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CENTRE FOR ADVANCED FINANCIAL RESEARCH AND LEARNING
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CAFRAL Newsletter
February and March 2019

Highlights of Research Conference

CAFRAL - Imperial College Business School Conference on Financial Intermediation Emerging Economies: March 19-20, 2019, Mumbai, India

Dr. Amartya Lahiri, Director, CAFRAL delivering opening remark at Conference, Mumbai

CAFRAL and Imperial College Business School jointly organised a conference on the theme of Financial Intermediation in Emerging Economies. It was held at the Reserve Bank of India's auditorium on March 19 and 20, 2019. The event was flagged off with opening remarks from Dr. Amartya Lahiri, Director of CAFRAL.

The first paper, entitled "Does the 'Foreignness' of Bank Loans Matter? Evidence from a New Dataset", was presented by Prof. Martin Strieborny of Lund University, Sweden. It used a newly-constructed global dataset to study the heterogeneity in borrower-lender interactions for different categories of foreign bank loans: loans taken by subsidiaries, foreign bank branches, and direct cross-border loans. The findings suggested that borrowers with loans from foreign bank subsidiaries closely mimic the behaviour of borrowers with domestic loans as opposed to other foreign loans. Loan conditions and borrower characteristics vary non-monotonically with the degree of the foreignness of banks. The discussant, Dr. Anand Srinivasan, highlighted the lack of focus on institutional characteristics and legal framework of the countries in the sample, since the degree of independence enjoyed by foreign banks in their choice to set up a subsidiary or a branch plays an important role in determining how strongly these results hold. Next, Dr. Leila Aghabarrari (World Bank) presented her paper, "Is there Help Indeed, if there is Help in Need? The case of credit unions during the financial crisis". It focussed on the differential behaviour of credit unions (CUs) relative to other lenders during stressed periods due to their unique governance structure. This paper was followed by a presentation on "Banking Growth: Evidence from a Regression Discontinuity Analysis" by Dr. Nathaniel Young from the EBRD.

After this, Mrinal Mishra of the University of Zurich presented "Please stay put: Lender behaviour in a competitive environment". The paper showed that new entrants in credit markets disburse loans to riskier individuals due to adverse selection. Consequently, incumbents also extend riskier loans with better terms to retain customers.

Shri Sudershan Sen, Ex Executive Director, RBI at Conference

Post lunch, Prof. Tarun Ramadorai from Imperial College Business School delivered a keynote speech on the subject "Household Finance in Emerging Economies". First, he showcased insights gleaned from micro data on household balance sheets in countries comprising 45% of the global population: China, India, Bangladesh, Philippines, Thailand and South Africa. The observed patterns were contrasted with those in advanced economies. Then, he summarised the nascent literature on household finance in emerging economies and discussed areas of overlap with the more well-

Shri. N S Vishwanathan, Deputy Governor, RBI, delivering keynote address at conference.

established research on advanced economies, as well as the large volume of research on development finance. He and his co-authors have found that there is rapid financial inclusion in emerging economies.

Later, Prof. Shusen Qi of Xiamen University presented his paper "Inter-industry FDI Spillovers from Foreign Banks: Evidence in Follower Countries". It studies the influence of foreign banks on the innovation of local firms in other industries. The results suggest that the presence of foreign banks does help in the transfer of new knowledge, either directly or by serving as a match-maker, connecting local firms with other knowledge providers. The final paper of the day was "International Coordination of Macro-Prudential and Monetary Policies" by Dr. Enisse Kharroubi from the BIS. He set up a model where two countries - 'Core' and 'Periphery' - offer insurance to each other. The main takeaway of the paper is that there are gains from coordinated macro-prudential policy only if such coordination does not exist in the monetary dimension. The second day of the conference was opened by Prof. Ioannis Spyridopoulos of American University. His paper "Behavioural Attributes of Strategic Default: Evidence from the foreclosure moratorium in Greece" studies Inter-bank Negotiable Certificates of Deposit (INCD) issues in the Chinese banking sector, and finds that in the years 2015-17 there were 180 upgrades but only 2 downgrades. The authors attribute this skew to ratings inflation and not genuine improvement in the banks' fundamentals. In fact, the market was aware of this, Ruan of NUS. Her paper, "The Economics of Shadow Banking: Lessons from surrogate intermediaries in China" tried to understand the growth of entrusted loans using data from mandatory disclosures of non-financial companies. Between 2011 and 2016, increased competition has eaten into Chinese banks' deposit funding. The authors exploit geographical heterogeneity in the classification of banks as constrained and unconstrained, and show that firms are more likely to be entrusted lenders and make profits in the constrained cities. Additionally, most of the providers of entrusted loans do not look for external sources of finance and instead use their own cash, which limits the impact of these products on financial stability. Arkodipta Sarkar from London Business School discussed his study, "Experience of Communal Conflict and Inter-Group Lending". The paper investigates the link between communal violence and market efficiency by looking at the impact of branch managers' exposure to riots on their subsequent lending decisions. The main result is that Hindu Branch managers with riot exposure prior to joining the bank lend relatively less to Muslim borrowers. Importantly, the Muslim borrowers that do get loans are less likely to default, indicating that the lower relative rate for Muslims is due to taste-based discrimination of branch managers. These effects are persistent across the manager's tenure, and early life exposure to riots matters more.

In "Financial Access under the Microscope", Dr. Andre Silva of the Federal Reserve Board examined the effects of a government-sponsored banking expansion program on financial access and the adoption of commercial bank services by previously unbanked borrowers in Rwanda. The dataset consists of four million observations of loan exposures on a monthly basis for 177,853 individual borrowers. The credit register does not collect information

Dr. Thorsten Beck, Cass Business School, United Kingdom at conference.

Dr. Tarun Ramadorai, Imperial College, London, UK at the Conference.

on borrower income, consumption, or assets; however, it has information on the individual's age, gender, marital status, and sector of employment. The empirical strategy compares switchers (those who swapped loans from U-SACCOs for those from a commercial bank) versus non-switchers. The main inference is that the small-credit expansion scheme through micro-finance institutions (MFIs) significantly increased the likelihood of access for previously unbanked individuals. Later in the afternoon, N.S. Vishwanathan, Deputy Governor, RBI delivered a keynote address which dealt with the central bank's long-standing mission to secure last-mile delivery of financial services at low cost by encouraging competition but not endangering financial stability. In this regard, he traced how the RBI has used its powers to shape the evolution of banking institutions over the decades. It was shown how the emphasis of policies has moved from stipulating the size of entities (co-operatives, Regional Rural Banks and Local Area Banks) to the exposures that they would be taking (small finance, payments etc). Each of these structures was analysed individually, and it was highlighted that each arose from the failure of existing arrangements to fulfil their objectives. The DG then discussed ways in which financial deepening was being stimulated by the RBI from both, the supply and demand sides. The talk also shed light on informational challenges involved in this endeavour and policies to work around them.The conference ended with the presentation of Prof. Shida Liu (Tsinghua University) on "How do regulations affect credit rating? Evidence from the upgrades in the Chinese Banking sector". In sum, the conference covered a broad array of topics in the area of financial intermediation, and by bringing together researchers from across the world, a productive exchange of views was facilitated, which will surely prove to be of great relevance to participants in their roles as academics and policy advisers

Dr. Raj Iyer, Imperial College, London, UK at Conference

Highlights of Research Seminars and Brown Bag

Bottlenecks Versus Ripple Effects: The Role Of Linkages In India's Product Market Liberalization by Vybhavi Balasundharam, University of Michigan at Mumbai, February 06, 2019

Paper Abstract

I investigate the impact of input-output linkages on aggregate productivity gains from reducing distortions in a market. Removing distortionary policies that implicitly tax larger and more productive firms within a market propagates to upstream suppliers as a demand shock and to downstream customers as an input cost shock. I analyze the heterogeneous response of firms in these linked markets, leveraging the elimination of firm-size restrictions for a set of product markets in India during the 2000s combined with rich firm-level data. Upon reform, I find an increase in aggregate productivity from both the directly exposed and linked markets. These gains are primarily driven by reallocation of inputs to larger and more productive firms. However, productivity gains are attenuated when linked markets are highly concentrated. More productive firms in concentrated linked markets raise their markups in response to the demand or supply shock, thereby increasing misallocation. The adjustment of markups is consistent with models where demand elasticity decreases with firm productivity and underlines the substantial bias from ignoring market structure in linked markets when assessing the

impact of piecemeal reforms. Conditional on the supply-chain being sufficiently competitive, linkages can amplify the overall gains from reforms that reduce distortions in a market.

Are IMF Rescue Packages Effective? A Synthetic Control Analysis Of Financial Crises by Mr. Kevin Kuruc, University of Texas at Austin at Mumbai, February 08, 2019

Paper Abstract

This paper estimates the output effects of IMF loans during acute macroeconomic crises. Using the universe of financial crises from 1975-2010, I study whether recovery dynamics differ across crises that do and do not receive IMF intervention. I condition on the type of financial crisis, employ a new estimator to find the most relevant controls units—the synthetic control method—and use forward looking variables to address the selection issues associated with IMF lending. In contrast to much of the existing literature, I find that IMF lending has large short-run effects. Countries that receive an IMF loan have GDP that is, on average, 1-2 percent larger in the 2-3 years following the onset of a crisis than what is predicted by their synthetic controls. Consistent with either a liquidity effect or policy advice specific to managing a crisis, the difference fades in the medium run. Likewise, I find the recovery effects are largest in countries with weak institutions: places where policy advice and an “international lender of last resort” may be most useful.

Policy Guidance And The International Transmission Of Macro News: Evidence From Investment Funds by Ms. Gabriele Ciminelli, University of Amsterdam at Mumbai, February 11, 2019

Paper Abstract

This paper contends that U.S. macroeconomic releases are an important ‘global’ factor driving cross-border flows and that their effect depends on the guidance provided by the U.S. Federal Reserve (Fed). I source data on allocations into investment funds and study the response of U.S. investors to domestic employment news, focusing on the post-Crisis period. I show that, when the Fed complemented its zero-rate policy with calendar-based forward guidance, monetary policy expectations were insensitive to macro releases and investors responded to positive employment news by re-balancing their portfolios toward faster growing and riskier countries. On the other hand, as the Fed progressively changed guidance to signal that it was ready to withdraw policy accommodation, investors perceived the same positive news to bring forward the moment of policy normalization and reacted by reducing their foreign market exposures. Countries with better institutions experienced less outflows, while those with a more open capital account fared worse. These findings highlight an important role of central bank guidance in determining how investors shift capital across countries in response to shocks. They also provide novel evidence of investors risk-taking abroad, following positive shocks at home, during periods of accommodative monetary policy.

Shocked By Bank Funding Shocks: Evidence From Consumer Credit Cards by Dr. Rohan Ganduri, Assistant Professor of Finance, Emory University Goizueta Business School at Mumbai, February 13, 2019

Paper Abstract

We examine the transmission of an unexpected sharp decline in banks' short-term wholesale funding availability in 2008 to their consumers using a comprehensive matched bank -- borrower data set. For the same consumer borrowing from two different credit card issuers, a 10% reduction in the bank's wholesale funding leads to a 0.74% reduction in credit card limits for its borrowers. Consumers could not completely hedge away the liquidity shock transmitted by their banks, leading to a 0.36% reduction in aggregate credit card consumption for a 1% reduction in aggregate credit card limits. The effects are more severe (0.68--1.54%) for credit-constrained consumers with lower credit scores and higher credit card utilization ratios in the short-run and the long-run. We confirm our primary results on the full universe of approximately 500 million credit cards. Our results suggest that the structure of a bank's balance sheet impacts their consumers, with banks transmitting their funding shocks to consumers through credit cards, thus affecting aggregate credit card consumption.

Consumption And Saving Response To A Tax-Subsidized Saving Policy by Prof. Sumit Agarwal, McDonough School of Business, Georgetown University, USA at Mumbai, February 22, 2019

Paper Abstract

To incentivize households to increase private savings, the Indian government implemented in July 2014 a new tax-subsidized saving policy that allowed homeowners to exempt an additional 50,000 INR ($833) of the mortgage principal and interest payments from taxable income. We exploit the exogeneous policy change and assess the extent to which households reduce their consumption in order to finance a tax-favored saving instrument using a unique administrative panel data of consumer debit card and credit card spending transactions. We find that about 31% of households with a mortgage increase the principal repayment amount after the policy change; the median annual increase in principal repayment is about US$307, which is about 36.8% of the higher tax exemption limit. We estimate that households with a mortgage reduce their consumption by US$25 (5.2%) per month on average in order to finance the tax-favored saving account. For a one dollar increase in the income tax exemption limit on long-term savings, private saving increases by $0.23 for the treatment group. Relative to annual income, private savings for the treatment group increase by about 1.87% on average.

Coordinated Work Schedules And The Gender Wage Gap Dr. German Cubas, Assistant Professor, University of Houston, USA at Mumbai, March 06, 2019

Paper Abstract

Using time diary data we construct occupation-level measures of coordinated work schedules based on the concentration of hours worked during peak hours of the day. While men and single women receive a wage premium in occupations with coordinated schedules, married women with children less so, suggesting that temporal constraints related to household care responsibilities restrict their choices. Calibration of a model with these elements generates a gender wage gap of 6.1 percent or approximately 27 percent of the wage gap observed among married men and women with children. If the need for coordination were to drop to the level of "Health Care Support"– an occupation with relatively low coordination, the gender gap due to women's higher demand for household time falls to 2.3%.

CAFRAL's "Calendar of Programs" FY 2019-20

Calendar of Programs for FY 2019-20 is now available on CAFRAL's Website (www.cafral.org.in)

Take Me To Calendar

Highlights of Learning Programs

CAFRAL Advanced Credit Risk Management Program: February 04-05, 2019, Mumbai, India

Program participants with Dr. Edward Altman at program on Advanced Credit Risk Management Program, Mumbai.

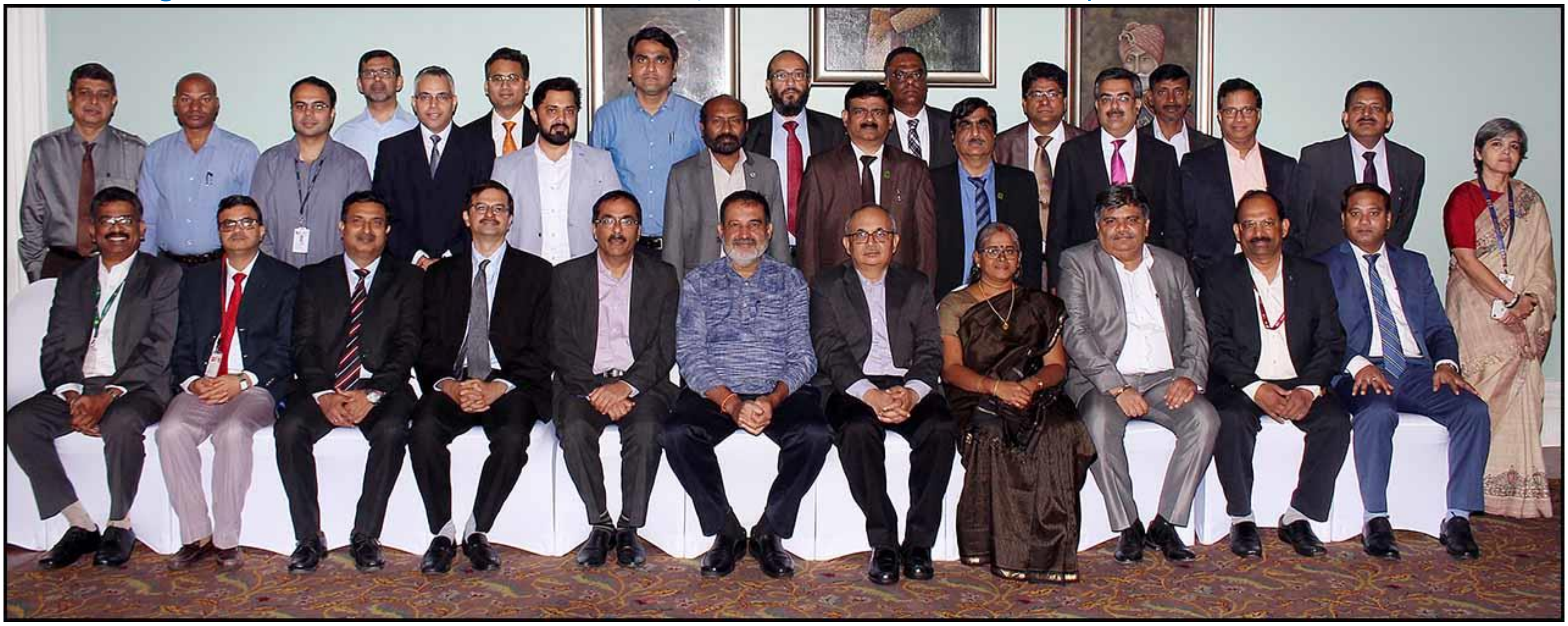
The objective was to expose senior officers from banks and financial institutions to the attributes of credit risk management by covering topics like project and corporate credit risk, financial distress and credit risk models, SME credit risk, retail credit risk and score card model, expected credit loss and impairment recognition under Ind AS and credit risk stress testing. Dr. Edward Altman of Stern Business School, New York University was the lead speaker for this program.

CAFRAL Program for "New Generation NBFCs": February 14, 2019, Mumbai, India

Program participants with speakers at program for New Generation NBFCs, Mumbai.

The objective of the program was to cover regulatory and supervisory requirements which need focus such as Policy documents on all business areas, Resource diversification, Risk management, ALM, Internal Controls and Compliance, Regulatory Reporting, etc. The program also provided the participants a platform to interact and exchange views with the regulators and peers. In particular, the themes covered were: RBI's Regulatory Framework; NBFCs linkages with banks and mutual funds; resource raising options; optimum ALM in the current environment; supervisory requirements and expectations; key challenges and outlook for NBFCs in the medium term; Fintech/Digital Lending tools for credit delivery; implications of Ind AS for NBFCs.

CAFRAL Program - 'CFOs in the Financial Sector: Past, Present and Future': February 26-27, 2019, Mumbai, India



Program participants with T V Mohandas Pai at CAFRAL program - 'CFOs in the Financial Sector: Past, Present and Future', Mumbai

CFOs used to fully focus on numbers, budgets and financial reports & statements. Post-crisis, they are also expected to add value to business and advise CEOs and the Board on strategy, risk, regulatory & legal compliance, and even technology. The program traced the evolution of the role of CFO across last couple of decades. Speakers dealt with the changing nature of finance function and the evolving role of CFOs besides the traditional areas of audit, taxation and legal & regulatory compliance. The Program highlighted the fact that the CFO role is in flux.

CAFRAL Program for Non-Executive Directors on the Boards of Banks: March 18-19, 2018, Mumbai, India

Program participants with speakers at program for Non-Executive Directors on the Boards of Banks, Mumbai

The program addressed the current issues and challenges faced by the banks including those relating to governance, strategy, risk, compliance and asset quality and also covered other topics like regulatory/supervisory perspectives, financial markets, role of treasury and domestic & international developments in the financial sector. With the aim of of improving the effectiveness of directors on the boards of banks, the specific topics covered in this edition were Role of directors, Business strategy issues, Banking sector outlook for FY 2019-20, Credit risk management, Progress under IBC, Regulatory compliance, Financial markets, New accounting standards, Risk Based Supervision, ICAAP and Stress Testing.

CAFRAL Financial Markets Program: November 14, 2018, Mumbai, India

Program participants with speakers at the Financial Market Program, Mumbai

The program provided a broad based understanding of financial markets to policy makers and market participants who may or may not have hands-on experience in this area. Practical exposures to market processes, products, players and infrastructure combined with insightful discussion on the economy in general and financial sector in particular were the highlights of this program. In particular, the focus was on the rationale behind some of the policy decisions and its impact in terms of outcomes. Speakers drawn from RBI, SEBI, BSE, AMFI, academia and the markets dealt with wide range of topics covering current trends in the economy and markets; working of monetary policy and interest rate transmission; operations, failures & regulations of financial markets; financial cycle & financial systemic risk; debt market; government securities market; mutual funds ; interlinkages among different market segments; functioning of stock exchanges etc.

Upcoming Learning Programs

Program Description & Nomination links are available on http://cafral.org.in/Upcoming-Programs

Sydney and Mumbai - CAFRAL and Macquarie University Program "Leadership, Strategy and Risk" Indian Leg: May 1 - 2, 2019| Mumbai (Non Residential) and Overseas Leg: May 5, 2019 – May 11, 2019| Sydney (Residential)

Program Objectives

The program, especially designed for senior executives of the Indian financial institutions, focuses on three key themes (i) Leadership, Management and Decision-making in a changing world (ii) Sustainable Strategies for Banks and Financial Institutions and (iii) Risk Culture, Risk Governance and Risk Management.

Participants Profile

Senior executives (of the level of General Manager or above) from Regulatory Agencies and Financial Institutions

Program on Resolution of Distressed Assets May 15, 2019| Mumbai

Program Objectives

The management and resolution of large volumes of distressed assets poses considerable challenges to lenders and as such needs setting up an operational framework covering various aspects of resolution/recovery/workout process. The Insolvency and Bankruptcy code (IBC) introduced in May 2016 has been a game changer in the resolution of NPAs in India because it provides a framework for time bound insolvency resolution. Resolution of NPAs are also being attempted outside the IBC mechanism by way of Bank Led Resolution Approach (BLRA) and the proposed AMC/AIF approach (under Sashakt) in partnership with Asset Reconstruction Companies (ARCs). This program would discuss several key features of these frameworks, including by drawing on international experiences

Participants Profile

Officers at the level of DGM (or equivalent) and above from banks, financial institutions and ARCs.

Nominate now