

Discussion of

External Finance Premium: Market Finance versus Bank Finance

by L. Chitu, S. Gori, and R.S. Gurkaynak

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Bank of England, CEPR, and CfM

Worlds apart: international macro in a changing world

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*The views expressed here do not necessarily represent those of the Bank of England or of any of its Committees.

My discussion

▶ The praise

- * Great paper, can help to improve our understanding of how monetary policy works
- * Crucial for understanding 'fragmentation' in the euro area

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▶ The comments

- [#1] Monetary transmission
- [#2] Country factors
- [#3] Loose ends (not for today)

Bond spreads recap: Determinants & Monetary Transmission

- ▶ Bond spreads reflect
 - * Firm's expected default risk
 - * Lenders' compensation for risk

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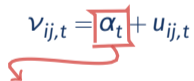
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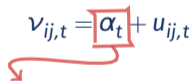
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- * Fitted value from pricing regression capture component due to firm fundamentals:

$$CS_{ji,t} = \alpha_i + \beta DD_{it} + \Gamma Z_j + v_{ij,t} \quad R^2 \approx 0.75$$

- * Common component of pricing errors $v_{ij,t}$ captures lenders' compensation for risk:

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[#1] **Monetary transmission**

Monetary transmission in the euro area

- ▶ **Question** Does monetary policy transmit heterogeneously across EA countries?
- ▶ **Approach** Event study panel regression:

$$\Delta CS_{ij,t} = \alpha_i + \beta_1 \varepsilon_t + \beta_2 \left(\mathbb{1}_{ij}^{\text{LowRat}} \times \varepsilon_t \right) + \gamma \mathbf{Z}_{ij,t} + e_{ij,t}$$

- * $\mathbb{1}_{ij}^{\text{LowRat}}$ is a dummy for a low-rated sovereign
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 - * Why tie your hands up with this specific dimension of heterogeneity?
 - * Does sectoral heterogeneity pose an identification challenge?

A more agnostic specification

- ▶ **Suggestion #1** Take an agnostic view on country heterogeneity

$$\Delta CS_{ij,t} = \alpha_i + \beta_1 \varepsilon_t + \beta_2 (\alpha_c \times \varepsilon_t) + \gamma \mathbf{Z}_{ij,t} + e_{ij,t}$$

- * α_c is a country fixed effect
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- * α_c is a country fixed effect
 - * ε_t is a monetary policy surprise
 - * $\mathbf{Z}_{ij,t}$ is a vector of firm/bond fundamentals
- ▶ What do the country-specific responses $\beta_2 \cdot \alpha_c$ correlate with?

A more tightly identified specification

- ▶ **Suggestion #2** Compare firms across countries in a given sector:

$$\Delta CS_{ij,t} = \alpha_i + \underline{\alpha_{s,t}} + \beta_2 (\alpha_c \times \varepsilon_t) + \gamma \mathbf{Z}_{ij,t} + e_{ij,t}$$

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 - * ε_t is a monetary policy surprise
 - * $\mathbf{Z}_{ij,t}$ is a vector of firm/bond fundamentals
- ▶ Are the results robust to sectoral heterogeneity in sensitivity to monetary policy?

[#2] **Country Factors**

Determinants of bonds spreads in the euro area

- ▶ **Question** To what extent are bond spreads explained by country factors?
- ▶ **Approach** Extract country-by-time fixed effects from euro area spreads

$$CS_{ij,t} = \alpha_{c,t} + e_{ij,t} \quad R^2 \approx 0.06$$

* $\alpha_{c,t}$ is a country-by-time fixed effect

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▶ **Comment** Useful to unpack a bit more the authors' intuition

Unpacking the authors' intuition

- Recall Gilchrist and Zakrajsek (2012)'s decomposition:

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- ▶ **Key object of interest** R^2 after controlling for default risk and common factor

What does it mean for the analysis in the paper?

- ▶ Assume that the common factor α_t has non-zero explanatory power, then:

$$u_{ij,t} = \alpha_{c,t} + e_{ij,t} \quad R^2 < 0.06$$

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- ▶ Great news! Results are stronger → Even lower role for country factors
- ▶ But... How do we make sense of such a low role for the EBP?
- ▶ **Question** Does it mean that lenders' compensation for risk does not matter for bond spreads?
 - * By construction, R^2 from common factor is bounded between 0 and 0.06

Playing around with the data

- ▶ Bond spreads data from ICE BoA from 2006 to 2021 for euro area firms
- ▶ Data treatment (some differences)
 - * Drop financials, auto, real estate sectors, keep senior unsecured ✓
 - * Monthly averages ✗
 - * Spreads computed relative to country government yields ✗
- ▶ Estimate role of time fixed effects:

$$CS_{ij,t} = \alpha_t + u_{ij,t}$$

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Authors' $R^2 < 0.06$

My $R^2 = 0.26$

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$$\begin{aligned} \text{Authors' } R^2 &< 0.06 \\ \text{My } R^2 &= 0.26 \end{aligned}$$

- ▶ How to reconcile the findings?
 - * Monthly vs. weekly frequency may be important → Bond staleness

Playing around with the data

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- ▶ How to reconcile the findings?
 - * Or maybe I've just done something wrong :)

[#3] **Loose Ends**

Loose ends

- ▶ Currency of denomination
 - * Dollar and non-dollar bonds behave very differently in crisis times
[Cesa-Bianchi, Czech and Eguren Martin (2024)]
 - * Keep only USD for US and EUR for euro area
- ▶ Surprising absence of average bond spreads response to monetary policy
 - * Very significant coefficient at monthly frequency (in my data)

In sum

- ▶ A very nice paper, with important policy implications
- ▶ Main suggestions
 - * Consider a more general notion of country heterogeneity
 - * Dig deeper into role of country factors
- ▶ Opens up interesting avenues for further work

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