Discussion of "Quantitative easing and bank risk taking: evidence from lending" (by Kandrac & Schlusche)

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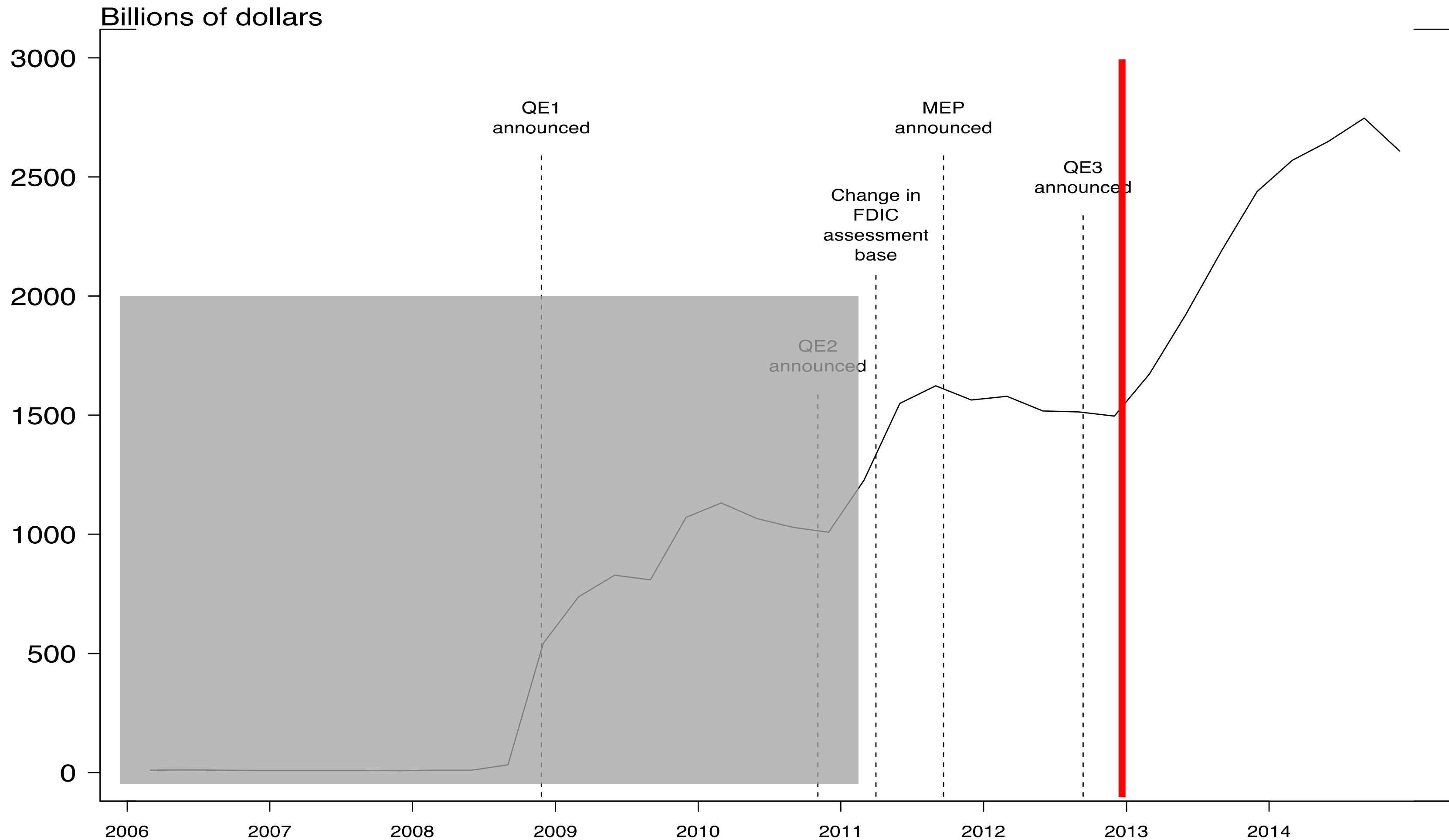
These are my private views and do not necessarily reflect those of the ECB or the Eurosystem

What the paper does

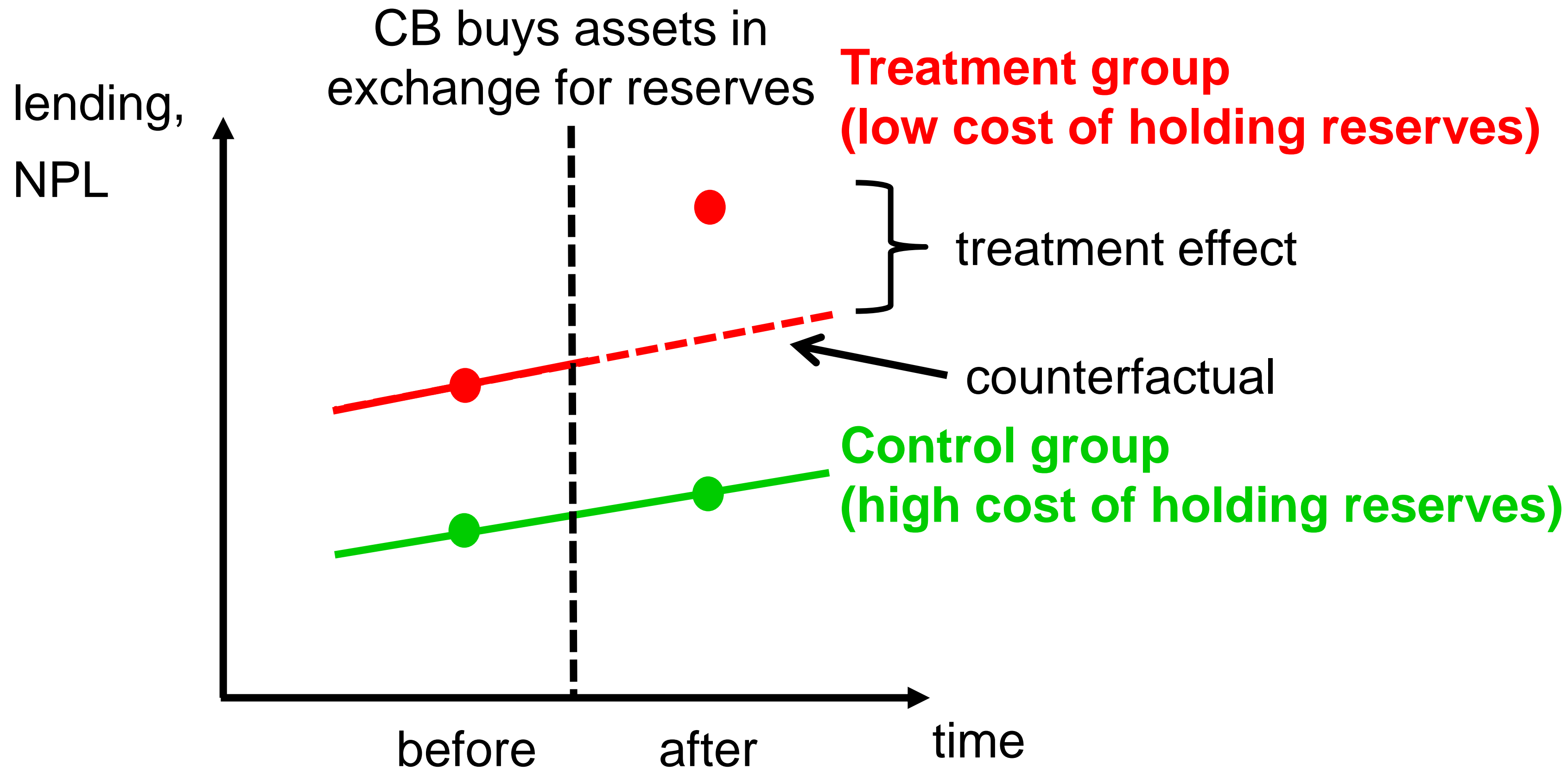
- What is the impact of QE on bank behaviour?
- Highly relevant
  - QE is all there is left for central banks
  - need to understand benefits and costs
- Problem: Endogeneity
  - banks decide on both, how much assets to sell (and obtain reserves) and what kind of lending to do
- Solution: Difference-in-difference approach
  - compare groups of banks with a different benefit of holding reserves
  - before and after a QE program

⇒ QE leads to more lending and more risk taking

The quasi-experiment

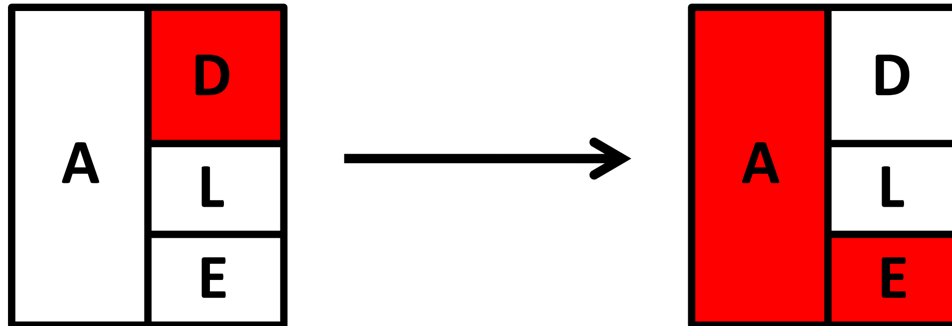


Difference-in-difference



Treatment and control group

- FDIC changes assessment for deposit insurance



- 3 groups of banks
  - domestic banks subject to U.S. deposit insurance
  - foreign banks not subject to U.S. deposit insurance
  - custodial banks

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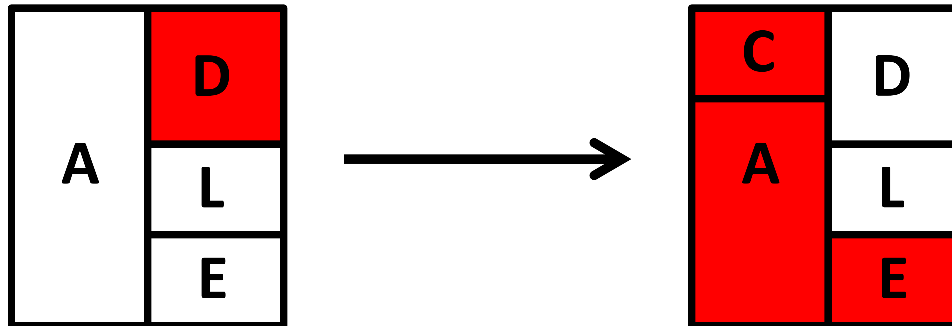

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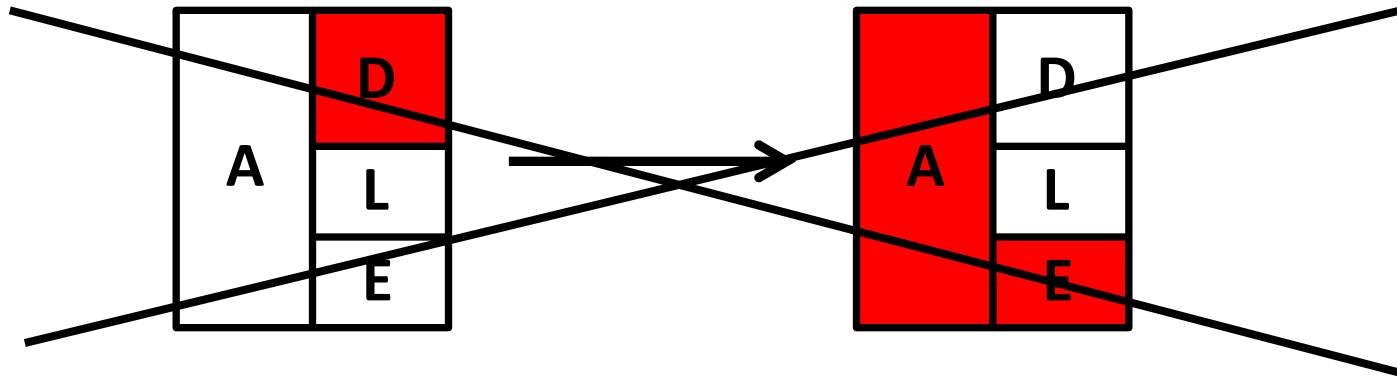

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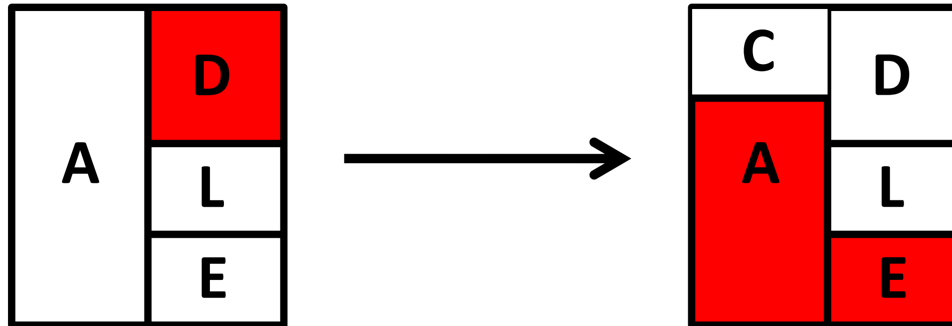

- 3 groups of banks
  - domestic banks subject to U.S. deposit insurance
  - foreign banks not subject to U.S. deposit insurance
  - custodial banks (reserves are exempt after FDIC change)

Treatment and control

- What the paper does
  - compares foreign & custodial to domestic, before & after QE3 (QE2) (post FDIC change)
  - "placebo" diff-in-diff: foreign & custodial to domestic, before & after QE1 (pre FDIC change)
- Hence
  - treated=foreign and custodian
  - control=domestic
- But
  - why do domestic banks have a larger cost of holding reserves than foreign banks?
  - foreign banks not affected by FDIC change
  - (are domestic banks affected by FDIC change?)

Better treatment and control?

- What I would do
  - treatment=custodian banks after FDIC chance
  - control=domestic/foreign banks

- Hence
  - compare custodial to domestic/foreign for QE3 (post-FDIC change)
  - compare custodial to domestic/foreign for QE1 (pre-FDIC change; placebo)

Summary

- Highly relevant issue: how does QE work?
- Focus on the behaviour of banks: they decide to be exposed to non-standard monetary policy
  - to overcome endogeneity, exploit institutional environment
  - Garcia-de-Andoain, Heider, Hoerova & Manganelli (2015): solve endogeneity using a structural VAR (timing of MROs)
- Rethink/explain treatment vs. control group
- Deal with usual diff-in-diff concerns
  - does the control group provide the counter-factual (placebo)?
  - anything else affecting only treatment group the same time as QE3?
- Needs to explain why exchanging assets for reserves makes banks lend more and take on more risk