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Macroeconomic implications of financial frictions in the euro zone: Lessons from Canada

comments by

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What is the paper about?

- Price and non price elements are important for credit supply, i.e. interest rate and **credit standards.**
- Paper aims to analyse the impact of credit standards on economic performance (i.e. growth), using Canada, the US and the Eurozone.
- The author also proposes to use the model as a stress testing framework to gauge the impact of Eurozone dissolution on the Canadian economy:
  - shocked values of financial conditions (ala Greece) are inserted instead of original Eurozone ones;
  - the impact on the real economy is assessed.

Empirical results/Overview

- The author shows:
  - statistically significant correlations between credit standards and GDP growth forecasts and between credit standards and real credit,
  - negative responses of real GDP and credit tightening for Canada, the US and the Eurozone,
  - higher contagion between financial and real variables for Canada, US and the Eurozone, with the important exception of no contagion from US to Canadian financial variables.
- Some work on cointegration / VECM still under way
- Interesting paper in „hot" area that can be used in today's debate about monetary policy and financial stability

Issue I, what is measured by credit standards?

- Is the author actually testing financial accelerator hypothesis, where firms ability to borrow depends on their net worth, which is stochastic?
- In that case we might have a problem: credit standards might only measure this problem, they are not the cause of the problem:
  - firms collateral value decreases or is “more” uncertain,
  - lenders tighten credit standards.
  - As a result, the change in the lending standards is just the consequence of stochastic value of collateral.

Some further thoughts...

- In addition to financial accelerator theory, are we showing / testing Minsky financial instability hypothesis?
  - In the wake of recession, financial institutions are extraordinary conservative, as people forget that failure is possible, an “euphoric economy” develops, eventually leading to a crisis.
- In that framework, it might be interesting to see how real economy influences credit standards, or more broadly what are determinants of credit standards? Are they to lax in the pre crisis period?
- Finally, the discussion in the paper somehow implies it is all about credit supply, but we are facing an demand issue also?
  - Lack of demand might coincide with stricter standards, as enterprenours are depressed about future prospects.

Minor issues

- Use of the framework as a stress testing tool for Eurozone dissolution?
  - Maybe use quantile VAR instead of normal VAR.
- The author proposes VECM with credit standards in cointegrating equation, but can credit standards have unit root?
- Do lenders fill in the survey in strategic manner?
  - Do they answer in a way that serves their best interest?
  - It is not a good idea to ask the bank about the demand for loans.

Thank you!