

DISCUSSION: “EXPECTATIONS AND BANK LENDING” MA, PALIGOROVA, PEYDRO

Juliane Begenau (Stanford & NBER & CEPR)

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- How do lender expectations shape credit supply & invest.?
- Relative contribution:
 - Prior literature *indirect link b/w* lenders' expectations & credit
 - FR-Y-14 data!
 - *Directly* show impact of banks' econ. expectations on credit supply

Main findings

- (1) Determinants and properties of bank expectations about MSA (findings consistent with prior literature)
 - Experience shape expectations (Malmendier & Nagel 2011)
 - Belief disagreements exist (Giglio et al 2020; Coibion and Gorodnichenko 2015; Bordalo et al 2020)
- (2) Bank expectations affect loan supply & invst. (novel in ident.)
 - Convincing evidence: MSA pessimists lend less at higher R
 - within MSA-year across lenders or within firm/MSA/year across multiple lenders
 - baseline expectations do not affect loans
- (3) Describe bank expectations and lending link during Covid-19
 - Pessimists lend less; lower loan losses

Comment (1):

Expand characterization of lenders' expectations

- Paper raises several interesting Q about lenders' belief determination
- What drives lenders' belief dispersion?
 - Lenders with pre-exposure to MSAs with worse economic outcomes are more pessimistic
 - Were they active in those MSA during 06-09?
 - What drove selection of pessimists into prev. worst MSAs?
 - Distribution of MSA & firm characteristics and lenders' beliefs?
 - Do pessimistic lenders under/outperform over time?
 - Whose beliefs are right?
 - Did pessimists just learn from prev. experience?
 - Short sample but could rank banks based on forecast errors and loan losses

Comment (2):

Loan market response to belief dispersion?

- Alternatives to bank credit on the rise
 - Fed Richmond 2015 business financing survey
 - 20% of credit applicants go to non-bank alternatives
 - Rejected SMB bank loan applicants turn to non-banks
 - Bank mortgage market share decline (Buchak et al, 2020)
- Baseline expectations a bit better for MSAs with worse crisis experience
 - Worst during crisis MSAs had stronger recoveries
 - Yet well-identified results in the paper suggest that lenders lend less in those MSA
 - How does this square with stronger recoveries?
- While large in bank asset size, only 11 banks included in the sample
 - What is their market share and evolution over time?

Comment (2) ctd:

Loan market response to belief dispersion?

- Recent research explores role of non-bank lenders and IO of finance
 - e.g., Bejenau and Landvoigt (Forthcoming), Buchak Matvos, Piskorski, Seru (2018), Jiang (2019)
- Substitution from nonbank or non-surveyed banks
 - Sample may be too short to detect substitution in firm level reg.

Comment (3) :

What is the take-away for policy?

Empirical results are strong - policy implications less obvious

- For welfare/policy source for expectation differences important
 - Role for learning/initial conditions
 - Not clear that pessimists aren't right about lending less
- Economic strength of beliefs relative to alternative mechanisms?
 - Balance sheet conditions
 - B/S conditions measured at book value may not capture actual state of bank health (Begenau, Bigio, Mayerovitz, Vieyra, 2021)
 - Consider exploring stress test result differences
 - Funding cost differences
 - Appendix introduces funding cost differences but unexplored
 - E.g., could use differences in deposit market power b/w banks to proxy funding cost var.

Conclusion

- Excellent paper!
Expectations matter in addition to balance sheet conditions: robust & plausible conclusion
- Before drawing conclusions for policy and/or welfare
 - What is the optimal amount of lending?
 - Explore role of balance sheet conditions / funding cost differences in conjunction with belief differences
 - Lending alternatives to sample banks (only 11 banks!) include non-surveyed banks and more importantly non-bank lenders

Small points

- Related earlier paper using the Fed's survey of loan officers should be added to the citation list
 - Lown, C. and Morgan, D.P., 2006. The credit cycle and the business cycle: new findings using the Loan officer opinion survey. *Journal of Money, Credit and Banking*, pp.1575-1597.
- The finding that small and large firms are different appears mechanical – larger firms are active in a broader market. No surprise that national expectations matter more for larger firms
- Did pessimistic lenders had a worse GFC experience compared to optimistic lenders?
- Covid-19 analysis could be richer. For example, did the aggregate Covid-19 shock increased or decreased dispersion in lenders' expectations?
- Are expectations and lending results consistent with survey of loan officers?
- Tiny typo: in title footnote Kathrin Schlafmann is written with an "i" not an "y" :)

Small comments on the model

- The write-up of the model is a bit unclear, e.g.,
 - Maybe I am missing something but IA1 is inconsistent with the text - looks like there is a typo in the text, in that the normal state has probability p and the SA has a prob. of $1-p$
 - You are making specific assumptions about the competitive environment in this lending market, it would be important to state those, i.e. ,perfect competition etc.
 - Why is the bank not optimizing to determine its loan supply? (in other words, I'm confused why you simply derive IA2 via a zero profit condition. would change IA2 just a little bit)
- Would explore funding cost differences and balance sheet strength differences in the model
- Personally, I think as is the model is not contributing much and could be perfectly omitted from the paper. As is, the results of the model are tautological. I do think that the paper could be even more interesting and could nail your conclusions (role of beliefs over balance sheet conditions) more forcefully with an actual role for a model. However, you might be as successful by simply not including it. To have a meaningful role for the model, it would be useful to add at least another force to the model (see mechanism slide).