

The effects of foreign and government ownership on bank lending behavior during a crisis in Central and Eastern Europe

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- The paper attempts to analyze the lending behavior of government owned as well as foreign banks during domestic and global financial crisis in central and Eastern Europe.
- The focus is on whether government owned banks provided stability during the crisis.
- During domestic banking crisis in these countries they find that foreign banks maintained or increased their credit levels.
- The domestic banks on the other hand may have faced declining credit in domestic crisis.
- There seems to be no conclusive evidence that parent banks' financial situation determines foreign subsidiary lending.

- In periods of host and home financial crisis only bank characteristics of profitability, liquidity and deposit growth were important in determining lending behavior.
- It is argued that a diversified ownership structure of banks helps when faced with a crisis.
- An important omission in the paper is a description of the nature of crisis in each country and a summary of what happened to bank lending in these periods in each country.
- In the absence of such a discussion it is a little difficult to appreciate the significance of the results presented.
- The paper uses an empirical specification that is very similar to the one used by Jayarantne and Morgan (2000) [Journal of Money Credit and Banking] but their interpretation of results is quite different compared to this paper.

- Jayaratne and Morgan (2000) use the following specification:

$$L_{it} = \alpha_0 + \alpha_i + \alpha_t + \alpha_1 D_{it} + \alpha_2 W_{it-1} + \epsilon_t$$

Where

- L_{it} is deposit growth, α_i and α_t are fixed bank and year effects, D_{it} is growth of insured deposits, W_{it-1} is vector of variables controlling for loan demand facing a bank (Tobins Q, lagged loan growth, beginning of period loan loss provisions, change in loan loss provisions over the previous year, growth rate of total lending by all banks in the state, size and holding of securities).

This specification is obviously very similar to the one used in this paper.

- Jayaratne and Morgan (2000) use this specification to estimate the extent to which deposit growth constrains loan growth.
- This is akin to the literature on finance constraints on investments for manufacturing firms [Fazzari, Hubbard and Petersen (1988)].
- They consider insured deposits with banks to be similar to cash flows of manufacturing firms.
- If there exists a perfect capital market then loan growth of banks would not be influenced by deposit growth after accounting for loan opportunities faced by the bank.

A positive coefficient on deposit growth is taken to be indicative of deposit constraints on loan growth.

- In the paper under consideration the authors do not adequately control for loan opportunities surrounding a bank and thus the JM interpretation cannot be applied.
- If one adds variables like the Tobins Q and loan loss provisions then the coefficient of deposit growth could be directly interpreted as being indicative of deposit constraints.
- The question then could be posed as to whether different ownership groups of banks face different deposit constraints.
- This would be a far more interesting question than the one posed in the paper.

- It could be argued that all results presented are driven by the fact that loan opportunities surrounding a bank are not adequately controlled for.
- If this is done then I suspect the results would possibly change.
- Another bank heterogeneity that is over looked is the loan characteristics of banks (extent of secured lending and loans made to small and medium enterprises).
- Comparing the size of the coefficient of deposit growth in the current paper and the JM paper it is surprising to note that the coefficients are strikingly similar in size.
- the coefficients are in the range of 0.4 and 0.6 in both the papers.

- By adequately controlling for loan opportunities surrounding a bank one could interpret the coefficient of change in deposits as signifying deposit constraints on bank loans.
 - One could then proceed to check for differences across bank groups to determine which bank group has lower deposit constraints.
 - That group which is less dependent on insured deposits to make loans could possibly be seen to be better capable of making loans in a domestic crisis.