Banking Globalization and International Business Cycles

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Discussion by

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Goal of the paper

♦ Construct a 2-country model with financial frictions to study the effects of asymmetric shocks.

Main results:

♦ Model shows that ‘credit chains’ induce positive correlation in GDP across nations (synchronization).

♦ Shocks to net worth of financial intermediaries in one country spills over to affect other economies.
Standard results

♦ **RBC model:**
  Productivity shocks induce negative correlation in I and Y. (Capital reallocation).

♦ **Financial accelerator models:**
  Net worth of firms matters for investment.
  Amplifies shocks and synchronizes Y and I

♦ **Issue:**
  Cannot explain synchronized movements in financial variables (lending and credit spreads).
This paper

♦ Introduce frictions on financial intermediaries as well.

   ▶ Hslds lend to ‘investors’ (no friction)
   ▶ Investors face CSV problem with intermediaries.
     Financial intermediaries net worth matters!
   ▶ Financial intermediaries face CSV problem with entrepreneurs.

♦ This creates ‘chained credit contracts’.
This paper

♦ FI’s lend across countries.

♦ Shocks to home FI net worth affect its lending abroad and foreign Y & I

♦ Amplifies monetary policy shocks.

♦ Shocks to foreign entrepreneurs net worth hurts home FI and lending at home.
Assessment

♦ Simple yet effective idea.

♦ Chain the frictions to each other to amplify and transmit shocks.

♦ Gets the main correlations right – suggests that a financial mkt shock in one country can affect the ROW.

♦ Takes intermediation seriously! (Unlike others)
Issues

♦ Chained credit contracts are real frictions.

♦ Should look at a RBC model with these frictions first.

♦ Allows us to understand how correlations are affected.

♦ Then add the sticky bits and pieces.

♦ Why have the complex, final good, retail good, wholesale good structure? Not the point of the paper.
Issues

♦ These models imply that I > firm net worth.

♦ Part of firm net worth is retained earnings.

♦ In U.S. data, aggregate retained earnings > I.

♦ No need to borrow from FI for I.

♦ The model misses this (all fin. accelerator models do).
  (So, what do FI’s really do?)
Issues

♦ Claims to the net worth of major firms and FI are publicly traded.

♦ This implies lots of public information on earnings.
  ⇒ Contradicts the essential idea of CSV!

♦ How can CSV determine debt contracts of FI’s yet their shares are publicly traded?

♦ Micro-foundations matter for breaking Modigliani-Miller.
Issues

♦ Are these the types of shocks behind 2007-09 crisis?

♦ The common cause seemed to be driven by eruption of severe information frictions (asymmetric info, lack of trust, sunspots).

♦ Assets were not contracted or priced correctly.

♦ CSV problems have well designed contracts and are priced appropriately. CVS not the problem.(?)
Issues

♦ The model has monopolistic FI’s with ongoing relationships.

♦ A standard debt contract driven by CSV is probably not optimal.

♦ Why don’t investors face CSV with hslds?.
Issues

♦ Portfolio allocation by FI’s across countries is exogenous and fixed.

♦ Sounds like a Lucas critique coming....

♦ If there was one thing that would be endogenous for an FI it would be its portfolio allocation.

♦ Finally, what are the welfare costs associated with these frictions?
Conclusion

♦ Nice idea that generates good empirical results.

♦ Takes intermediation and information seriously.

♦ Do a real model first, then the sticky stuff to help understand the model.

♦ The retained earnings puzzle needs to be addressed.