Banking Networks, Systemic Risk, and the Credit Cycle in Emerging Markets

Discussion

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Paper

- Important empirical work on systemic risk movements for emerging market economies
- Measure of systemic risk allows for disaggregation into credit risk and network risks
- Examination of macroprudential linkages between potential default levels and current systemic risk metrics
- Analysis controls for relevant firm-level balance-sheet information

Main results

- Significant heterogeneity in evolution of systemic risks across EMs
- High degree of concentration in systemic risks among major banks in each region
- Credit and network risks together explain majority variation in systemic risks
- Contamporaneous and lagged effects in systemic risks in raw correlations among systemic risks though spillover effects of systemic risks across regions is weak

Comments

- Where do credit cycles fit in?
  - The paper can be better situated in the credit cycles and systemic risk literature with a discussion on the interactions between network effects and region-specific credit market conditions
- Properties of interbank networks
  - **Too Central to Fail (TCTF)**: A focus on the GSIBs - and their impact on regional banks[1]
  - First 3 principal components are tied to US default, exchange rate shocks - Add a control for foreign debt/funding

[1] Farmer et. al (2016)

Comments

- Heterogeneity of financial institutions
  - Theoretical aspect: Dynamics of the distribution of leverage across intermediaries is a key determinant of financial stability [Coimbra and Rey (2017)]
  - Core banks more densely interconnected - **possible correlation in default risk**
  - Collective moral hazard problem - higher risk-taking behaviour
  - Account for country/jurisdiction-specific limited liability provisions
- Risk dynamics depend on informational asymmetries
- Empirical consideration: Statistical robustness of links
  - Returns with and without the effect of market mode excluded
  - Network measures reported are average values aggregated over the time period (pre/post-crisis) - Statistical reliability of the networks
  - Different institutions might react differently to the same exogenous shock - useful to check the robustness of the metric to an extreme adverse balancesheet shock versus a moderately adverse shock

Thank you