Discussion of "Required Reserves, Liquidity Risk, and Credit Growth" by K. Alper, M. Binici, S. Demiralp, H. Kara, and P. Özlü

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- Evolution towards indirect instruments of monetary policy in recent decades for most emerging countries

- But return to direct instruments after the financial crisis

- Turkey is an interesting case

- In particular with active management of reserve requirements

Paper's contribution

- Describe recent policies by CBRT

- Propose a small model for the impact of RR

- Focus on the liquidity channel

- Empirical analysis with recent bank-level data in Turkey

Theoretical background

- In standard static Monti-Klein model, RR is similar to a tax on deposits

- In a more macroeconomic framework, a RR may be equivalent to a tax on deposits + an open market operation
  - E.g. see Romer (1985), Bacchetta and Caminal (1994) in a dynamic OLG model

- A tax on deposits has typically no *direct* impact on lending interest rates

- But an increase in RR may indirectly decrease lending and increase

Standard channel

L	D
B^L	
RR	

- The tax on deposits may reduce banks' liabilities
  - when no close substitute to deposits

- This should reduce assets and may increase the lending rate

- Also associated with lower liquid securities B^L

Two additional channels

- The authors consider two additional channels so that RR have a direct impact on lending rates

- **interest rate risk channel**

- **liquidity channel**

- Only the liquidity channel is modeled

The liquidity channel

- Banks value liquidity holdings B^L, instead of loans, as they might face liquidity shocks

- With higher liquidity, banks are willing to lend more and decrease their lending interest rate

- A higher RR reduces B^L

- This may increase the lending rate and decrease lending: *direct* effect

- The impact of RR may also depend on the level of liquidity

Empirical results

- Analyze impact of RR and liquidity on interest rates and on quantities of loans and deposits

- Three sets of results

1. An increase in RR:
   1. increases lending rate
   2. reduces the quantity of new loans
   3. increases deposit rate

- 1 and 2 are consistent with various theories; 3 can be consistent with liquidity channel, but not with standard one

2. An increase in liquidity

   1. decreases lending interest rate
   2. decreases deposit rate
   3. tends to increase loans, but not very significant

- 2 is inconsistent with theories

3. RR increases have more impact for banks with less liquidity

   1. on consumer loans
   2. on commercial loans interest rates

Main comments

- Nice and novel empirical results on the liquidity channel
  - Even though results are not fully consistent with theory
  - Serious endogeneity issue with liquidity variable

- The paper is "preliminary and incomplete", with room for improvement

- The theoretical framework is suggestive, but too simplistic

Comments on theoretical framework

- Based on old paper (Orr and Mellon, 1961)

- Add cost C decreasing with B^L in simple Monti-Klein model
  - This negative cost function is purely *ad hoc*

- Would be nicer to have a more structured macro framework

- Would allow to think about central bank behavior

Two crucial assmptions

1. The cost C increases with RR
   - implicitly RR decreases liquidity

- But why aren't reserves liquidity?

- May depend on frequency. Also should the requirement be satisfied on a daily or a monthly basis?

2. The impact of RR is larger for lower levels of B^L

- Not clear why

Conclusion

- Useful and interesting empirical results

- Draws attention to the Turkish case

- A more precise theoretical framework is missing