

DISCUSSION:
THE PROFIT-CREDIT CYCLE
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OVERVIEW

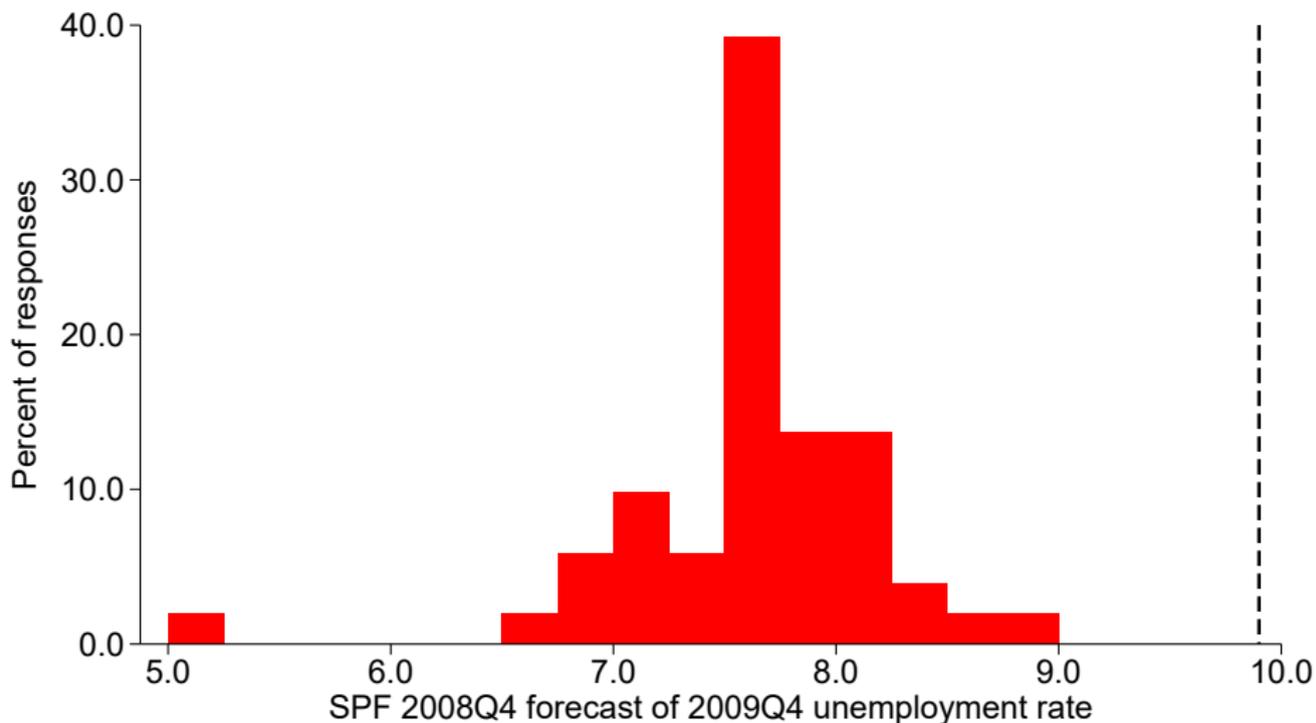
- ① Bank accounting profit booms increase probability of financial crisis.
- ② Especially decline in loan loss provisions.
- ③ Profit booms coincide with decline in bond spreads.
 - ▶ Evidence of credit supply \uparrow , default risk \downarrow , or bond market liquidity \uparrow ?
- ④ Higher paid-out dividends and retained equity both \Rightarrow higher credit growth.
 - ▶ Evidence against leverage constraint? Pay dividends today \Rightarrow more constrained tomorrow.
 - ▶ Maybe put future leverage constraint on LHS?
- ⑤ Bank credit growth high when CFOs are over-optimistic, low when they are too pessimistic.

Overreaction in Macroeconomic Expectations[†]

By PEDRO BORDALO, NICOLA GENNAIOLI, YUERAN MA, AND ANDREI SHLEIFER

We study the rationality of individual and consensus forecasts of macroeconomic and financial variables using the methodology of Coibion and Gorodnichenko (2015), who examine predictability of forecast errors from forecast revisions. We find that individual forecasters typically overreact to news, while consensus forecasts underreact relative to full-information rational expectations. We reconcile these findings within a diagnostic expectations version of a dispersed information learning model. Structural estimation indicates that departures from Bayesian updating in the form of diagnostic overreaction capture important variation in forecast biases across different series, yielding a belief distortion parameter similar to estimates obtained in other settings. (JEL C53, D83, D84, E13, E17, E27, E47)

DID BELIEFS OVER-REACT IN 2008-09?



WHAT ABOUT HOUSE PRICES?

Table 3. Short- and Long-Term Home Price Expectations, by Survey Location and Year, 2003–12

Mean response (percent)^a

| Survey year | Survey location | | | |
|-------------|--|------------------|------------------|---------------|
| | Alameda County | Middlesex County | Milwaukee County | Orange County |
| | <i>“On average over the next ten years how much do you expect the value of your property to change each year?”^c</i> | | | |
| 2003 | 12.3 | 8.9 | 7.1 | 11.5 |
| 2004 | 14.1 | 10.6 | 10.4 | 17.4 |
| 2005 | 11.5 | 8.3 | 11.9 | 15.2 |
| 2006 | 9.4 | 7.5 | 9.9 | 9.5 |
| 2007 | 10.7 | 5.3 | 8.1 | 12.2 |
| 2008 | 7.9 | 6.4 | 7.2 | 9.4 |
| 2009 | 8.5 | 6.2 | 8.2 | 6.9 |
| 2010 | 9.8 | 5.0 | 7.3 | 5.7 |
| 2011 | 7.6 | 4.1 | 4.7 | 7.1 |
| 2012 | 5.4 | 3.1 | 3.1 | 5.0 |

COMMENT: MORE EPISODE-BY-EPISODE ANALYSIS

The close relation between changes in the stock of money and changes in other economic variables, alone, tells nothing about the origin of either or the direction of influence. The monetary changes might be dancing to the tune called by independently originating changes in the other economic variables; the changes in income and prices might be dancing to the tune called by independently originating monetary changes; the two might be mutually interacting, each having some element of independence; or both might be dancing to the common tune of still a third set of influences. **A great merit of the examination of a wide range of qualitative evidence, so essential in a monetary history, is that it provides a basis for discriminating between these possible explanations of the observed statistical covariation. We can go beyond the numbers alone and, at least on some occasions, discern the antecedent circumstances whence arose the particular movements that become so anonymous when we feed the statistics into the computer.**

–Friedman and Schwartz.

Appendix slides