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.
  $\Rightarrow$ 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.