Monetary Policy Limits:
Security and Credit Application Registers' Evidence

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Extended Abstract (WORK IN PROGRESS)

Monetary policy has been a crucial, active public policy since the start of the crisis, but there could be key limits on its potency. We study the transmission channel of monetary policy via banks including securities trading by banks, in addition to credit. In particular, we analyze the monetary policy effects depending on: (i) securities holdings versus credit supply channel; (ii) crisis vs. normal times; (iii) differential bank capital; (iv) reach-for-yield in both securities holdings and in credit supply; (v) held-to-maturity vs. available for sale and trading book; (vi) differential haircuts for accessing Eurosystem liquidity.

For identification, we exploit the security and credit application register owned by the central bank of Italy in its role of bank supervisor. The data is monthly from 1999:M1 to 2013:M12. The securities register contains at the security (ISIN) level data all securities investments of all Italian banks (not just government bonds, or just securities that banks pledge as collateral to borrow ECB liquidity). We consider only bonds (83% of holdings), and, for each security, we obtain its yields, prices, issuer, rating and remaining maturity. The comprehensive credit register, apart from the granted loans, includes loan applications and loan rates. For identification, we analyze the data at the security-month-bank level and at the loan application-month-bank level, and in the strongest regressions, we control for security*month and firm*month fixed effects respectively. We match the two registers with supervisory bank-level balance sheet information and exploit bank capital heterogeneity – leverage ratio – controlling for other bank variables. Finally, we analyze monetary policy since the crisis via the size of the ECB balance sheet, and before the crisis via a measure related to Taylor shocks.

We find the following results. (1) When monetary policy becomes softer (conventional in normal and unconventional in crisis times), banks increase their holdings of securities. In crisis times, softer monetary policy has moreover more positive effects in securities holdings than in credit. (2) During the crisis, banks with lower (compared to higher) capital expand more into securities when policy is softer, whereas the opposite happens on the credit supply: banks with lower capital grant less loan applications to the same firm in the same month. Hence, banks with lower capital prefer securities to credit supply to firms in crisis times when monetary policy is softer. Differently, in normal times, banks with lower capital does not expand more on securities, but more on credit supply with softer policy. (3) The reach-for-yield in securities in crises is by banks with higher (not lower) capital, which is not consistent with risk-shifting when policy is softer. (4) In crisis times, results suggest that access to ECB liquidity and risk bearing capacity are the main drivers in securities trading; whereas in normal times, banks with lower capital reach-for-yield in credit, and use the security portfolio to rebalance the higher risk they assume in lending.

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