

Discussion
“Shocks and financial stability”

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How to think about financial resilience: three lenses

Theme of the workshop: where we stand after COVID, the war in Ukraine and the 2021–23 rate cycle. **Resilience to what, and seen from where?**

- **Which shocks?** Domestic macro (growth, inflation, the policy rate) versus *external and imported* (foreign regulation, global uncertainty, a crisis in a partner country). For small open economies the second group dominates — and it is the one domestic policy cannot offset, only cushion.
- **Which part of the bank?** *Funding* can the bank keep its external liabilities? *Solvency* do capital and asset quality hold? *Earnings* can profits absorb losses before capital is touched?
- **Has transmission changed?** The post-2008 reforms, the low-rate decade and the 2021–23 tightening are different regimes. A shock that was benign in one can be damaging in another. The empirical question is not the average effect but whether it has *shifted*.

General message from the three papers: EM banking systems absorbed the shocks of 2020–24 reasonably well, but the vulnerability that remains is to external and macro shocks transmitted through funding, real financing conditions and credit quality.

Three dimensions of resilience

Lens	Paper	Shock studied	Type	Headline result
Funding (external liabilities)	Colombia	Fed 2022 stress capital buffer	External, regulatory	Short-term dollar lines from affected US banks halve; only partial substitution
Overall soundness	Tunisia	Growth, inflation, policy & real rate, global uncertainty	Domestic and external	Global uncertainty and real rates transmit asymmetrically; growth and policy rate barely matter
Earnings	Albania	Credit risk, growth, rates, FX, three crises	Domestic and imported crises	NPL shocks absorbed within ~3 quarters; Greek crisis hurt, GFC did not

Common message. In each paper the shocks that matter most originate abroad or are beyond domestic control; domestic activity is a weak driver; and the buffer that matters — diversified funding, capital, earnings — works with a lag and never fully. For me aspect of interest is the extent to which these relationships have *shifted across regimes*.

Colombia: Fed capital rules and EM bank funding

What the paper does and finds

- Weekly data on every foreign credit line of 12 Colombian banks; 26 US lenders, 11 subject to the Fed stress test.
- Three 2022 events: stress-test results (23 June), individual requirements (4 August), implementation (1 October).
- Credit from affected US banks falls by about **half** relative to a synthetic control; the effect starts on announcement and deepens at implementation.
- Entirely in **short-term lines**; long-term credit and credit limits little changed. Partial, delayed substitution toward unaffected US banks; essentially none toward non-US lenders.

Why it matters for the theme

- A clean *external, non-market* shock: a regulatory decision in the core reshapes funding in the periphery within weeks.
- Transmission runs through *expectations* since banks adjust when the information arrives, not when the rule binds.
- The adjustment falls on the most runnable instrument, and diversification has limits: the US is the dominant lender and nobody else steps in.

Colombia: which shock?

- **2022 was a year of overlapping external shocks.** The Fed's capital decision coincided with Fed tightening from March, a record dollar and Colombia's June election followed by peso depreciation. Large global banks with country limits react to all of these; small US banks do not. Using each bank's *actual* requirement change as the intensity of treatment would separate the regulatory shock from the global risk-off and from Colombia-specific risk.
- **One-off or structural? Use the other years.** The 2021 placebo is reassuring, but the data cover 2020 (COVID), 2021, 2022 and could cover 2023 (SVB). Repeating the exercise around each Fed cycle would tell us whether EM funding lines have become *structurally more sensitive* to US regulatory events since 2020.
- **Who absorbs the shock on the Colombian side?** Which banks found alternative funding, large vs small, foreign-owned vs domestic, those with bond-market access? This heterogeneity informs resiliency.
- **From funding to the real economy.** USD 21 M per line, what share of external funding and FX liquidity, and did dollar lending to Colombian firms (trade finance, working capital) change?

Colombia: lessons

Lessons from the study

- Regulation in the core is an external shock for the periphery and it works as announced.
- It changes the *composition* of funding, not only its level: short-term dollar lines are the adjustment margin for the lender and the run risk for the borrower.
- Geographic diversification is limited in practice.
- Symmetry: lighter US regulation would ease EM funding just as fast, and make it more pro-cyclical.

Policy lessons

- Think about short-term FX lines from a few global banks as a *systemic vulnerability* in EM macroprudential frameworks.
- Calibrate FX liquidity buffers and NSFR-type rules to a sudden halving of short-term lines.
- Encourage diversification across lenders and instruments in good times.
- International coordination matters most for the *timing and predictability* of regulatory changes in the core, not their level. Shocks matters more?

Tunisia: financial stability index

What the paper does and finds

- Quarterly composite index (2011Q4–2024Q4) from capital, asset quality, profitability, efficiency and two macro conditions (domestic debt/GDP, import cover).
- The index rises strongly over the period, dips in 2020, recovers from 2021 with the Central Bank's easing and refinancing measures.
- Responses to five shocks: growth, inflation, the policy rate, the real rate, and global uncertainty (WUI). Asymmetric responses only for **global uncertainty** and the **real rate**; growth and the policy rate have small, symmetric effects.
- Time-varying causality: links intensify around 2015, COVID, the 2021–23 inflation surge and 2023.

Why it matters for the theme

- A quarterly index as a surveillance tool.
- Policy rate (no asymmetry) vs real rate (strong asymmetry) captures the 2021–23 experience: inflation surges affects stability before monetary policy catches up.
- Global uncertainty dominates domestic activity underscoring the importance of external factors; and transmission is *regime-dependent*.

Tunisia: the index and its drivers

- **how does index relate to financial conditions?** It summarises bank soundness plus two macro conditions. Show how it relates to credit growth, lending rates and spreads, liquidity, the sovereign–bank nexus, and to existing stress or financial-conditions indices. Is it leading or lagging?
- **The index trends toward more stability** From ≈ 5 in 2011 to ≈ 100 in 2023: the most striking fact in the paper, and it deserves its own analysis. *Structural* candidates: the 2016 banking law, tighter capital and provisioning rules, restructuring of public banks, NPL work-out, better supervision. *Cyclical* candidate: margins widening as the policy rate rose from 3.5% to 8%. Decompose the trend.
- **How should the index be used to assess risk?** A trending index has no natural “stress” reading. Risk dimension: deviations from trend, thresholds calibrated on known stress (2013, 2020), comparison with supervisory judgement.
- **Beyond domestic macro: Tunisia’s external linkages.** The finding that the external shock dominates argues for going further. Exposures run through the euro area (trade, tourism, remittances, ECB conditions), energy and food import prices, and sovereign external financing (reserves, IMF programme). Add euro-area activity and financial conditions, oil prices, a sovereign-risk measure, with sub-samples around 2020 and the 2022–23 financing squeeze.

Tunisia: lessons

Lessons from the study

- Bank soundness has improved markedly since 2011 — the open question is how much is structural and how much the margin cycle of rising rates.
- Domestic growth and the policy rate transmit weakly; external uncertainty and real financing conditions transmit asymmetrically and persistently.
- Inflation surges damage stability through the real rate before the policy response arrives.
- Given trade, tourism, remittance and sovereign-financing links, the relevant external shocks are euro-area conditions, import prices and sovereign risk — these belong in the analysis.

Policy lessons

- Publish the index with its components and a trend/cycle decomposition, so supervisors can separate structural improvement from cyclical margins.
- Add a risk-assessment layer so the index signals *when to act*, not only where we are.
- Track real financing conditions, euro-area financial conditions, import prices and sovereign spreads alongside domestic macro.
- Use the high-profitability years to build counter-cyclical buffers; against external shocks the domestic rate is a weak lever.

Albania: drivers of bank profitability

What the paper does and finds

- Panel of 11-16 banks, 2002–2024; ROA explained by growth, capital adequacy, inflation, exchange rate, policy rate, credit risk, size and efficiency, combining monthly and quarterly data (MIDAS).
- Credit risk lowers profitability immediately; the effect is absorbed within about **three quarters**.
- Growth, capital and efficiency raise profitability; policy-rate increases and depreciation lower it in the short run; inflation is insignificant.
- Three crises: the Greek sovereign crisis and COVID reduced profitability; the GFC did not.
- Three phases: expansion (2002–08), stagnation with NPLs at 25% (2009–16), consolidation and re-intermediation (2017–24).

Why it matters for the theme

- Focus on earnings: the paper measures how fast profitability absorbs a credit-quality shock.
- A small, euroised, foreign-owned system hit by an *imported* crisis: Greece matters.
- Capital pays off with a lag suggesting the importance of building buffers in good times; and the domestic policy rate is a weak lever in a euroised system.

Albania: three phases

- **The narrative has three regimes; the estimates pool them.** Crisis dummies capture level shifts but not changes in transmission. Ideally, estimating by phase (or before/after 2016, when NPL resolution and consolidation began) would show whether the sensitivity of profitability to credit risk, growth and rates has fallen as the system matured which is at the core of resilience.
- **The interest-rate environment changed in 2022–24.** Rates fell for most of the sample, so the negative policy-rate effect comes largely from that period. Yet the 2022–24 hikes coincided with record profitability (ROA 1.8% in 2024), driven by euro rates on FX assets. A sub-sample for the hiking episode, or an interaction with the euro share of business, would show whether the sign has flipped and the role of euroisation.
- **Exchange rate: depreciation risk or appreciation windfall?** The Lek appreciated strongly in 2022–24 alongside record profits. Is the effect symmetric? The policy-relevant channel is credit risk on unhedged borrowers after depreciation which the timing analysis could separate from the immediate valuation effect.

Albania: lessons

Lessons from the study

- Profitability absorbs a credit-quality shock within about three quarters with earnings as a fast buffer, provided margins are healthy.
- Capital strengthening improves performance gradually, not instantly.
- Proximity and ownership links, not global size, determine which foreign crisis hurts.
- In a euroised system growth and credit quality drive profitability; the domestic policy rate is second-order and its sign may depend on the regime.

Policy lessons

- NPL resolution and write-off frameworks are immediate resilience tool: they shorten the period of impaired earnings.
- Build capital and counter-cyclical buffers in high-profit years; the pay-off arrives with a lag and cannot be created in a downturn.
- Monitor concentrated exposures to parent-bank home countries; imported crises transmit through ownership.
- Address FX risk on unhedged borrowers and the limits euroisation places on monetary policy, de-euroisation is a financial-stability policy,

Resilience, where do we stand?

- 1 External and macro shocks dominate.** A Fed rule, global uncertainty, a partner-country crisis: domestic activity is a weak driver in all three papers. EM banks absorbed 2020–24, but their exposure is to shocks that buffers cushion, not offset.
- 2 Buffers work with a lag, never fully.** Capital lifts profitability and soundness over several quarters; diversified lenders allow partial, delayed substitution. Built in good times or not at all.
- 3 Transmission is regime-dependent.** Stronger causal links in Tunisia since 2020; a hiking cycle that turned rates from a drag into a windfall in Albania; funding lines that moved on announcement in Colombia. Sub-sample evidence is important for understanding results in the papers..
- 4 Short-term FX funding is the adjustment margin.** The lender cuts the revolving dollar line first
- 5 Real financing conditions, not the policy rate.** Damage from an inflation surge occurs through real rates before policy responds; in euroised or dollarised systems the domestic rate is a weak stability lever either way.
- 6 Measurement is not neutral.** A soundness index rising with inflation, ROA as a resilience proxy, drawn credit as outcome: profitable $\neq$ resilient.

Policy lessons

- **Build in good times.** The 2022–24 profitability windfall is the moment for counter-cyclical capital and FX liquidity buffers; every paper shows the pay-off arrives with a lag.
- **Watch funding composition.** Short-term FX lines concentrated in a few global banks deserve explicit macroprudential limits and diversification incentives.
- **Track real financing conditions.** Surveillance indices should include real rates and external uncertainty, and separate structural soundness from rate-driven margins.
- **Coordinate on timing.** Core-country regulatory changes spill over on announcement; predictability and phasing matter more for EMs than the level of requirements.

Summary All three papers find the domestic policy rate a weak or ambiguous instrument for financial stability, and all three find the decisive shocks are external. Which are the right policy tools? Capital and FX liquidity buffers, funding diversification, and international coordination on the timing of regulation in the core?