

Conference Agenda

Session

WED1-01: Federal Reserve Board Special Session: Credit risk

Time: Wednesday, 15/Sept/2021: 12:30pm - 2:30pm

Session Chair: Ricardo CORREA, Federal Reserve Board, United States of America

Presentations

Bank Credit and Default Risks in Infinite Horizon

Charles A.E. Goodhart¹, Dimitrios Tsomocos², Xuan Wang³

¹London School of Economics and CEPR; ²SAID Business School, University of Oxford; ³Vrije Universiteit Amsterdam and Tinbergen Institute, Netherlands, The

Ever since the Great Financial Crisis, if not before, it has become clear that there are complex interactions between the real and nominal sectors of the economy. These interactions are even more relevant today. Indeed, the COVID-19 pandemic crisis has led to money-financed fiscal expansions and enormous debt buildup. What is the role of money-financed fiscal expansion and its impact on allocations, inflation, and corporate default? When do monetary and financial policy goals conflict with each other? When is monetary policy a complement to or a substitute for macroprudential policy? We develop a dynamic stochastic general equilibrium (DSGE) model featuring deposit issuance via bank credit and endogenous corporate default risks. We argue that the official policy rate and the financial wedge, namely the spread between loan and deposit rates, are the key variables for the analysis of the interaction between price stability and financial fragility. We show that both the monetary policy rate and the financial wedge exert real effects, even though prices are fully flexible. We establish that first, contractionary monetary policy, typically, is unable to effectively lean against the wind during periods of financial deregulation; second, macroprudential policy is procyclical; third, monetary policy is more effective when the economy is more liquidity constrained; and fourth, money-financed fiscal expansion is effective in raising output and inflation, accompanied with lower corporate credit risks.

 [Goodhart-Bank Credit and Default Risks in Infinite Horizon.pdf](#)

Expand or Avoid: Microfinance Credit Risk and Climate Vulnerability

Iftekhar Ahmed¹, Ivan Diaz-Rainey¹, Helen Roberts¹, Dung Thuy Thi Nguyen²

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This study investigates the association between climate vulnerability, geographic expansion and credit risk in microfinance institution's (MFIs) loan portfolios. It is motivated by inconclusive evidence concerning the climate vulnerability-bank risk nexus and the geographic expansion-bank risk nexus. Applying system generalized method of moments (GMM) to a sample of global MFIs over the period 1999-2019, we report evidence that climate vulnerability and geographic expansion increase MFI credit risk. The risk is more pronounced for non-shareholder-owned MFIs compared to shareholder-owned MFIs. This suggests MFI expansion into climate prone regions is curtailed in the case of shareholder-owned MFIs to minimize credit risk, overshadowing the microfinance mission to provide banking services to the poorest and the most vulnerable. In addition, we report evidence that climate vulnerability moderates the consequences of geographic diversification in the microfinance industry.

 [Ahmed-Expand or Avoid.pdf](#)

Credit Shocks and Populism

Alessandro Pizzigolotto¹, Nicolò Fraccaroli²

¹Norwegian School of Economics (NHH), Norway; ²W.R. Rhodes Center for International Economics and Finance at the Watson Institute for International and Public Affairs, Brown University, RI, USA

We investigate whether credit shocks increase the electoral support for populist parties. To this end, we exploit the impact of an exogenous lending cut by a large German bank in 2007-08 on the voting behaviour of individuals settled in counties exposed to the cut. We measure voting intentions using individual-level survey data. We identify the degree of populism over time using a semi-supervised machine learning approach applied to the parliamentary speeches of each party. We find that voters exposed to the credit shock are more likely to vote for parties that are populist, that adopt a populist rhetoric and that discuss more frequently bank-related topics. Overall, our evidence show that credit shocks favour the growth of populism.

 [Pizzigolotto-Credit Shocks and Populism.pdf](#)

Owe a Bank Millions, the Bank Has a Problem: Credit Concentration in Bad Times

Sumit Agarwal², Ricardo CORREA¹, Bernardo Morais¹, Jessica Roldan³, Claudia Ruiz⁴

¹Federal Reserve Board, United States of America; ²National University of Singapore; ³Casa de Bolsa Finamex; ⁴World Bank

We study banks' lending decisions when a large negative shock hits their material borrowers through the lens of models of bargaining power. Exploiting the universe of Mexican commercial bank loans, we show that after the 2014 collapse in energy prices, banks ex-ante more exposed to the energy sector further increased their lending to the sector at looser credit terms, particularly to larger borrowers, despite the soaring borrower credit risk. These banks amplified the sector-specific negative shock to the rest of the economy by contracting lending to other sectors, with large negative macro spillovers, especially in the capital-intensive manufacturing sector.

 [Agarwal-Owe a Bank Millions, the Bank Has a Problem.pdf](#)