Discussion
Bank Competition and Risk-Taking
by Jorge Pozo and Youel Rojas

Carola Müller
Center for Latin American Monetary Studies CEMLA

XXV Meeting of the Central Bank Researchers Network
28-30 Oct 2020
Two opposing views

Keeley (1990), ...
... Müller/Noth (2018)
competition erodes profits
more incentives
to make bad loans
(less screening + monitoring)

Boyd/De Nicolo (2005)
borrowers face
lower bankruptcy risk
+ less moral hazard
competition lowers interest rates

Competition-Fragility

Competition-Stability
The question!
U-nifying approach

Martinez-Miera/Repullo (2010)

Risk-shifting effect

Margin effect

Competition

Risk

CEMLA Carola Müller 3/12
This paper!

Peru, 2004-2018

Risk vs. Competition
What they do

⇒ They take on an extremely important question!

⇒ They test the U-shape hypothesis based on data of the Peruvian financial system from 2004 to 2018

• Evidence for a emerging economy

• Evidence for a highly concentrated banking system (?)

• Combine credit registry and tax data to get borrowers’ location

• Identification on a granular, regional level

It is a well-written, highly relevant paper that you should read!
What flips the $\cup$ to a $\cap$?

- Why is it important to revisit the question for an emerging economy?
- What is different in Peru / emerging economy?
- How does it influence the aforementioned channels?
- What channels can explain the inverse U?
One trial with adverse selection and risk-based pricing
Testable implications

- At low levels of competition leads an increase in competition to an on average worse borrower pool.
- At high levels of competition leads an increase in competition to more adequately priced loans.

\[
Risk_{btr} = \beta_1 \text{competition}_{itr} + \beta_2 \text{competition}^2_{itr} + \alpha_{it} + \gamma_{tr}
\]

- borrower-based risk measure would allow for inter-bank across region identification.
Interesting paper with great data and surprising results! Great potential if you come up with a good explanation!
Further comments to the authors

▶ Focus on the granular identification. This is where the contribution lies.
▶ High concentration nationwide, but competitive regional markets? Tell a consistent story.
▶ The Fixed-Effects puzzle: Why do bank FE kill the results?
▶ The competition measure puzzle: Why do concentration measures deliver opposite results? (See: Carbó-Valverde et al., 2009)
A list of ideas for robustness checks

▶ Robustness on the risk measure (NPL), would be ideal to get a borrower-level risk measure from tax data or corporate reports.
▶ Robustness on the competition measure (C3, C5, Lerner index).
▶ Robustness on the province-based competition measure. How is the relationship between risk and region-based measure from the bank-level analysis?
▶ Robustness on the regions. How much is driven by metropolitan Lima area? Urban vs rural?
▶ Exclude 2004, the reporting seems odd (graphs).
▶ Split the sample in different periods / business cycle / pre-post GFC.
A list of information I would have liked to have

► Information on the regional dispersion of banks (and fin. institutions): In how many regions do they operate? How many nation-wide operating banks exist?

► Information on the borrower/client based data: How many borrowers per bank/region? 6000 observations for 10 years seems small. What are the limitations of the data or what gets lost in matching?