Discussion of
"The Effects of Asymmetric Information Between Borrowers and Lenders in an Open Economy"

Sylvain Leduc

*Federal Reserve Bank of San Francisco*

Reserve Bank of New Zealand

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Models with financial intermediaires 1

- Pre-crisis: overall, little used in closed-economy macro
- Response of output to a technology shock in CF
Models with financial intermediaries 2

- Response of output to a monetary shock in BGG
Financial crises in EMEs

- Clearer importance of financial intermediaries
- More consideration for other shocks than real shocks
- Importance of the interaction of agency costs and monetary policy (GGN (2007))
Lenders’ opportunity cost

- In CF, entrepreneurs transform $IN_t$ units of inputs into $\omega_t(i)IN_t$ of capital.
  - The opportunity cost is holding on to the funds for the remainder of the period.
  - So it's 1.

- In BGG, entrepreneurs borrow today to buy capital for use at $t+1$.
  - The opportunity cost is holding a riskless bond.
Lenders’ opportunity cost in Iris’s model

- Lenders can hold a risk-free foreign bond.

- But buying a bond today pays at $t+1$: after the uncertainty about $\omega(i)$ is revealed.

- So what’s the opportunity costs to the financial intermediary?

\[
g(\omega_t)\hat{\Psi}_t IN_t \geq \frac{(1 + l^*_{t+1})Q_{t+1}(IN_t - NW_t)}{1 + \Pi^*_{t+1}}
\]

- Could the FI lend to the entrepreneur, get the funds at the end of the period, and still invest in the foreign bond?

- Discussion of aggregate uncertainty arising via currency risk.
In Iris’s model, the (gross) lending rate is

\[ R_t^k = R_{t+1}^* \frac{\bar{\omega}_t}{g(\bar{\omega}_t)} \]

So, the external finance premium is:

\[ \left[ \frac{\bar{\omega}_t}{g(\bar{\omega}_t)} - 1 \right] \]

This premium is pro-cyclical
Behavior of lending rate

- With a productivity shock, RER *appreciates*
- *Reduces* return from holding a foreign bond in foreign currency
- Reduces the gross lending rate
Behavior of RER

- Why is RER appreciating?
- What defines RER in the model?
  - the terms of trade (home bias is unity)
- Following the productivity shock, domestic inflation is rising