Discussion of

Boissay, Collard and Smets

# Booms and Systemic Banking Crises

By

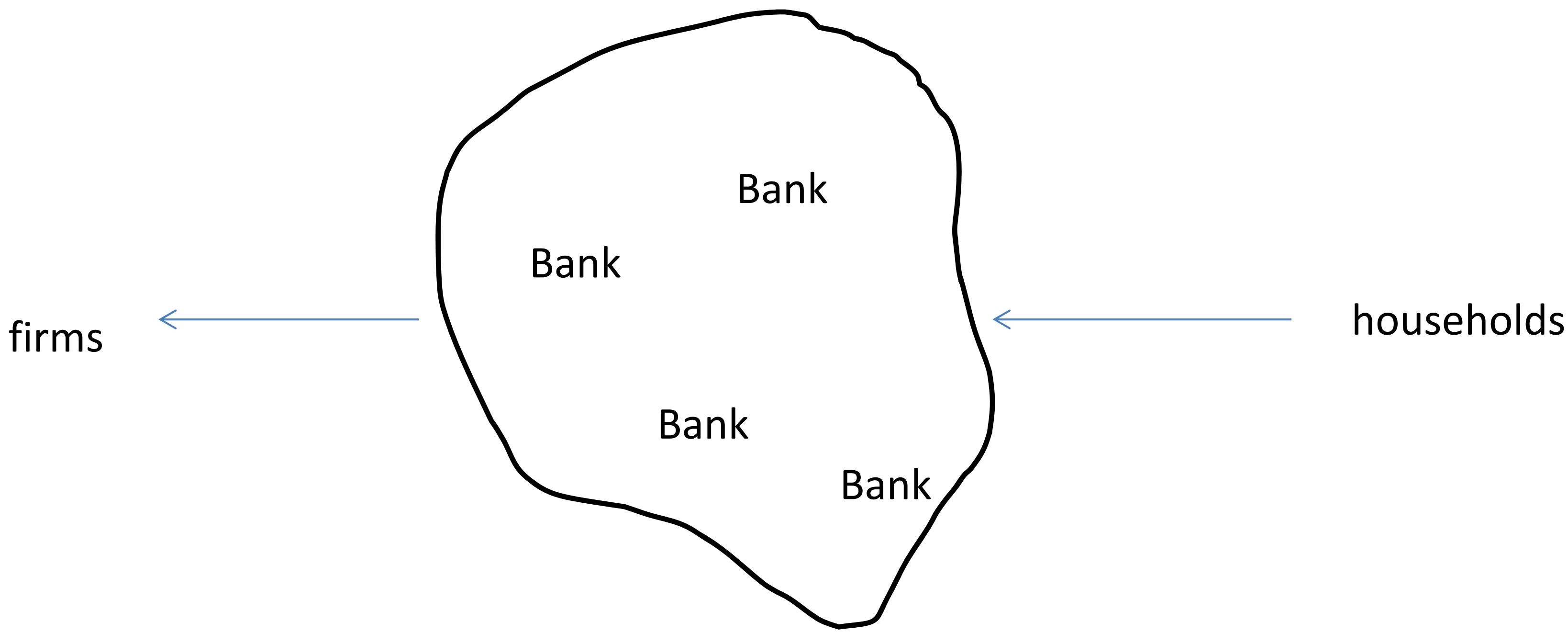
Lawrence Christiano

# Brief Summary

- Simple benchmark: neoclassical growth model.
  - Temporary, positive technology shock.
    - Initially drives up interest rate, consumption, investment, employment.
    - When shock goes away, consumption falls back to steady state and interest rate falls.
    - ‘Banking system’ trivial.

- In the model of the paper
  - High interest rates promote the efficiency of the banking system.
    - Accelerates expansion while shock is high (‘accelerator effect’).
  - Low interest rate damages banking system
    - In normal times, accelerates the decline back to pre-shock state.
    - In crisis times, qualitative shift in the economy, with a major collapse.

# Banks

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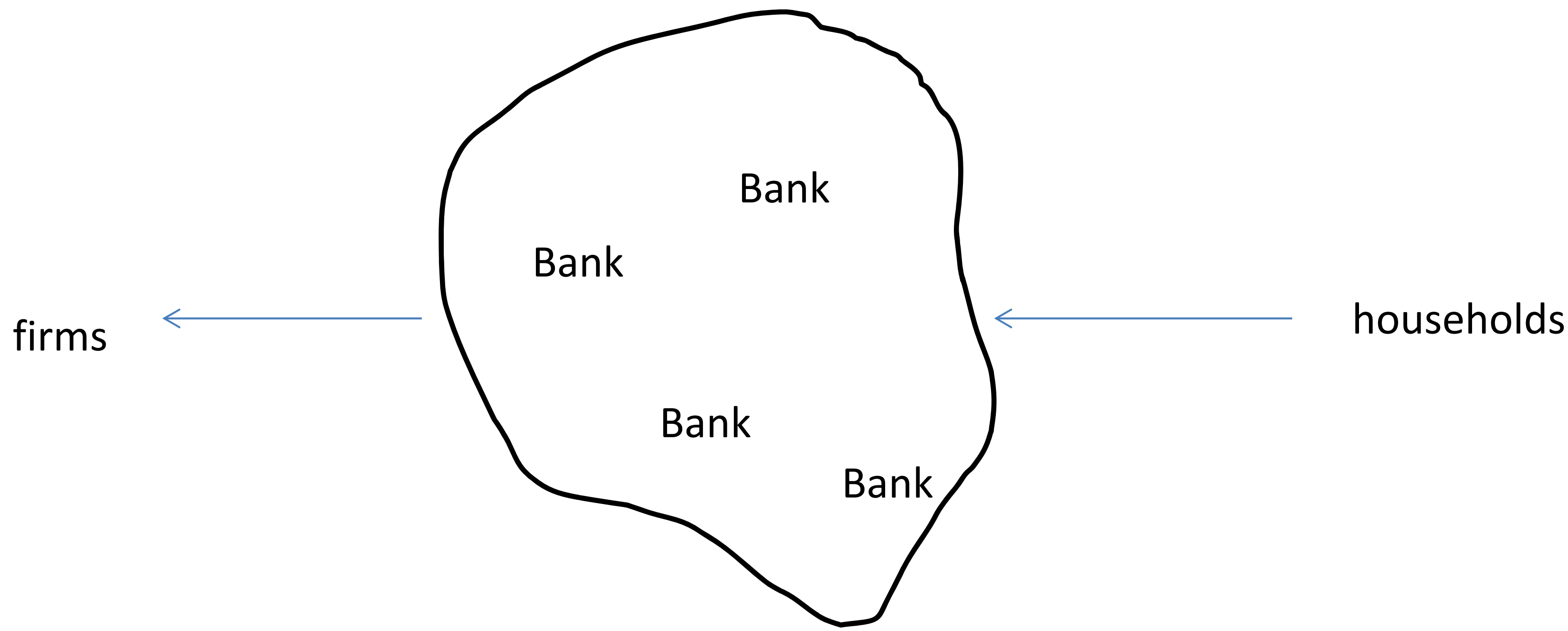


- Banks differ according to their productivity in making loans.
- First best efficient arrangements: low productivity banks lend funds to high productivity banks in the interbank loan market.

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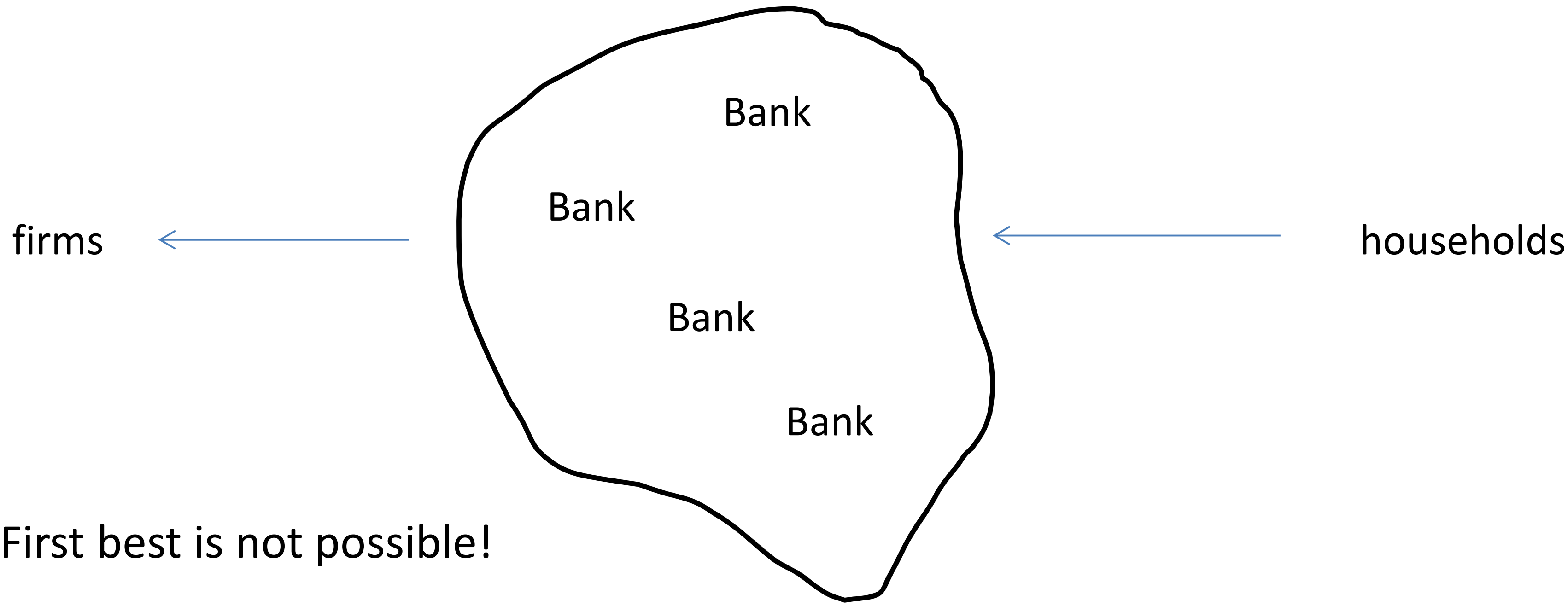


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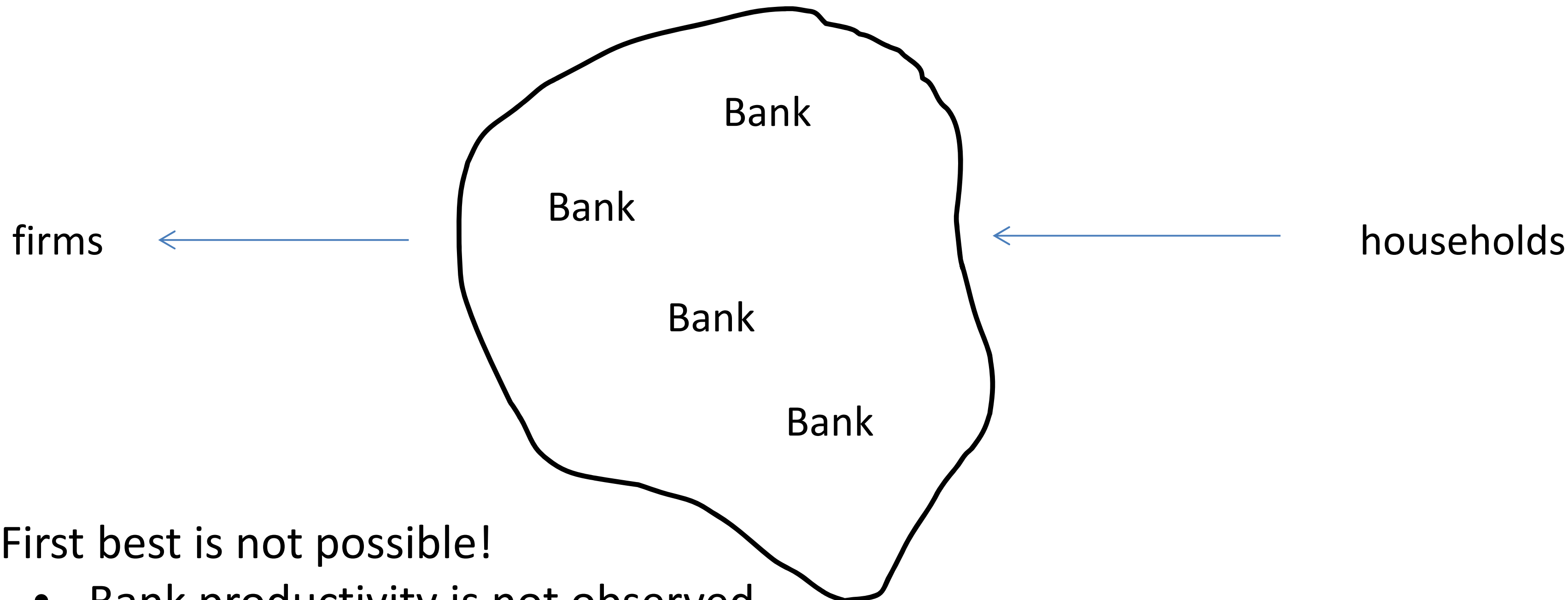


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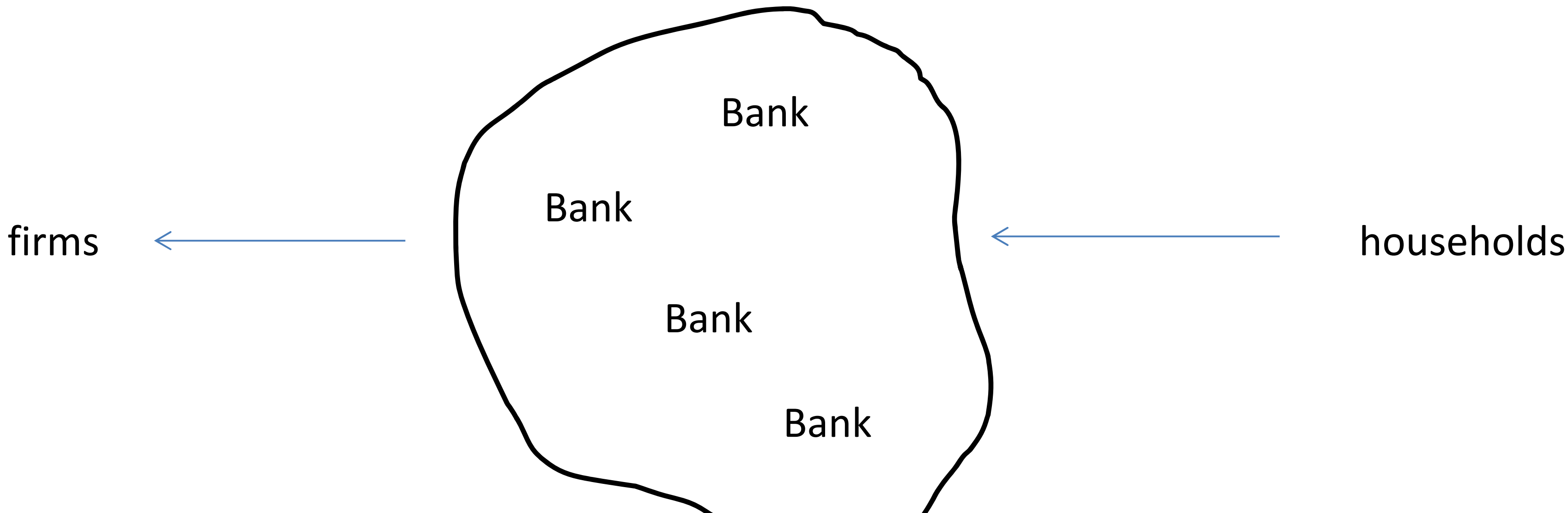


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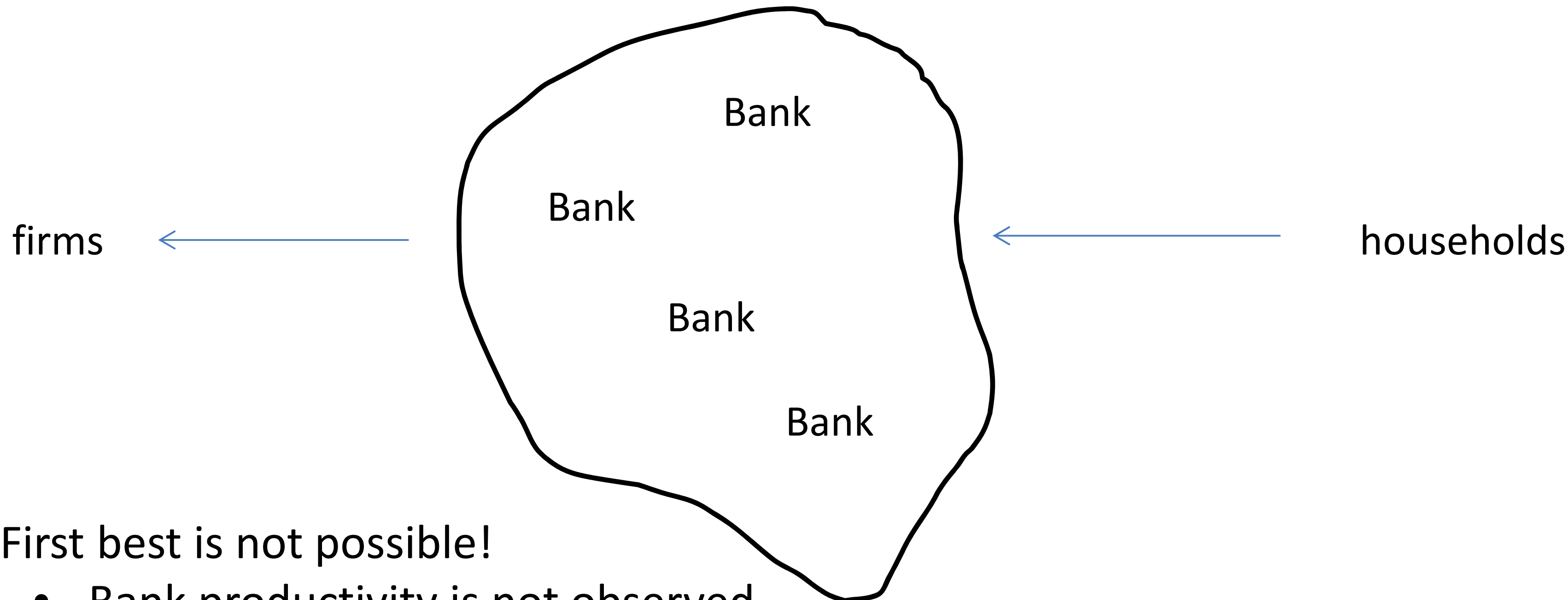


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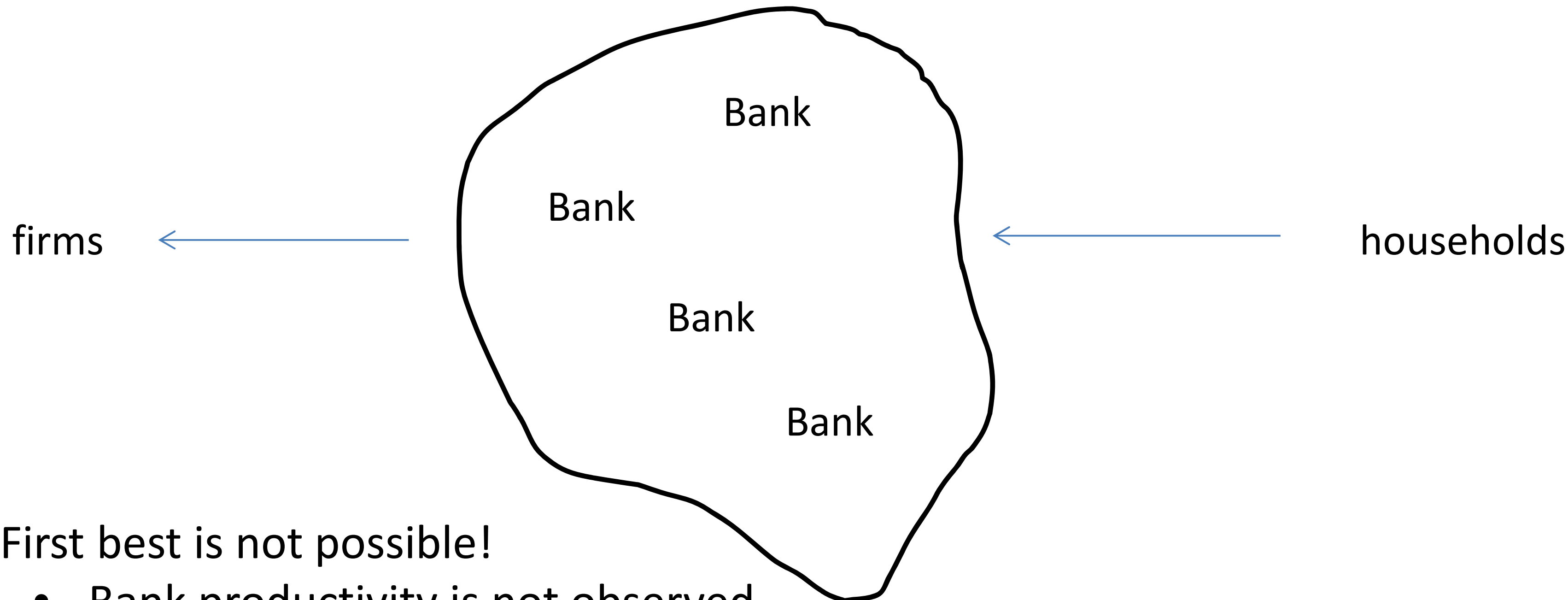


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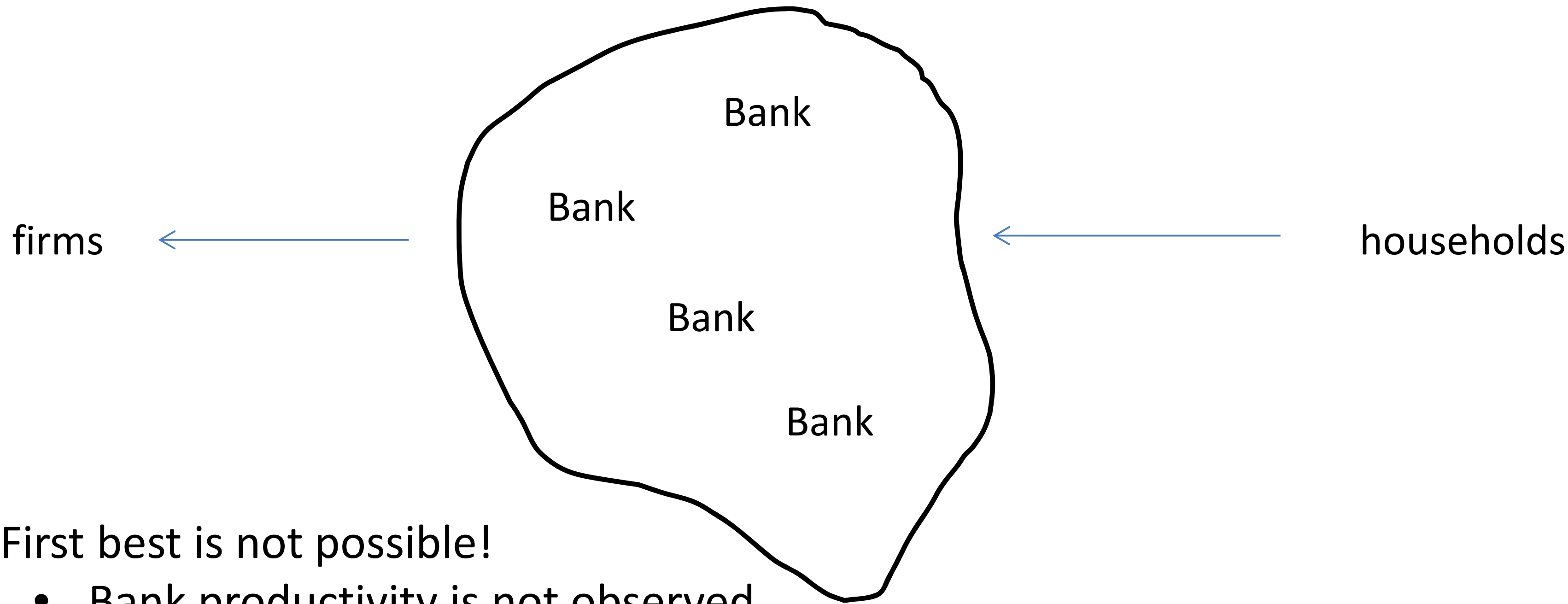


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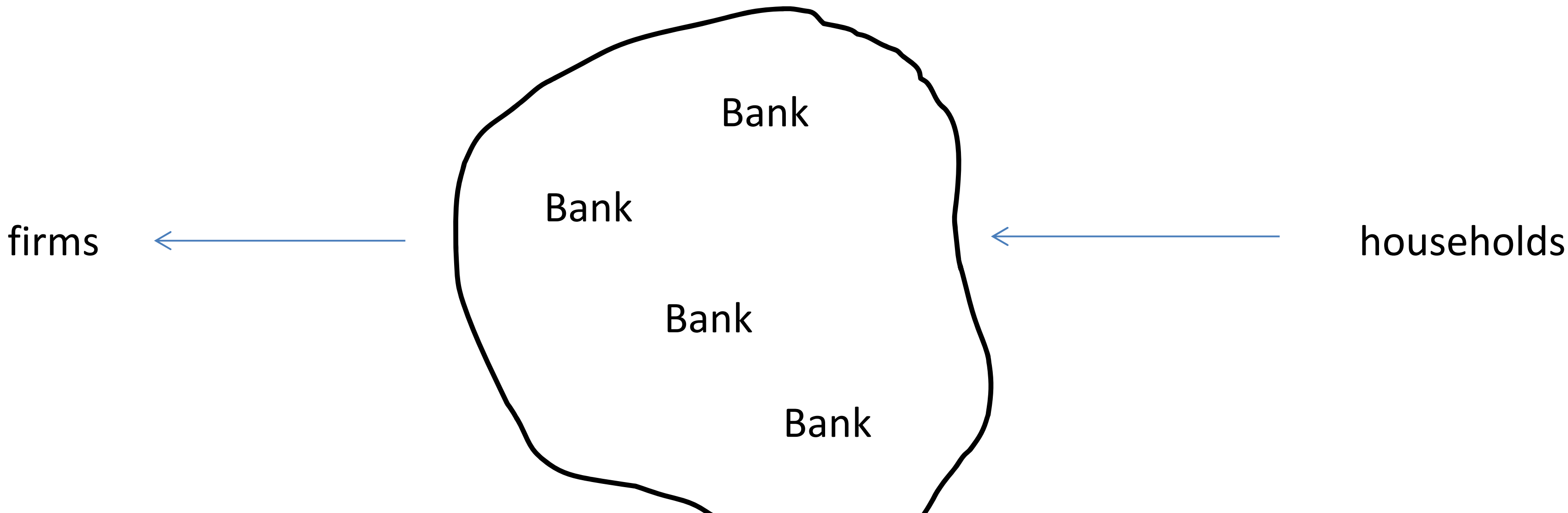


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- Low interest rates
  - Low productivity firms now tempted to exercise outside option and borrow in the interbank loan market.
  - Everyone understands this, leading to shutdown in interbank loan market.

# Comments/Questions

- The ability to default on interbank loans as the core financial friction could use more motivation.
  – How to interpret this assumption in light of the ability to do collateralized lending?

- Model leaves no scope for bank reputation, so punishment of defaulting banks is modest.

- How to interpret banks' outside option? Why does it not also go down when interest rates are low?

- Two crises, the S&L crisis and Great Depression, are times of high interest rates.
  – How to interpret this from the perspective of the model?

- Rates are very low now. Does the model predict a shutdown in interbank loan market?

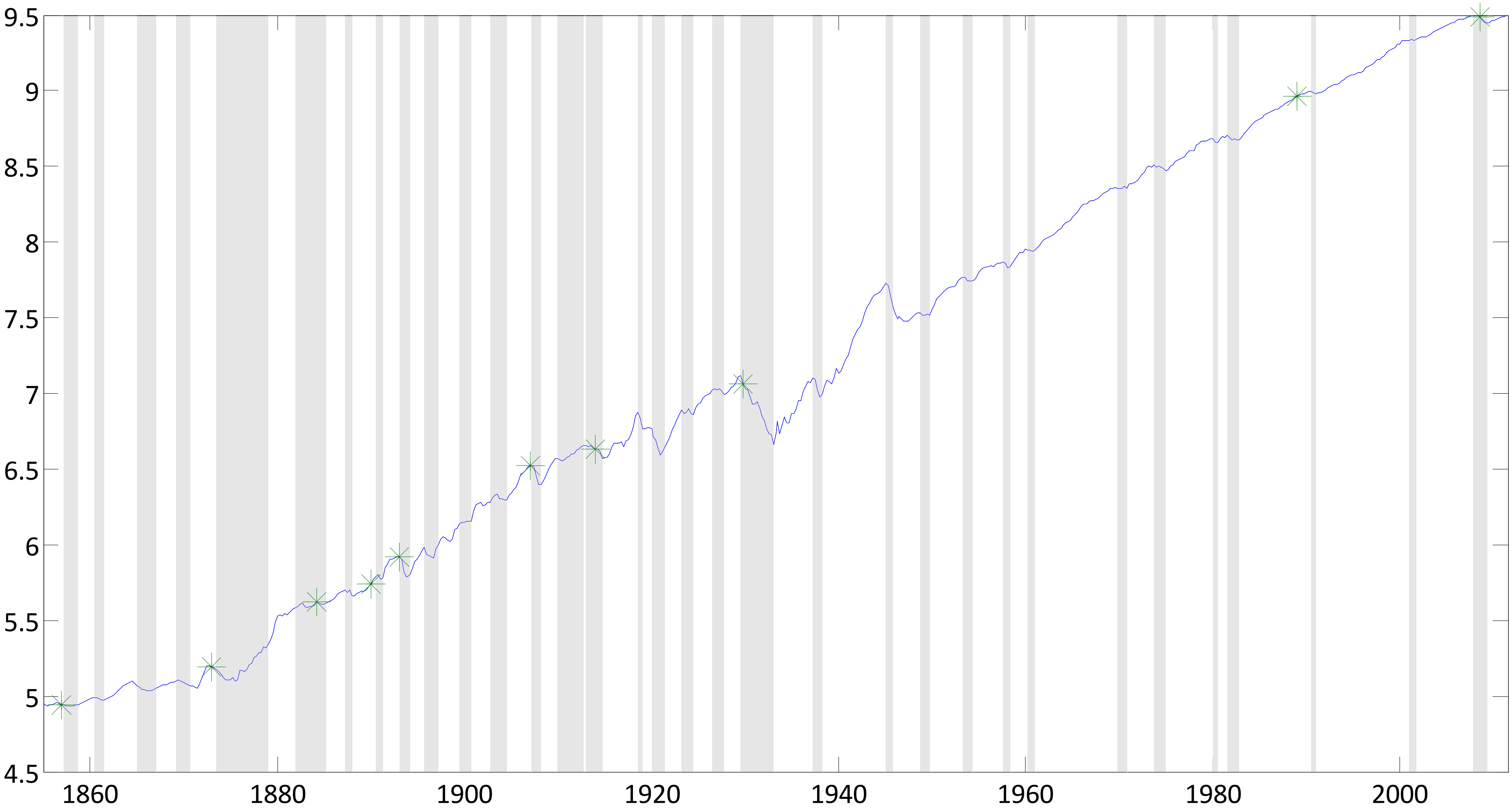
# US Data on Severity of Financial Panic Recessions

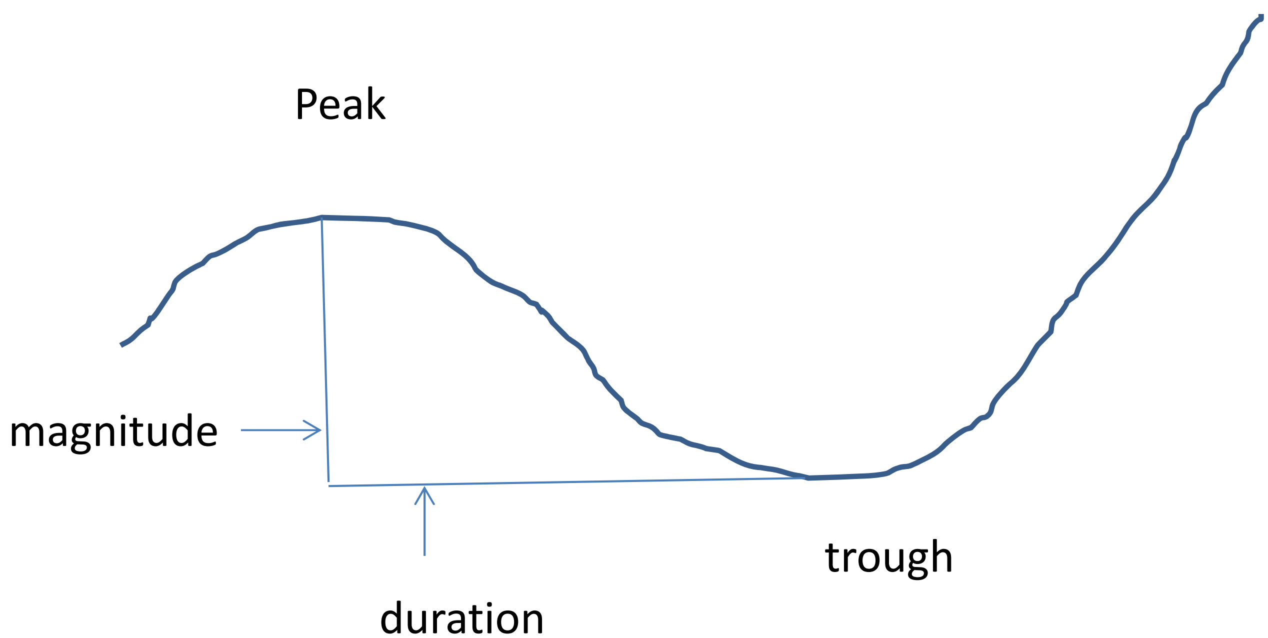
- The paper reports evidence that contractions associated with banking crises can be very severe (complements other work).

- The authors' evidence (sensibly) uses a cross-section of countries.

- What does the US experience say about the severity of banking crisis recessions?

Log, Per Capita US GDP




Peak
magnitude
duration
trough

| Statistics on Recessions and Banking Crises | | | |
| --- | --- | --- | --- |
| Recessions | number | magnitude (%) | duration (years) |
| | | from peak to trough | |
| | | | |
| with banking crises | 10 | 6.5 | 2.3 |
| | | | |
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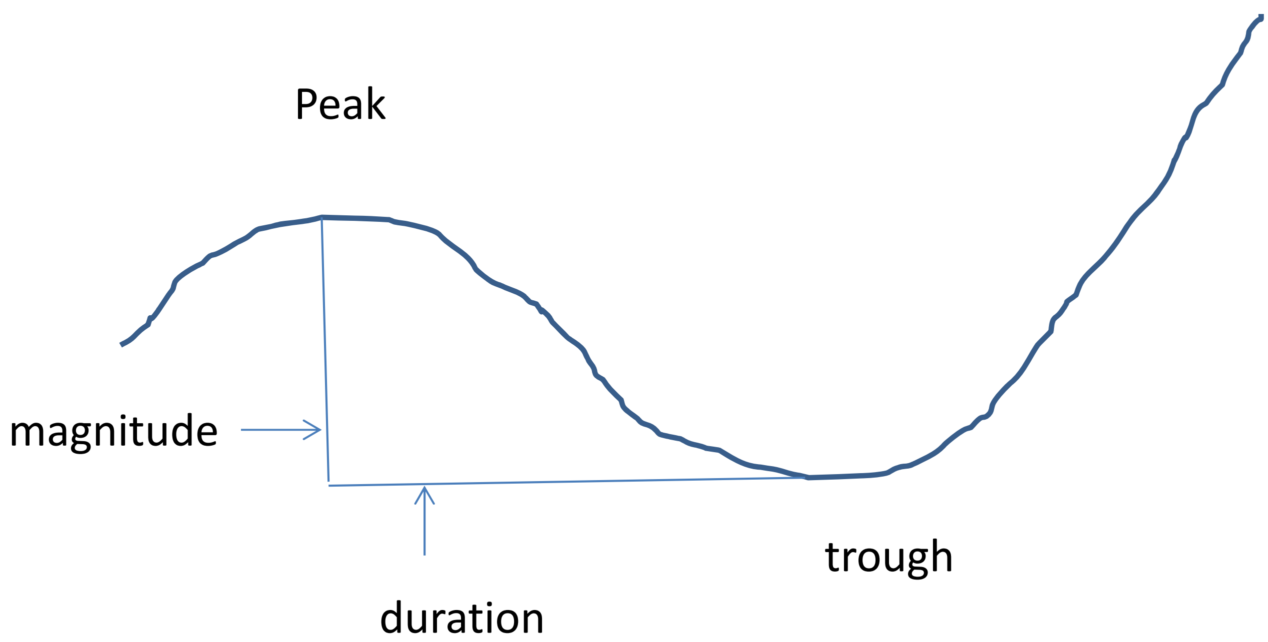

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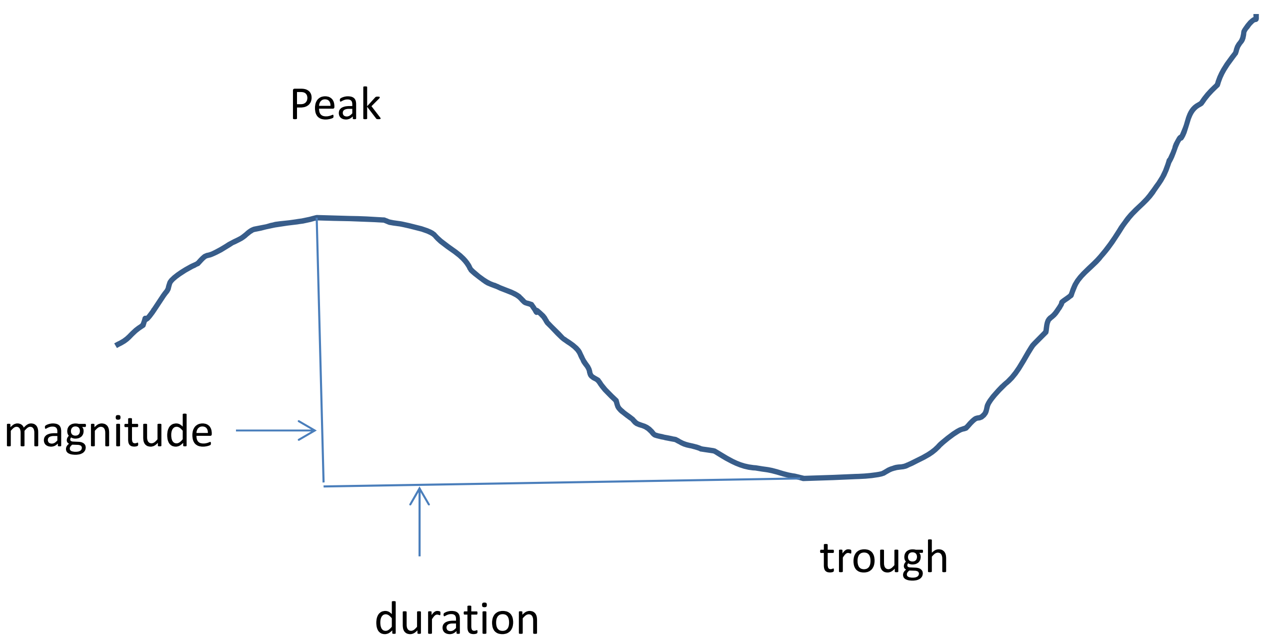

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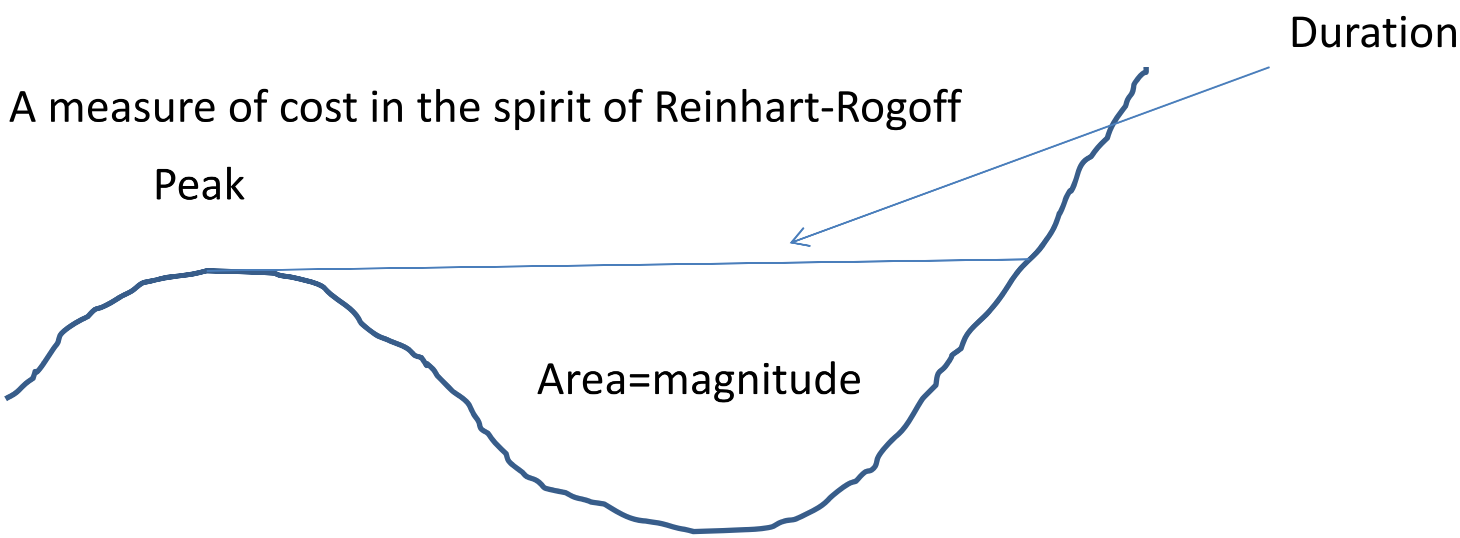
A measure of cost in the spirit of Reinhart-Rogoff



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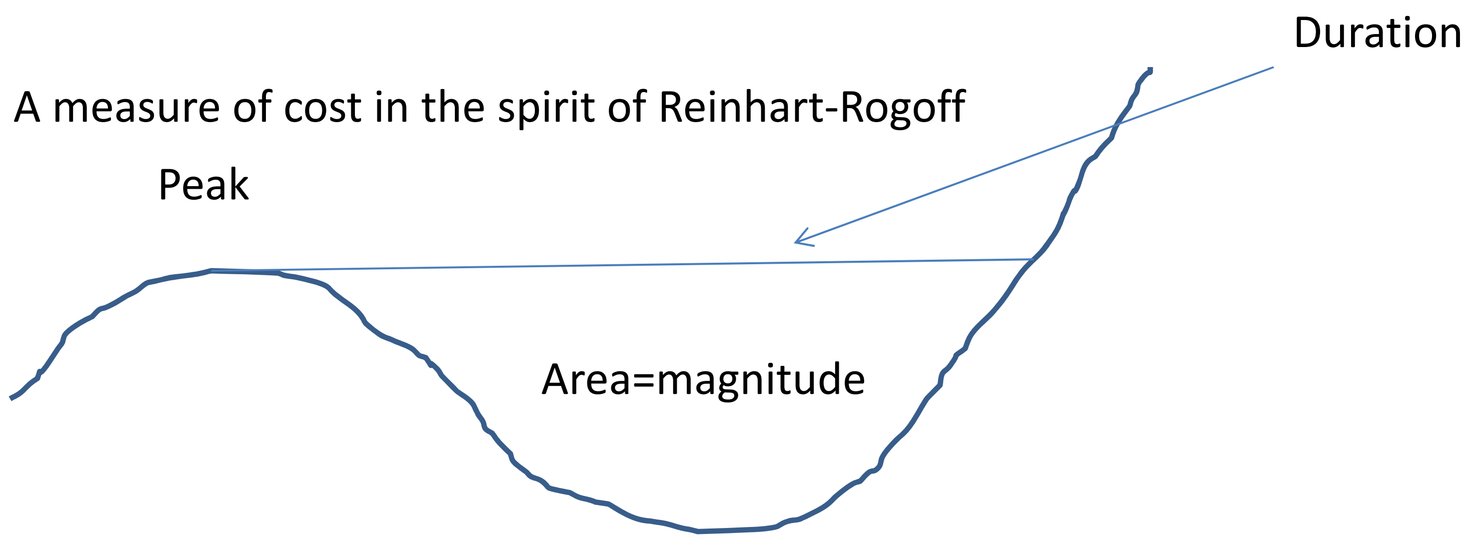

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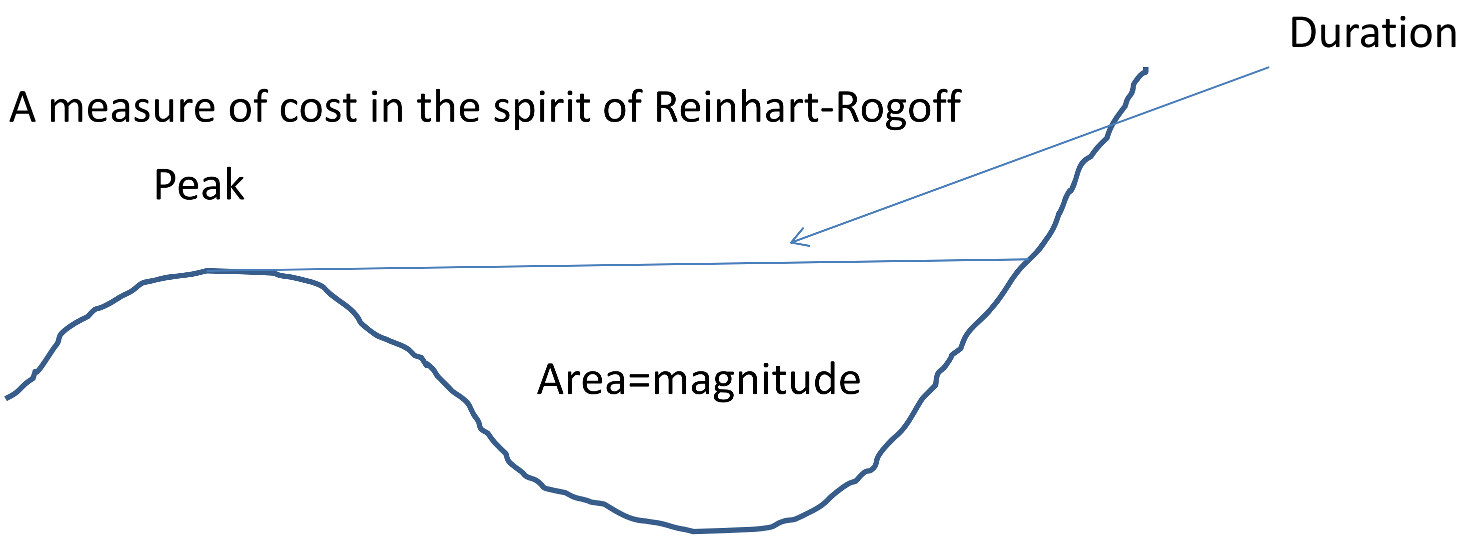

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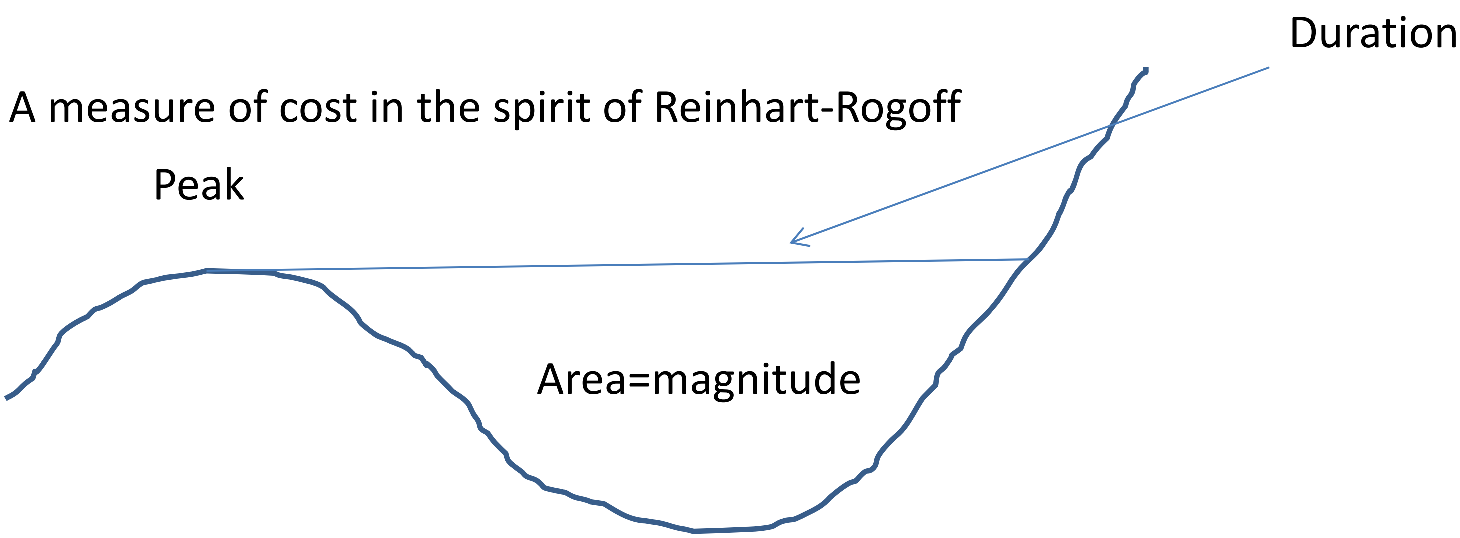


Evidence from US data which supports idea that banking panic recessions are particularly bad comes from the Great Depression, not the other episodes.

# Conclusion

- This is a very ambitious paper.
- Begins by quantifying the financial market phenomenon of interest.
- Builds a model to interpret the facts.
- Model interprets crisis episodes as times of structural shift, in the sense of changing equilibrium conditions.
- It is a technical *tour de force*.
  - It would be great if some of the interpretational issues could be addressed.