“The Effect of Structural Risks on Financial Downturns”

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Views of the speaker not of the IMF

Summary

- **Vulnerabilities during financial cycle upturn $\leftrightarrow$ NPLs in downturn**
  - Establish turning points of the financial cycle
  - Use panel data on economic and financial conditions
- **NPLs during downturns higher when (one year lagged):**
  - More debt (public, private)
  - Weaker/riskier banks (capital, leverage, RW, liquidity, RE concentration)
  - More bank-dominated or more open economies
  - Looser monetary policy
- **Relationship driven by countries with above-median vulnerability**
  - RE concentration, leverage, PNFS debt, loose monetary policy

Assessment

- **Not the first paper to consider drivers of NPLs**
  - Single vs. multi-country
  - Steady state NPL vs. post-crisis NPL
- **What is new and useful in this paper**
  - NPLs at the turn of financial cycle → a good event definition
  - Drivers of NPLs most pronounced in vulnerable countries
    → Interesting, policy-relevant
  - Attempt to separate structural and cyclical vulnerability
- **Let me ponder on the last two**

“Drivers of NPLs most pronounced in vulnerable countries”

- **Seems like the “star” result of the paper**
- **Threshold effects are rarely discussed, but believable**
  - Example: pre-GFC capital did not matter for bank conditions linearly, but banks with very low capital have failed
- **Explain the mechanism better**
- **Dimensions of vulnerability**
  - RE concentration, PNFS debt, leverage, loose monetary policy
  - Why these? Do others work? Is there a story?
  - Create an index measure & assess best threshold of vulnerability (which max the significance of pre-crisis conditions for post-crisis NPLs)?

“Structural vs cyclical factors”

- **Less convinced of terminology**
  - Structural = time-invariant: competition, ownership, banks-vs-markets, interconnectedness
  - Debt/GDP, bank capital/liquidity, ROA seem not structural but cyclical.
- **In the end, matters little except for exposition**

- **Alternative story (for another paper?):**
  - Time-invariant structural factors make both the financial cycle upturn and downturn more pronounced

Summary

- Pleasant to read and thought-provoking
- NPLs around the turn of the financial cycle is a good angle
- Results are believable
- Drivers of NPLs most pronounced in more vulnerable countries
  - This result deserves more emphasis.
  - Possible mechanism?
  - Policy implications?
- Can be published very well