Universal banks vs Retail banks during the Great Recession, by Frederic VINAS

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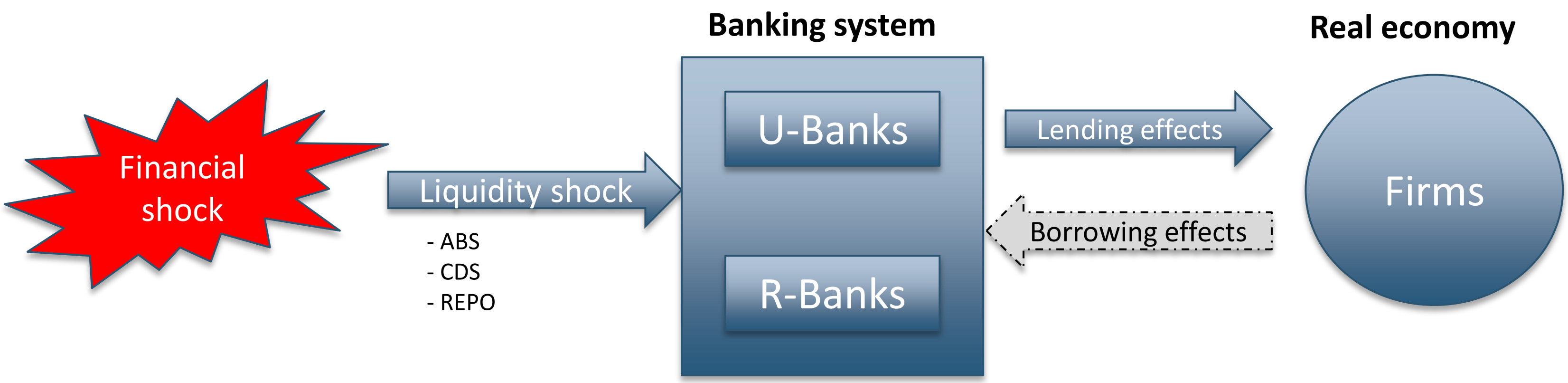
Literature and framework

1. How Liquidity shocks impact the real economy: lending vs borrowing channel *(Bernanke & Blinder , Kashyap , Khwaja & Mian 2008)*
2. How banks with different business model behave through the business cycle, (Bolton , Freixas et al), (Universal vs Retail)
3. Firms' multi-bank relationships



How do banks with different business model transmit liquidity shocks to the real economy

Model and identification issues

- To estimate difference in Loan growth due to a liquidity shock we have to Control for Loan Demand (Khwaja & Mian 2008).

  I. Correlation between credit demand and supply shock → overestimation of Beta
  II. Spurious credit demand is taken out (firm specific)

$$\Delta L_{ij} = \beta_0 + \beta_1 * \Delta D_i + \eta_j + \varepsilon_{ij} \xrightarrow{\text{Fixed effects}} \Delta L_{ij} = \beta_j + \beta_1 * \Delta D_i + \varepsilon_{ij}$$

- Bank multiple firm relationships: Can banks lend to more than one firm ??

→ *firm j's bank shock must be orthogonal to firm j's credit demand*

- Shock anticipation by firms or banks → Fixed effects don't work
  - Banks cut lending to firms with exposure to Real estate in US
  - Firms cut borrowing from banks who could become less profitable due to the liquidity shock

Results

- **Credit supply of R and U-banks** (lending)**:** R-Banks higher credit supply than U-Banks
  - U- Banks more reliant on Repo , big R-banks with relatively safer assets as collateral (Treasury)
  - Few U-banks→ unbalanced sample→ undesired bias
  - U-Banks capital injections during the crisis (control for change in capital not only 2006)

- **Substitution effects:** The more firms were exposed to U-banks before the crisis the less they borrowed (no substitution effect, only on long term loans)
  - Missing factors : Yield curve inversion in 2006
    - Appetite for Long term debt changed
    - Small capacity of R-Banks depending on the size

Conclusions and further analysis

- Very Preliminary draft
- Heterogeneity in U-Banks response according to their exposures (Repo, ABS, collateral)
- Investigate how shocks affect loan price according to the Business model
- Riskiness of firms: ratings
- Adding a new category (Small Retail)→ unbalanced sample, collateral control