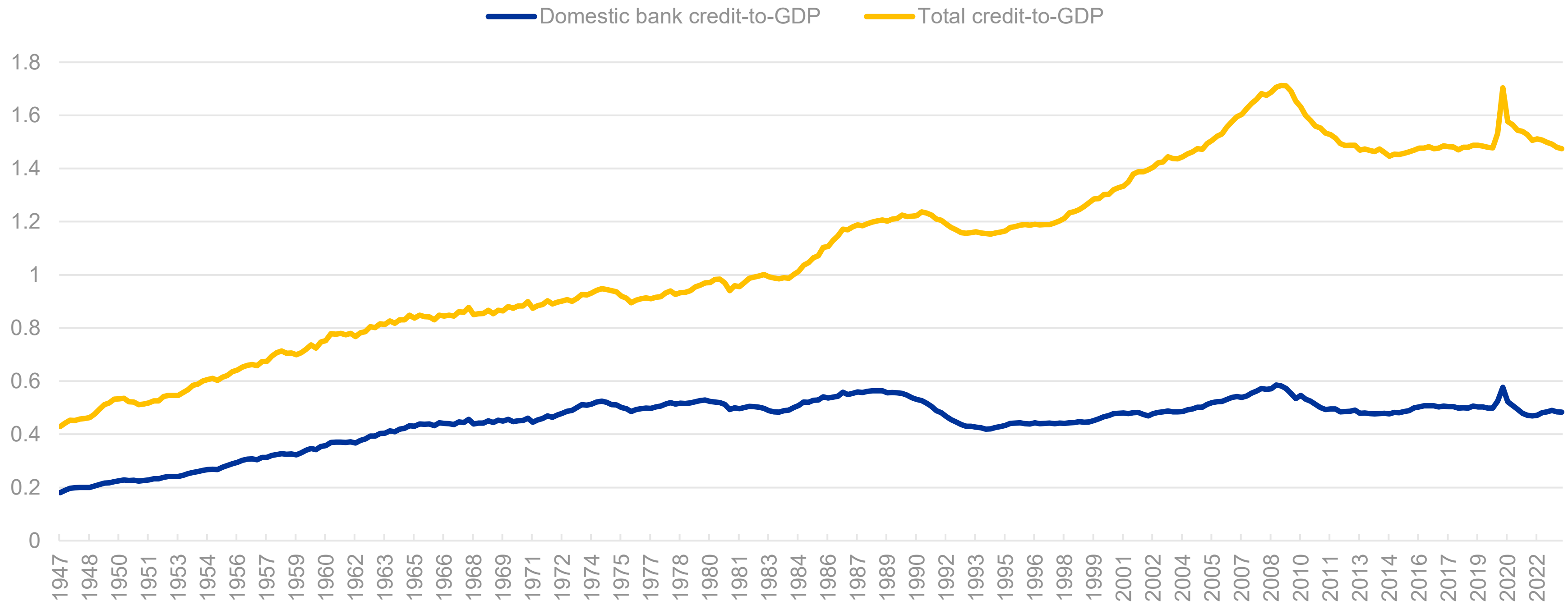
Source: Form PF, Balance sheet of Hedge Funds, Securities and Exchange Commission
https://www.federalreserve.gov/releases/efa/efa-hedge-funds.htm

Syndicated loans by banks & other financial institutions



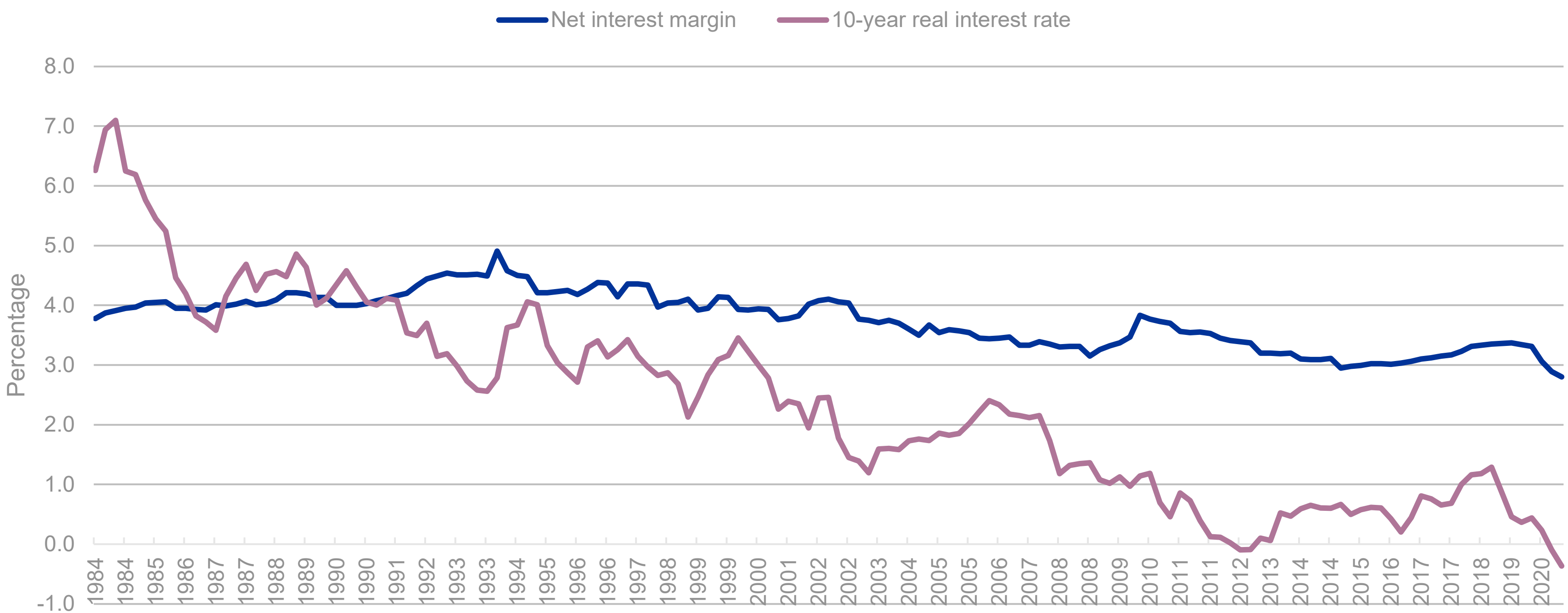
Source: Quarterly reports of the Shared National Credit (SNC) Program
https://www.federalreserve.gov/releases/efa/efa-project-syndicated-loan-portfolios-of-financial-institutions.htm

Overall private indebtedness has increased but bank credit has been stable relative GDP



Source: BIS credit data; US BEA

Interest rates and net interest margins have declined



Source: FRED

2 Model

Some limitations or possible extensions

Structural model is left with many parameters to estimate, forced to make many assumptions

Not always clear what exactly is captured by the different wedges (e.g. “subsidies” for bank intermediation)

Normalization imposed assumes that growth in originate-to-distribute intermediaries is not driven by changes in borrower preferences

- There may well have been a shift in the preference for housing and mortgages due to housing policies (e.g. resulting from Community Reinvestment Act of 1977)

Focus is on improvements in securitization technologies

- What about improvements in other lending technologies (e.g. credit scoring, lending platforms, etc.) that allow nonbanks to compete with banks?

Possible extensions

Focus is on improvements in securitization technologies

- What about improvements in other lending technologies (e.g. credit scoring, information acquisition, lending platforms, etc.) that allow nonbanks to compete with banks?

Model could be extended to allow non-banks to compete with banks for informationally sensitive loans (currently non-banks can only originate-and-distribute and hold securities)

3 External validity

Is the US a special case?

Rise of agency/GSE debt special to US

- Implicit government guarantee

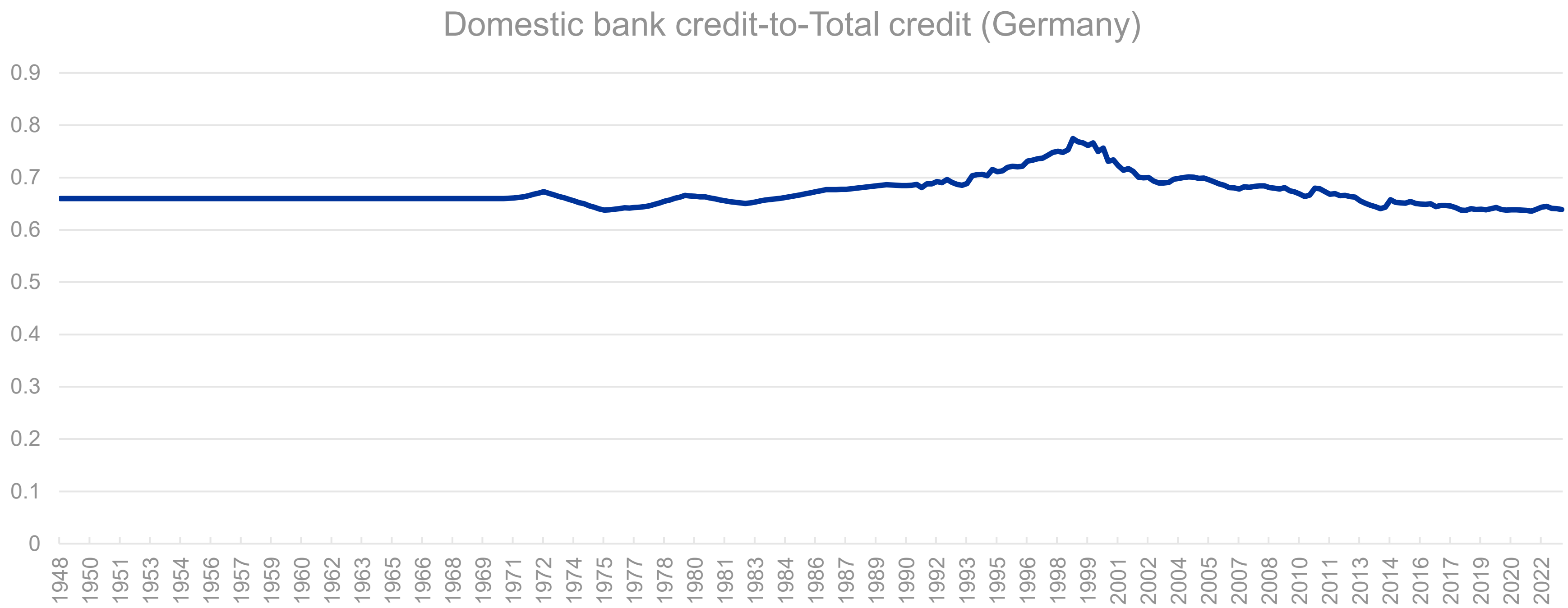
Other advanced economies have seen no decline in the role of banks in the provision of credit

- In Germany, the share of credit by banks in total credit has been flat since 1948

Housing with or without private debt

- In US, a lot of private debt created by GSEs; recorded as private debt but with implicit government guarantee
- In Germany, housing mostly rented, funded by private wealth or government (social housing)

Credit share by banks in Germany has been stable



Source: BIS credit data;
CRDQDEAPABIS and CRDQDEBPABIS

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Conclusions

Conclusions

Bank lending has been displaced by agency/GSE debt

- This has made total lending less sensitive to prudential regulation

Is this a healthy financial system?

- Rapid increase in private indebtedness
- Distorted by implicit government backing

Will banks be able to compete with nonbanks going forward?

- Reduction in informational advantage and cost of information acquisition
- Do we need a regulatory level-playing field between banks and nonbanks?