

DISCUSSION OF:
BAŞKAYA, HARDY, KALEMLI-ÖZCAN, YUE (2022)

“SOVEREIGN RISK AND BANK LENDING:
THEORY AND EVIDENCE FROM A NATURAL DISASTER”

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Minneapolis Fed Sovereign Debt Conference
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MOTIVATION

Interesting and important paper:

- *Existential* question for our literature
- Nice data and natural experiment
- Strong and eye-opening results

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First Stage: LHS = Gov Bond Holdings X Yield		
	(1)	(2)
Gov Bond Holdings _{it-1} × Earthquake _t	0.112*** (0.0388)	0.122*** (0.0383)
Gov Bond Holdings _{it-1}	0.609*** (0.0268)	0.614*** (0.0350)
F-Stat	8.33	10.16
Second Stage: LHS = Private Lending		
Gov Bond Holdings _{it-1} × Yield _t	-0.550* (0.326)	-0.276* (0.148)
Gov Bond Holdings _{it-1}	0.121 (0.209)	0.150 (0.0963)
Observations	5059	5042
Banks	82	82
BankFE	Yes	Yes
TimeFE	Yes	Yes
BankQuarterFE	No	Yes
Controls	Yes	Yes

DISCUSSION OVERVIEW

3 points:

1. Identification
2. External validity
3. Broader implications

IDENTIFICATION

Earthquake setting:

- Definitely exogenous and unanticipated ...
- ... but also affecting *all* agents in local economy

Identification challenges:

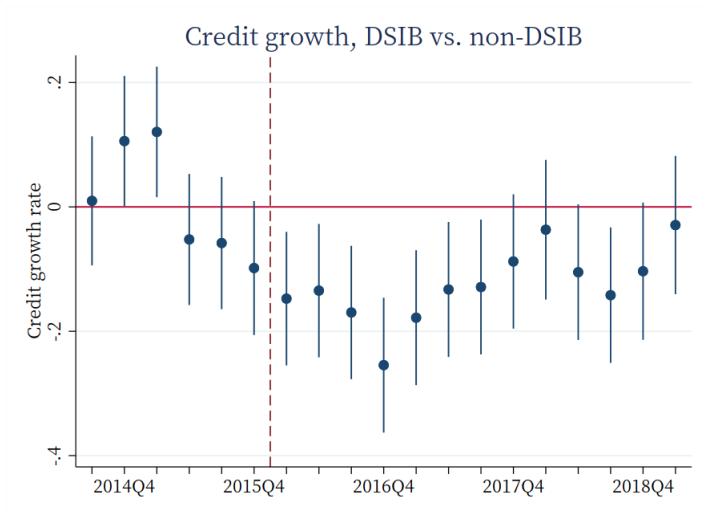
- 1 Separating supply of loans from the demand

EXAMPLE: LEE, LEE AND PALUSZYNSKI (2022)

$$\Delta \ln total_credit_{ijt} = f_i + f_j + f_t + \gamma_t \cdot DSIB_j + \Psi X_{ijt} + \varepsilon_{ijt}$$

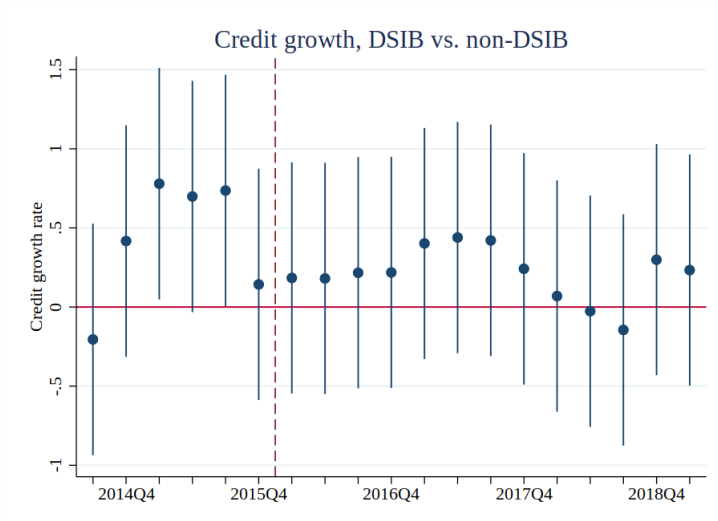
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EXAMPLE: LEE, LEE AND PALUSZYNSKI (2022)

$$\Delta \ln total_credit_{jt} = f_j + f_t + \gamma_t \cdot DSIB_j + \varepsilon_{jt}$$



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 - ▶ Kundu, Park, and Vats (2022): deposits are highly concentrated and affected by natural disasters

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Suggestion:

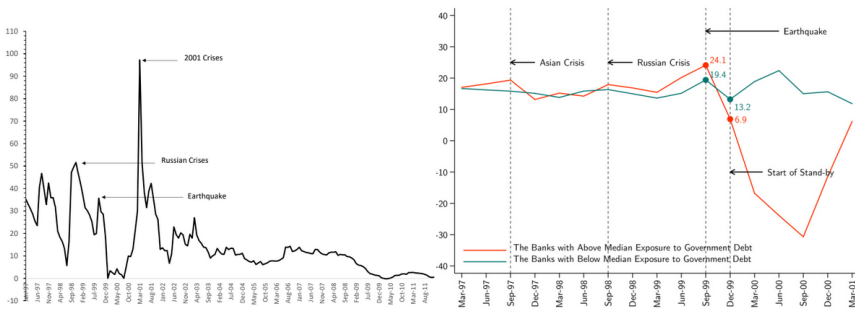
- Earthquake effects radiate → exploit geographic variation?

EXTERNAL VALIDITY

- Episode set amidst recurring crises 1997-2001
- Earthquake provides a natural experiment to study
- But mechanism should be present in surrounding crises

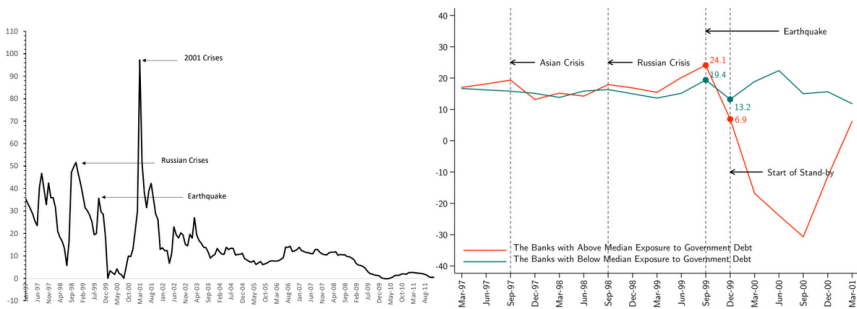
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● Suggestion:

- ▶ Use other crises to provide conditions for a doom loop, or explain why earthquake was unique

BROADER TAKEAWAY

- Results contribute to increasing evidence on the effect of sovereign risk on economic outcomes:
 - ▶ Hebert & Schreger (2017); Arellano, Bai and Bocola (2020) among others
- Currently: impact of sovereign risk on bank credit provision
- Would be useful to know how it translates to economic outcomes
 - ▶ Role of non-bank credit, internal and external equity financing, etc.