

Discussion by **Diana Bonfim** SSM Conference, Frankfurt, June 11-12, 2024





SUMMARY OF THE PAPER

We know that **zombie lending** and **credit misallocation** are important problems (for supervisors, financial stability, for economic growth and productivity,...).

Challenge: how to spot it? (important mission for supervision!)



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This paper: the comparison of <u>interest rates on loans</u> to "<u>breakeven interest rates</u>" can be insightful.

- During the Greek crisis, safer borrowers are charged significant markups.
- In stark contrast, **riskier borrowers** are charged **smaller and even negative markups** (**cross-subsidization of bad credit**).



MY COMMENTS

ARE LOWER
INTEREST RATES
ENOUGH TO KEEP
WEAK FIRMS ALIVE?

02
THE ROLE OF COLLATERAL

03

WHY DO BANKS SUBSIDIZE LOANS?

04
MINOR ISSUES



1. ARE LOWER INTEREST RATES ENOUGH TO KEEP WEAK FIRMS ALIVE?

Main result: banks offer riskier firms interest rates that are below their breakeven rate.

Is this enough to make firms survive?

Zombie lending often involves also the permanent **rollover of loans** (or even additional lending). How different is the lending behavior towards weaker and safer firms (assuming demand is the same)?

How do other banks lending to the same firms behave?



2. THE ROLE OF COLLATERAL

Main reason for banks' behavior: "banks may be reluctant to terminate loans, because of **depressed collateral values**."

This is for sure an important mechanism. But others may be at work:

- Lower **likelihood** of seizing collaterals (in a crisis).
- **Systemic** risk in liquidation of collateral in a crisis.



2. THE ROLE OF COLLATERAL

Indeed, this is important in the **model**. In the post-crisis period, terminating lower-profitability borrowers is profitable.

But, in the empirical analysis, collateral is not explored in depth.

Is there data on **recoveries**?

Do loans with and without collateral show differences? And with different LTVs?

Are there differences in different stages of the crisis?



3. WHY DO BANKS SUBSIDIZE LOANS?

- Main explanation: to avoid liquidation of depressed collateral values.
- The bank was "well-capitalized" and received a capital injection during the crisis.
 - Zombie lending is often associated with weakly capitalized banks (Giannetti and Simonov, 2013). Maybe not always?
 - What if the bank didn't have so much capital?

Interesting feature: when the bank offers an interest rate below the breakeven rate, "the new framework required internal approval that stated the <u>justification</u> for the discount".

Frustration: authors are not allowed to use this!



3. WHY DO BANKS SUBSIDIZE LOANS?

- The restrictions on data may not permit, but it would be interesting to know more about how is the breakeven rate estimated.
 - Which ingredients? Some references in page 18 and 31, but too general.
 - Is it estimated through the cycle? Or how often is it updated?
 - Are there some firms/industries where loans can be more objectively priced than in others (especially in a crisis?). What if the markups are capturing this uncertainty?



4. MINOR ISSUES

- Why is the focus only on larger borrowers (150)?

How heterogeneous are these firms?

Are some multinationals?

- The observable firm-level and loan-level characteristics do not have a strong explanatory power over the actual interest rate.

And over the breakeven one?



Great paper.

Take away for supervisors:

- loan pricing can be informative about risk-taking and credit misallocation.



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