DISCUSSION:
THE PROFIT-CREDIT CYCLE
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**Overview**

2. Especially decline in loan loss provisions.
3. Profit booms coincide with decline in bond spreads.
   - Evidence of credit supply ↑, default risk ↓, or bond market liquidity ↑?
4. Higher paid-out dividends and retained equity both ⇒ higher credit growth.
   - Evidence against leverage constraint? Pay dividends today ⇒ 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?**

The graph shows a histogram of SPF 2008Q4 forecasts for 2009Q4 unemployment rate. The x-axis represents the SPF 2008Q4 forecast of 2009Q4 unemployment rate, ranging from 5.0 to 10.0, while the y-axis indicates the percent of responses, ranging from 0.0 to 40.0. The distribution is skewed towards higher unemployment forecasts, with a significant peak around the 8.0 mark.
What about house prices?

Table 3. Short- and Long-Term Home Price Expectations, by Survey Location and Year, 2003–12
Mean response (percent)‎

<table>
<thead>
<tr>
<th>Survey year</th>
<th>Alameda County</th>
<th>Middlesex County</th>
<th>Milwaukee County</th>
<th>Orange County</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>7.6</td>
<td>4.4</td>
<td>5.5</td>
<td>9.4</td>
</tr>
<tr>
<td>2004</td>
<td>9.3</td>
<td>7.6</td>
<td>6.4</td>
<td>13.1</td>
</tr>
<tr>
<td>2005</td>
<td>9.6</td>
<td>6.3</td>
<td>6.6</td>
<td>8.7</td>
</tr>
<tr>
<td>2006</td>
<td>7.4</td>
<td>1.9</td>
<td>5.9</td>
<td>6.0</td>
</tr>
<tr>
<td>2007</td>
<td>4.9</td>
<td>2.9</td>
<td>6.1</td>
<td>−0.1</td>
</tr>
<tr>
<td>2008</td>
<td>−1.6</td>
<td>−0.7</td>
<td>2.4</td>
<td>−2.6</td>
</tr>
<tr>
<td>2009</td>
<td>2.4</td>
<td>2.0</td>
<td>1.5</td>
<td>0.7</td>
</tr>
<tr>
<td>2010</td>
<td>4.4</td>
<td>2.2</td>
<td>3.7</td>
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<tr>
<td>2011</td>
<td>2.3</td>
<td>2.3</td>
<td>1.7</td>
<td>0.3</td>
</tr>
<tr>
<td>2012</td>
<td>4.4</td>
<td>2.3</td>
<td>2.3</td>
<td>3.6</td>
</tr>
</tbody>
</table>

“On average over the next ten years how much do you expect the value of your property to change each year?”

Source: Authors' surveys.

a. Means are 10 percent trimmed means; that is, we dropped the highest and lowest 5 percent of responses before calculating the mean.

b. Survey question 6.

c. Survey question 7; in the 2012 survey only, the words “On average” and “each year” were underlined.

The right-hand panels show the trimmed means of our respondents' annualized 10-year expectations, again by location. A large difference is observed between the 1-year and the 10-year expectations. The 1-year expectations are much more volatile and at times negative, whereas the 10-year expectations follow a simpler pattern, peaking around 2004 and then only gradually declining. The 10-year expectation
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