# Monetary Policy at Work:
# Security and Credit Application Registers Evidence

**José-Luis Peydró Andrea Polo Enrico Sette**[*]

***Extended Abstract (Work in Progress)***

The potency of the bank lending channel of monetary policy may be limited if for example banks hoard the liquidity in, or do risk-shifting with, securities. We analyze the transmission channel of monetary policy focusing on banks' securities trading, in addition to lending, in turn allowing us to also test the empirical importance of some key financial frictions and channels. Not only do we analyze the overall effects of monetary policy on securities holdings and credit supply, but also the heterogeneous effects depending on: (i) bank capital; (ii) security and loan yields; (iii) crisis vs. normal times; (iv) haircuts to obtain (ECB) public liquidity; (v) accounting and regulatory differences in banking vs. trading book.

For identification, we exploit, since the creation of the euro, the security and credit registers owned by the central bank of Italy, a bank dominated economy. The supervisory registers contain – at the security (ISIN) level – all securities investments of all Italian banks, including e.g. yields, ratings and maturity at the security-bank-month level, and apart from the granted loans, contain loan applications and loan rates at the firm-bank-month level.

We find the following results. First, in both normal and crisis times, when monetary policy (respectively conventional and unconventional) becomes softer, banks increase their holdings of securities. Effects are stronger in crisis times for securities than for credit supply. Second, in crisis times, low capitalized banks prefer buying securities than increasing credit supply to firms (not due to lack of good loan applications). Moreover, lower capitalized banks buy less risky securities, which is inconsistent with the risk-shifting hypothesis. Our results suggest that the main channels at work are access to public liquidity and risk-bearing capacity (not regulatory arbitrage). Finally, in normal times, low capitalized banks increase more the supply of credit and to higher-risk borrowers, while they prefer securities with lower yield (consistent with using security portfolio to rebalance the higher risk they get on the loan portfolio)

*Keywords*: monetary policy, financial frictions, investments, bank capital, credit supply.

*JEL Codes*: E52, E58, G01, G21, G28.

[*] José-Luis Peydró: ICREA-Universitat Pompeu Fabra, CREI, Barcelona GSE and CEPR, jose.peydro@upf.edu; Andrea Polo: Universitat Pompeu Fabra and Barcelona GSE, andrea.polo@upf.edu; Enrico Sette: Bank of Italy, enrico.sette@bancaditalia.it (contact author). We thank Jordi Gali, Peter DeMarzo, Marco Pagano, Huw Pill, Annette Vissing-Jorgensen and seminar participants at Stanford, Berkeley, CREI, Zurich, LSE, Bocconi and participants at the ECB conference on "Non-standard monetary policy measures" for helpful comments. The views of this paper are those of the authors and do not represent the views of Banca d'Italia or of the Eurosystem. We are grateful to the Assonime/ CEPR Research Programme on Restarting European Long-Term Investment Finance (RELTIF) for financial support of the research in this paper. Peydró acknowledges financial support from project ECO2012-32434 of the Spanish Ministry of Economics and Competitiveness and from the European Research Council Grant (project 648398).