INSTITUT DE HAUTES ÉTUDES INTERNATIONALES ET DU DÉVELOPPEMENT
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Discussion of

Determinants of bank profitability in emerging markets

The influence of monetary policy on net interest margins: evidence from Albania

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The relevance of bank profitability

- Banks are the main intermediaries for financing firms, especially small and medium ones.
- International bank flows – including operations through affiliates – have developed rapidly.
- Profitable banks are necessary to avoid disruptive contraction of credit in recessions.
  - Understanding what drives their profitability, and the role of policy, is a central issue.
- First paper considers the drivers of profitability in a broad sample of emerging economies.
  - Higher short interest rates reduce profits, higher long rates boost them, higher loan growth is associated with high profits.
- Second paper focuses on Albania
  - Short interest rate has a non-linear impact for small banks.

Paper 1: role of loan growth

- Large panel of banks in several emerging countries.
- Regress measure of profitability at *t* (ROA, ROE, NIM) on:
  - Loan growth at *t*.
  - GDP growth at *t*.
  - Interest rates at *t*.
  - Bank characteristics at *t*.
- Why not lag some variables, in particular bank characteristics?
- Causal interpretation loan growth (“profitability responds positively to credit growth”) is questionable.
  - Both are endogenous and could reflect third factors (risk on).
  - Large literature points that credit booms often end up badly.
  - Include lags of credit growth.
  - Consider «excess» credit growth (deviation from some trend).

Paper 1: Global factors

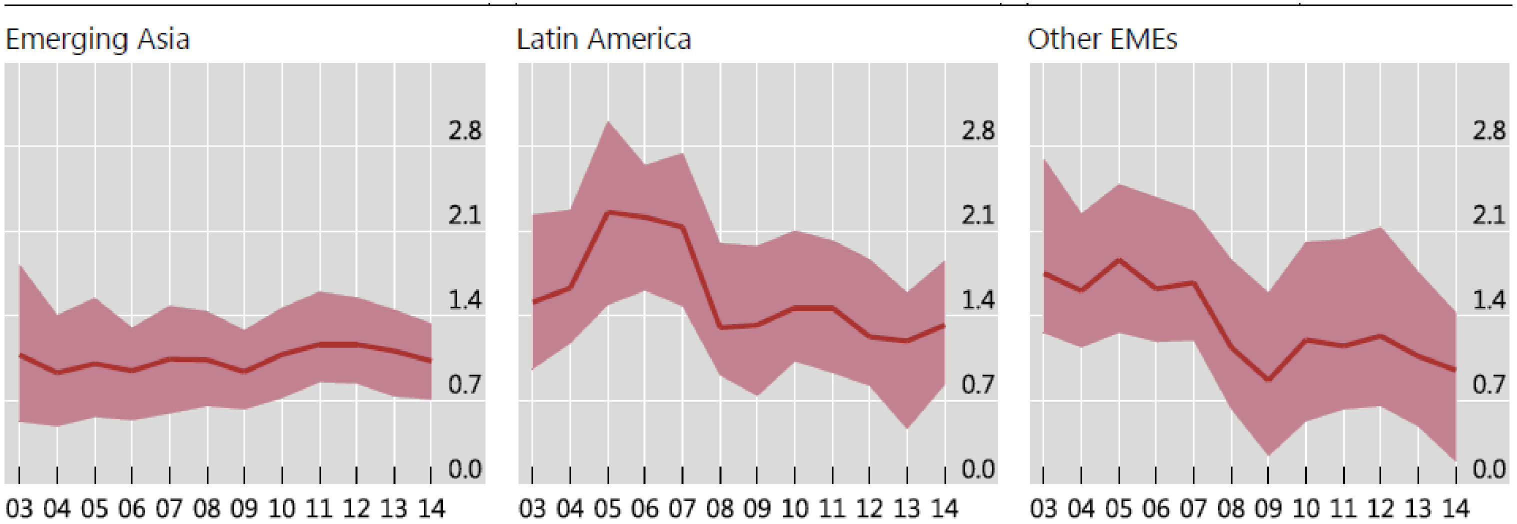
- The empirical analysis considers domestic variables.
- But banking activity has become much more global.
  - Prominent role of policy in core countries. Literature on global financial cycle.
  - Strong evidence on role of push factors for large movements in capital flows.
- Include variables capturing the global dimension.
  - US policy interest rate.
  - Vix, broker dealer leverage.
  - Banking capital inflows, possibly fine-tuned by country of origin using rich BIS data.

Paper 1: Regional dimension

- ROA quite contrasted by regions (figure 3).

Evolution of ROA by regions

Median and interquartile ranges — Figure 3



- Weak performance in other EMEs, mostly Europe.
- Explore this further.
  - Source countries of international lending: European banks suffered and retrenched more in the crisis.

Paper 2: Model

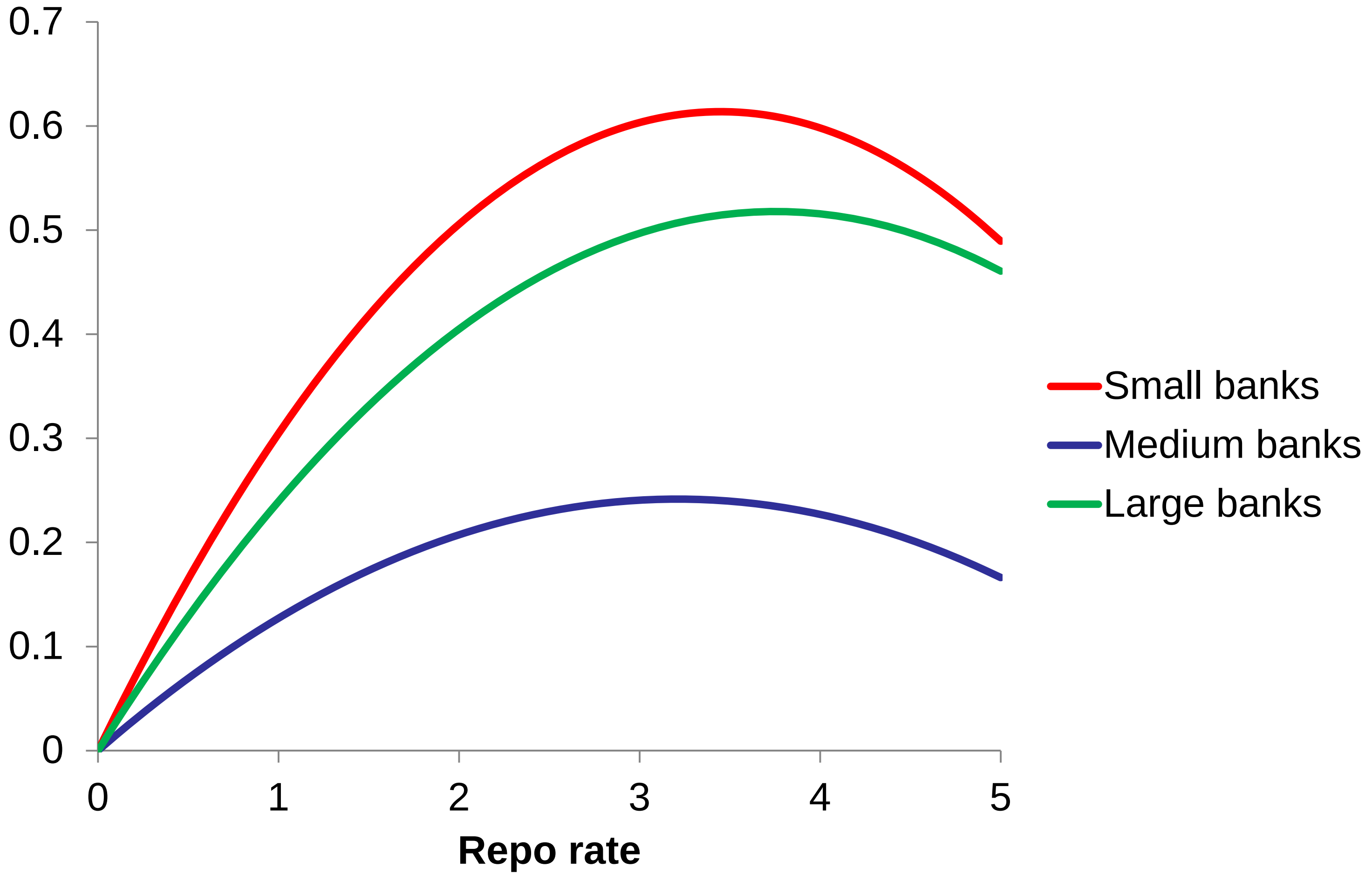
- Equity capital is directly proportional to loans.
  - Higher lending implicitly assumes that new equity is raised.
  - More realistic to have higher lending out of lower position in the money market *M*.
  - Capital requirements are in terms of assets, not just loans.
- What happens when the number of banks becomes very large?
- Lending and deposit interest rates are identical across banks (function of *L* not *Li*).
  - Allow for different rates across banks, depending on individual bank's lending, not overall.
  - Different elasticities of lending and deposit across banks.
- Instead of *N* identical banks, consider that there are *N1* small ones and *N2* large ones.
  - Market share of a large is x (>1) times share of a small one.

Paper 2: Focus on quadratic

- Empirical analysis focuses on whether the impact of the policy rate is non-linear.
- The effect of the policy interest rate is often non-significant. At odds with the model.
  - Not surprising given figure 1 (decrease in interest rates) and figure 2 (steady net interest income).
- What are the results if we do not include the quadratic term?
  - Do they match the finding of earlier contributions?
- The impact of the policy rate is quite similar for small and large banks, but only significant for small ones.
  - Suggests that policy rate only matters for low values.
  - Medium sized banks are the one standing out.

Impact of policy rate

a1 * Repo – a2 * Repo ^ 2 (equation 2 in tables 1-3).



Paper 2: Additional variables

- Expand the empirics beyond the net interest margin.
- Components of the margin: lending rate and deposit rate.
- Volumes of lending and deposits.
- Include long interest rates in regression (evidence from paper 1).
- Control for extent of foreign ownership.
  - Are medium and large banks foreign-owned?
  - Relevant funding cost is not the local one but the one in the home country.
- Expand the econometric section and shorten the presentation of the data, focusing on variables that are in the regressions.
  - Charts on maturity sructure not needed.