Discussion of Fabiani, Piñeros, Peydro, and Soto (2020): "Capital Controls, Domestic Macroprudential Policy and the Bank Lending Channel of Monetary Policy"

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Summary

- The paper identifies the effects of a 40% unremunerated reserve requirement (URR) on FX debt inflows and increase in reserve requirements (RR) on domestic bank deposits introduced in May 2007 in Colombia.
- Using administrative credit registry and supervisory banks' balance-sheet data, the paper establishes the following findings:
  - FX-indebted Banks use cheaper FX-funding from abroad to arbitrage contractionary local monetary policy (bearing more risk in the process);
  - URR reduces the interest rate differential, effectively breaking the carry trade mechanism, and thus enhances the bank-lending channel of local monetary policy while reducing bank risk-taking;
  - RR increase reduces credit supply during the boom but does not amplify monetary policy shocks' effects.

General Take

- Interesting and well executed paper that makes a nice contribution.
- Able to identify mechanisms underlying URR and RR.
- Analysis has much value from both a scientific and policymaking standpoint.

Comments: Systematic Monetary Policy

- The authors acknowledge the endogeneity of the monetary policy rate and control for lagged GDP growth, CPI, and exchange rate.
- But the potential *independent* effect of credit spreads or other proxy for credit market sentiment are not controlled for.
- Such effects may bias the estimation and contribute to the significantly positive estimated effect of MP shocks on credit volume.

Comments: Unconventional Effects of MP Shocks

- Contractionary MP shocks significantly raise credit volume *on average*.
- This contrasts conventional wisdom.
- This would not matter so much for the estimation of MP shocks' *differential* effects as long as favorable credit supply shocks effects' aren't materially different across the pre- and post-2007:Q2 periods.
- This may not be the case owing to leverage changes.
- More generally, I would also control for leverage in the regressions by adding $\beta_4 Leverage_{f,yq-1} i_{yq-1}$.

Comments: Unconventional Combined Effects of URR and RR Shocks

- In a previous version of the paper, the regression from Table 2 reported $Post_{yq}$ and had a significantly positive coefficient.
- That implies that URR and RR shocks significantly raise credit volume on average.
- Table 10 shows that RR shocks alone likely reduce it and in the least saturated specification from that table $Post_{yq}$ has a significantly negative coefficient.
- A litmus test for the success of the joint policy shift is for there to be a robust negative coefficient on $Post_{yq}$.
- Right now it is not clear if that litmus test is passed.

Comments: Carry Trade Mechanism

- Shocks to interest rate differential have significantly positive effects on both credit volume and credit price for banks with large FX-funding relative to less FX-indebted banks.
- If carry trade mechanism is credit-supply-driven, we should expect a negative effect on credit price.
- In the URR and RR period these banks' credit volume and price responses are less positive.
- Unclear that this speaks to an amplification or moderation of carry-trade mechanism.

Comments: Obtaining Impulse Responses

- Estimated effects are currently largely static (barring Figure 5).
- An additional specification to potentially look at is a local projection framework.
- This would allow a more dynamic look at the effects of MP shocks as a function of the URR and RR states, even if the these states do only last for roughly 6 quarters.