Banking Market Integration and Interconnectedness

Discussion by
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Banking Market & Financial Market Integration

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Connections Between Markets

- Capital Market Flows & Capital Constraint
  - External capital markets (to highest value)
  - Internal capital (to whose highest value)

- Informational Flows
  - Low investment opportunities where shock
  - Low opportunities elsewhere?

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Cetorelli & Goldberg

- Economic Shock: Great Recession
- Allocation of Capital Globally
  - More exposed banks: Greater response
  - Move $ from source to projects
  - Reverse with second shock
  - Magnitude of reversal?
- M&M World: Fund all +NPV projects
Liquidity Management of U.S. Global Banks:
Internal Capital Markets in the Great Recession

Cetorelli & Goldberg

- M&M World: Fund all +NPV projects
  - External capital market
  - Internal capital market

- Integration and Stabilization
  - “From “host country” perspective, i.e. a country that allows foreign banking activity, macroeconomic transmission from foreign banks may be less a function of its overall openness and more related to the particular distribution of foreign banks engaged in their economy, the balance sheets of those foreign banks, and the mode of operations within the country.”

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Economic Shock: Housing Price Collapse

Not Simple Capital Supply: Mortgages
- No response from non-mortgage losses
- Bank capital doesn’t matter
- Securitization: Increases with losses

Mortgage lending
- Mortgage losses reduce lending elsewhere
- Effect is small if other region is small

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The Cross-Market Spillover of Economic Shocks through Multi-Market Banks

Berrospide, Lamont & Keeton

- Information story
  - Banks have less capital: Allocation?
  - Market specific information (Las Vegas?)
  - Economy wide information

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Financial Integration, Housing and Economic Volatility
Loutskina & Strahan

- Economic Shock: Housing Price Collapse
- Demand or Supply
  - Supply shocks $\rightarrow$ reduces $\sigma$
  - Demand shocks $\rightarrow$ can increase $\sigma$
    - Credit flows lead to more construction (low $\sigma$)
    - Steep supply curve $\rightarrow$ greater $\sigma$
- Capital as a Constraint on Bubbles

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Financial Integration, Housing and Economic Volatility

Loutskina & Strahan

Has Housing Volatility Increased?
The Valuation Effects of Geographic Diversification: Evidence from U.S. Banks

Goetz, Laeven, & Levine

- Economic Shock: Δ Geographic Diversity
- Micro Effect of Geographic Diversification
  - Diversification destroys value
- Cost of Monitoring
  - Geographic reach / Size
  - Complexity: Soft vs. hard information

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The Valuation Effects of Geographic Diversification: Evidence from U.S. Banks
Goetz, Laeven, & Levine

- **Empirical Design and Findings**
  - **OLS** → Little to no effect
  - **Instrumental variables: Deregulation**
    - **Diversification** → Value destroying
    - **Opportunities for div** → Destroy value
    - **Actual diversification** → Creates value
  - **Deregulation’s other negative effects**

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Integration and Stabilization
Good For Whom?

- **Integration: Simple Case**
  - Capital flows to highest value
  - Risk (idiosyncratic) is reduced
  - Assumes correct incentives [LS & GLL]

- **Capital Supply and Demand**
  - Capital is scarce, but scarcer elsewhere
  - Great inv oppt, but better elsewhere

- **Comparison to International Trade**
Questions from the Audience