Comments on "The Bank Lending Channel in a Frontier Economy"
by Abuka, Alinda, Minoiu and Peydro

Hideaki Hirata

Hosei University and JCER

Q: Transmission of MP to Credit (MTM) in a Frontier Economy

- Do contractive monetary policy (and adverse economic conditions) reduce bank loan supply?

  - Bernanke and Gertler (1989, 1995)

- Does the reduction in credit availability depend on bank balance-sheet strength?

  - Bernanke and Gertler (1987), Bernanke and Blinder (1988)

- The quantitative evidence on the strength of the MTM in developing economies is mixed.

Impressively Unique and Rich Dataset

- **Data: Over 30,000 Loan-level data in Uganda**
    - Sector & region info is associated but BS & PL data of firms aren't

- **Sample Period: 2010Q3-2014Q2**
    - CB Target: Money to Inflation after July 2011

Identification

- **Supply of credit needs to be disentangled from its demand**
  - Monetary tightening and poor economic performance may reduce both loan supply and demand
    - Supply: Due to an increase in agency costs for banks
    - Demand: Because a firm's net worth and its expectations for investment are reduced & financing cost is higher

- **Endogeneity of monetary policy**
  - Separating the effects of monetary conditions from those of economic activity

LHS

- ## Extensive margin

  - Purpose: To examine the link between the monetary policy stance and the probability of loan granting
  - *LOAN GRANTED$_{ibt}$* : Probability of loan granting to firm *i* by bank *b* at *t*

- ## Intensive margin

  - Purpose: To examine the link between the monetary policy stance and the quantity of credit
  - *LOAN AMOUNT$_{jbt}$* : The volume of credit granted to firms in district-industry *j* by bank *b* at *t*.

Main Findings

- Higher short-term interest rates reduce (1) the probability that a loan application is granted and (2) quantity of credit granted

- Weaker monetary policy transmission than in advanced economies

- Better capitalized banks transmit monetary policy changes less than other banks

Contribution

- Great examination of Jimenez et al. (2012, AER) for a developing country with possibly "hampered" monetary transmission mechanism

    - "hampered" possibly due to small and shallow financial markets, oligopolistic banking systems, excess bank liquidity, monetary policy frameworks with limited ability to anchor inflation expectations, and poor institutional and legal environments that raise the costs of lending
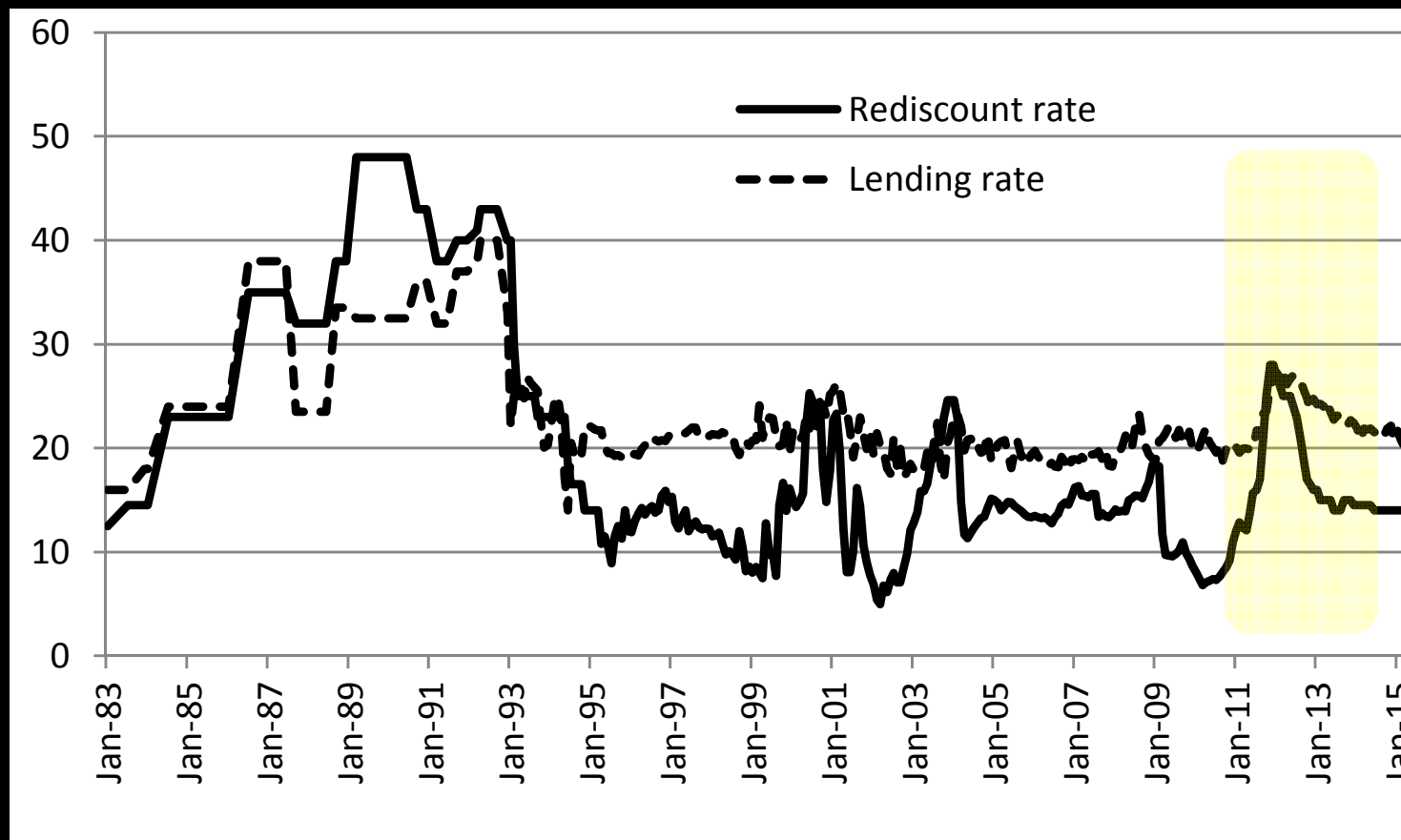
Comment 1: Identification -Extensive Margin-

- **Endogeneity of monetary policy**
  - "The timing of the tightening were partly UNANTICIPATED by economic agents," thereby assuming "pre-shock adjustment in banks' lending behavior was limited"

  - 3 reasons
    - CB had reacted little to a shock during 2007-2008
    - A dovish attitude (little reason to anticipate tightening)
    - Pre-tightening communication emphasized the need for the monetary authority to support strong economic activity

Policy Rate and Bank Lending Rate from 1983 to 2015

Comment 1: Identification -Extensive Margin-

- Large variations in interest rates over a relatively short period of time happen at least twice after the late 1990s in Uganda
  - Not sure if "pre-shock adjustment in banks' lending behavior was limited"
  - BTW, visually, the response of lending rate to policy rate is stronger this time than the previous cases
    - Most of the increases (decreases) in policy rate seem to be not passed on to borrowers by commercial banks. IMF (2012) suggests less competitive environment.

Comment 2: Identification -Extensive Margin-

- The effects of monetary policy (and economic activity) on the loan granting probability, depending on the strength of bank balance-sheets
  - Cannot control for time-varying firm heterogeneity
    - What if firm A and firm B submit loan applications to Bank X at the same time?
    - I am not sure if it is worth discussing <u>quantitative</u> impact of a change in interest rates w/o controlling for time-variant firm data.

Comment 3: (A)Symmetry -Extensive Margin-

- **NPLs story is one plausible hypothesis**

  - Why not include NPLs/Total Assets?

- **Other hypothesis (e.g., EIU, Jan 23, 2014)**

  - "The central bank tried to put pressure on commercial banks to reduce their lending rates more steeply in 2013, but to little effect, …."

  - "Reduction in demand for loans can be explained by the appreciation of the Ugandan shilling, which made foreign-currency-denominated loans less attractive."

Other Comments

- Why lags of RHS variables differ in the case of extensive and intensive margins?
  - Fitting game?
- In the case of intensive margin model, panel tobit model at firm level seems to work.
  - Is OLS at district-Industry-quarter level advantageous?

Other Comments

- About interest rate pass-through, lags of policy rates would be considered in light of the presence of policy lag.

- As a proxy for (time-invariant) firm size ….
  - Average amount of loans in the sample period might be used

In conclusion…

- Very interesting paper

- With lots of findings to think about!