Discussion of the paper

"What Happened to Profitability? Shocks, Challenges and Perspectives for Euro Area Banks"
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1The views expressed are those of the discussant and do not necessarily represent those of DNB.
Main question: Evolution of bank profitability in Euro area

Methodology: panel data model for new dataset of 310 banks in 19 euro area countries 2005-2014

Main focus:
- dynamics of bank profitability and cross-sectional heterogeneity
- main determinants of bank performance:
  - macroeconomic cycle,
  - bank business model, and
  - bank capitalization

Discussion: What Happened to Profitability?
Main results

- A big number of results on dynamics of banking sector
  - shift to more liquid security holdings
  - larger CB funding

- Two shocks hit European banks’ profitability:
  - **Global shock**: Spillovers from the US 2008 crisis in subprime mortgage market affected banks with more market-based business model
  - **Local shock**: European debt crisis of 2011 weakened banks with traditional lending model (especially in peripheral Europe).
Contribution

- Detailed database of European banks
  - including net interest and non-interest income and provisions

- Link to the discussion on transaction vs relationship lending
  - Bolton et al. (2015)

- Link to the literature on global shock transmission
  - Cetorelli and Goldberg (2011)

- Interesting policy implications:
  - capital and leverage regulation
  - structural reforms
Methodology: Causality

- the model does not allow for causal claim
  - higher equity or retail orientation increases profitability
  - the most mechanical effect: higher profit increases equity

- effect of macroeconomic variables (GDP, gov debt) would be more convincing for larger sample
  - data can be extended to cover more than one macroeconomic cycle
Challenging model: Variables

Variables: Defining business model

- Claim: retail-oriented bank has higher RWA/TA ratio
- But: bank with few loans and corporate debt can have higher RWA/TA than bank with many loans and sovereign debt.
- Interpretation is more related to asset risk
Challenging the model: Extension

Extension:

- **Claim**: traditional bank model is more popular in southern Europe where local shocks occurred.

- **Two alternatives**:
  - Generally, banks with more traditional model suffer from local shocks more than market-based ones
  - Or banks from countries subject to local shock suffer more than banks in other countries.

- Important to disentangle: interaction terms?
Policy implications

- What are the regulatory tools?
  - capital regulation
  - structural reforms:
    - separating traditional activities to limit spillover effects
    - but what if the local shock occurs in the country where banks have more market-based model?