Discussion of "International Spillovers and Local Credit Cycles" by Giovanni, Kalemli-Ozcan, Ulu and Baskaya

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Global Research Forum on International Macroeconomics and Finance

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The Contribution

1. Quantify the aggregate impact of Global Financial Cycle (GFC) on domestic credit growth in Turkey over 2003-2013 period
   - Capital flows induced by GFC is proxied by movements in VIX

2. Identification of channels through which the GFC is transmitted to the local credit conditions
   - "Interest rate channel" – time varying deviations from uncovered interest rate parity condition (currency risk premium)
   - "Exchange rate and collateral channel" – leveraged and mismatched firms

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   - "Interest rate channel" – time varying deviations from uncovered interest rate parity condition (currency risk premium)
   - "Exchange rate and collateral channel" – leveraged and mismatched firms

→ Use of matched firm-bank-loan level data on the universe of bank loans to nonfinancial firms in Turkey!

Main Results

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   - Main mechanism through which GFC are transmitted to local credit conditions in Turkey, **especially during the boom phase of the GFC**
4. "Exchange rate and collateral channel" largely irrelevant

Outline for Today

1. My Discussion
   - International Spillovers in a medium-scale New Keynesial DSGE model
   - Thoughts on the "exchange rate and collateral channel"
   - Monetary and macroprudential policy in Turkey

2. Conclusion

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International Spillovers in a DSGE Model

- Canonical open economy NK-DSGE augmented with financial frictions and currency mismatch in borrowers' balance sheets
- Key channel: *Time varying deviations from UIP, consistent with evidence*
  - Gopinath and Stein (2017) and Akinci and Queralto (2018)

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  - $\mu_t^* \neq 0$ and related to **Domestic Balance Sheet Risks**

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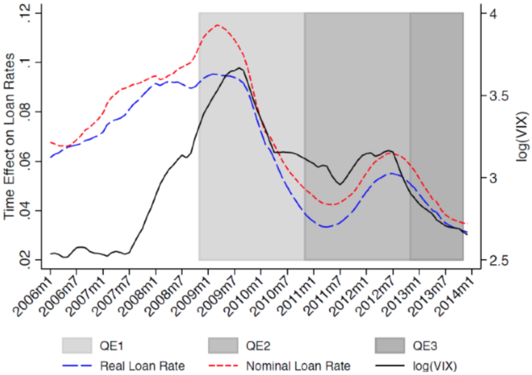
- Quantify the impact of international shocks on the real economy beyond its impact on credit cycle

Model Experiment: Q.E. in the U.S.

Figure: Q.E., VIX and Borrowing rates in Turkey



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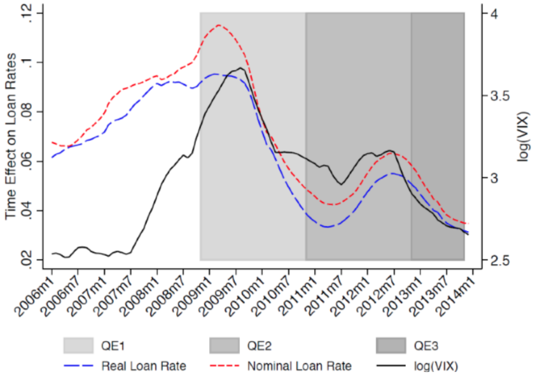


- 20bps drop in the 10-year term premium in the U.S., the estimated effect of \$500 billion of Q.E. (Kiley (2018)) ≈ one-fifth of the overall Q.E.
- ...U.S. GDP expansion of slightly above 0.4% after 2 years

Figure: Spillovers from Q.E. in the U.S.

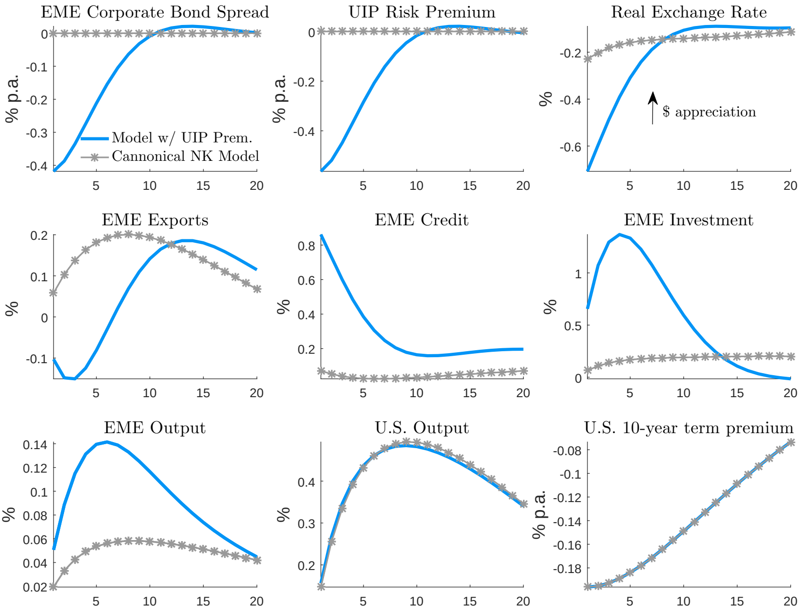
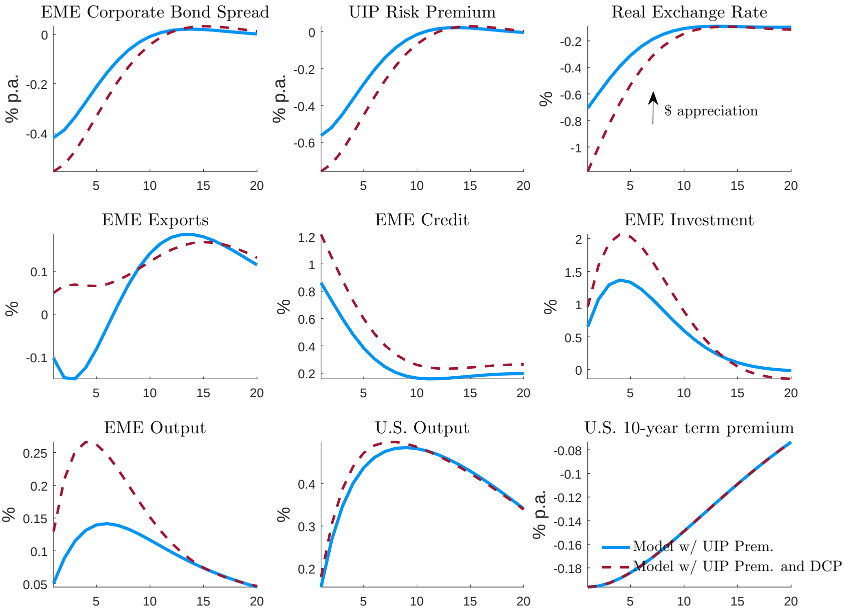


Figure: Spillovers from Q.E. in the U.S. with DCP



Key Takeaways

- Model predicts exchange rate appreciation, lower corporate borrowing rates and local credit expansion in response to a fall in US term premium

- Balance sheet revaluation due to exchange rate changes in EMEs could be important in accounting for the spillovers

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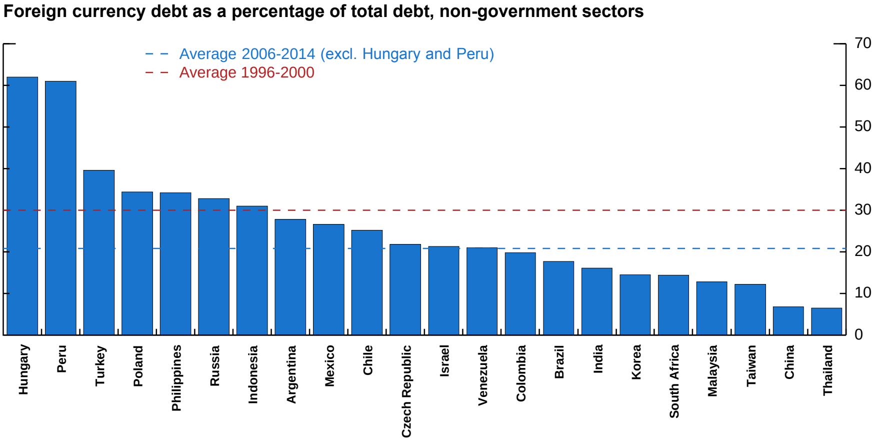
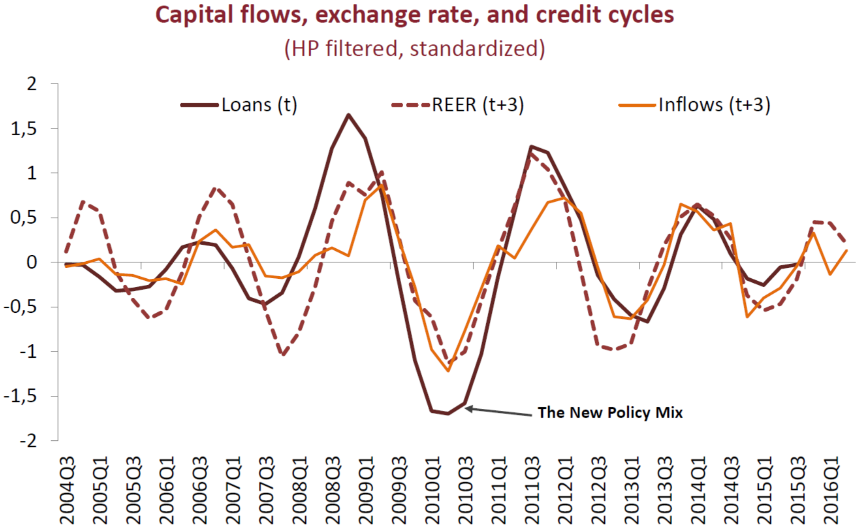
Exchange rate and Collateral Constraints

- Several other research emphasize the importance of foreign currency debt in accounting for international spillovers to EMEs
  - Krugman (1999), Cespedes, Chang and Velasco (2004), Bruno and Shin (2015), Aoki et al. (2016), ...
- The authors argue this channel is largely irrelevant for Turkey
  - Triple interaction: **Leverage, FXshare and VIX or ΔNER**
  - Currency composition of balance sheet data not available – a proxy used.
    - Alternative measures of FX share or different cutoff to group firms as mismatched?

Currency Mismatch still sizable in Turkey

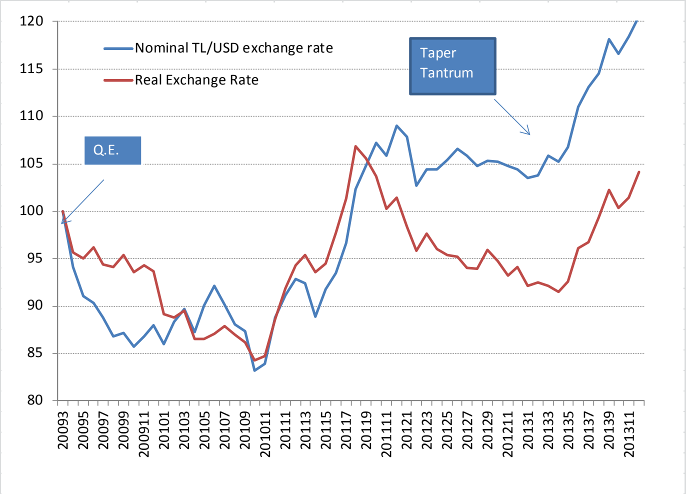


Source: Chui, Kuruc and Turner (2016)


Capital flows, exchange rate, and credit cycles
(HP filtered, standardized)
Loans (t)
REER (t+3)
Inflows (t+3)
The New Policy Mix
2
1,5
1
0,5
0
-0,5
-1
-1,5
-2
2004Q3
2005Q1
2005Q3
2006Q1
2006Q3
2007Q1
2007Q3
2008Q1
2008Q3
2009Q1
2009Q3
2010Q1
2010Q3
2011Q1
2011Q3
2012Q1
2012Q3
2013Q1
2013Q3
2014Q1
2014Q3
2015Q1
2015Q3
2016Q1

Source: CBRT.

Exchange Rates in Turkey



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Other policy tools

- Reserve requirements and interest rates were used jointly for both monetary policy and macroprudential purposes during the authors' sample period

- In particular, RRR and remuneration rates are adjusted to favor
  - Core liabilities over non-core liabilities
  - Long-term over short-term
  - TL over FX

- Additional measures to limit FX borrowing

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- Additional measures to limit FX borrowing
- How do authors control for other policy tools?

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- Excellent paper!
- Micro data analysis is very rich
- Important empirical evidence on international spillovers