Monetary and macroprudential policy: theory and policy advice

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Standard disclaimer applies.

Cohabitation between monetary and macroprudetnial policy

Monetary policy and asset bubbles: lean (Borio and Lowe, 2002) vs clean (Bernanke and Gertler, 2002)

Financial crisis of 2007-2008

Monetary policy, macroprudential policy and asset bubbles (and credit)

- **Separate goals**: price stability for monetary policy, financial stability for macroprudential policy (Bernanke 2011), Svensson (2014)
- **Shared goals**: monetary policy should include financial stability as an objecive and lean against the wind (Stein 2013)

Theory and policy advice

Few papers analyze monetary policy in economies with bubbles

Gali (2014, 2018), Ikeda (2017), Asiryan et al. (2017), Dong et al. (2018), Guerron-Quintana et al. (2018), Allen et al. (2018)

And fewer still include macroprudential policy.

Takeaways from F. Allen, G. Barlevy and D. Gale (2018)

- **Monetary policy**: should not fight bubbles (unless the crises are very costly), but might commit against them.
- **Macroprudential policy**: be bold.

F. Allen, G. Barlevy and D. Gale (2018)

Start with simple OLG endownment model and expand it

Production economy with sticky prices, cashless-economy monetary policy with recurring rational bubbles (Gali 2014)

Depending on equilibrium monetary policy can augment or dampen the bubble

Bubbles ameliorate innefficiency: no reason to lean against bubbles, bubbles are good!

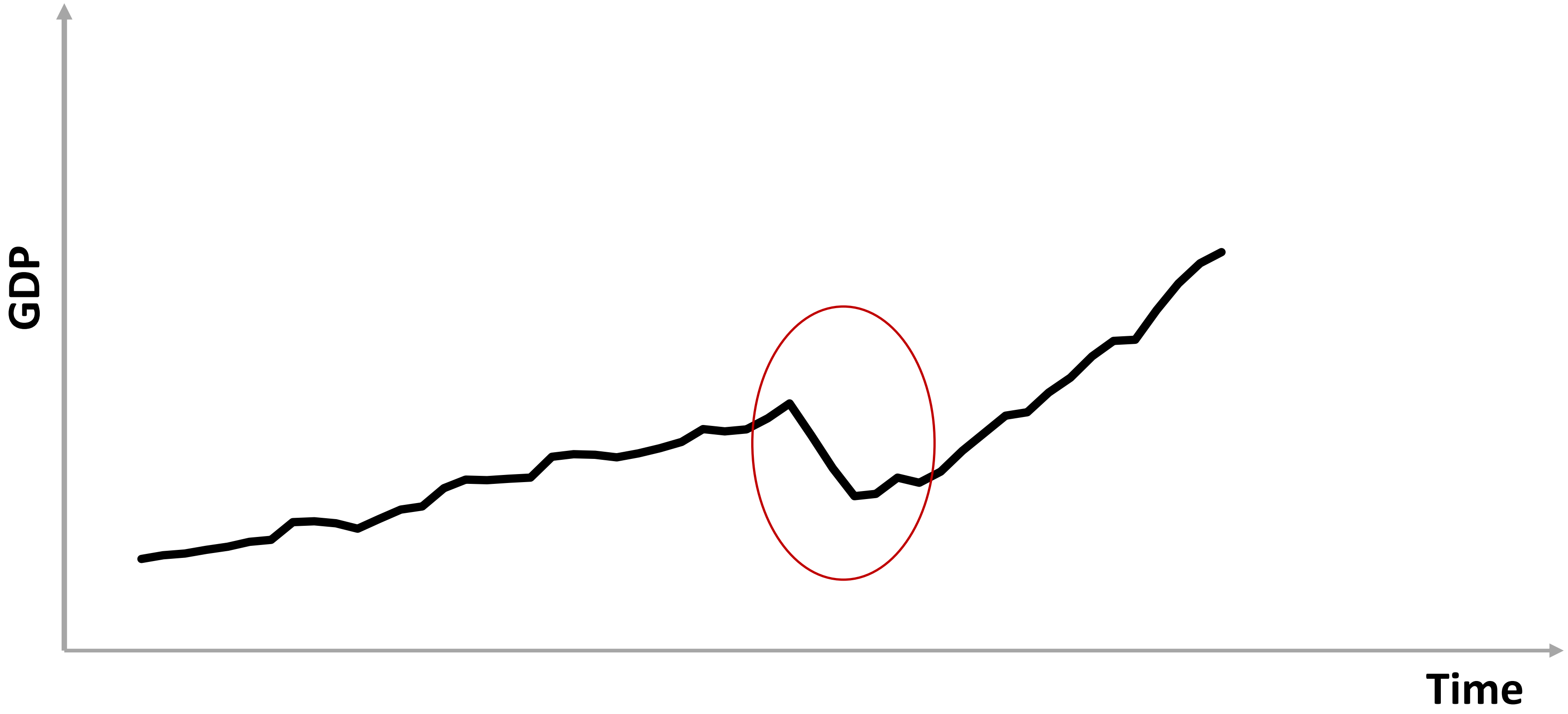
Credit

Bubbles crowd out productive investment, but leaning against them with monetary policy makes things even worse

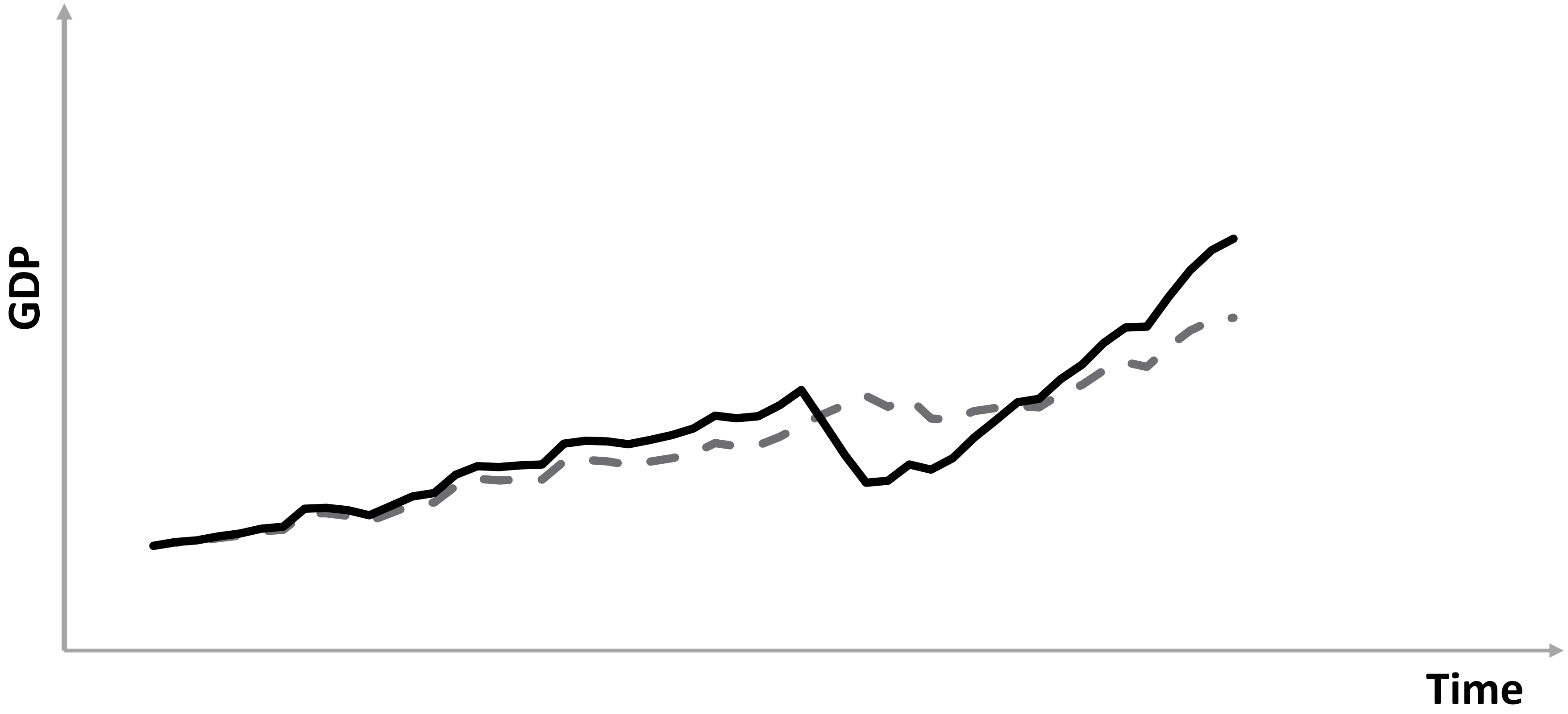
Default (cost proportional to amount of credit)

The bigger the buble, the bigger the crunch: leaning against the bubble prevents the crunch and is welfare improving

Macroprudential policy: be bold…

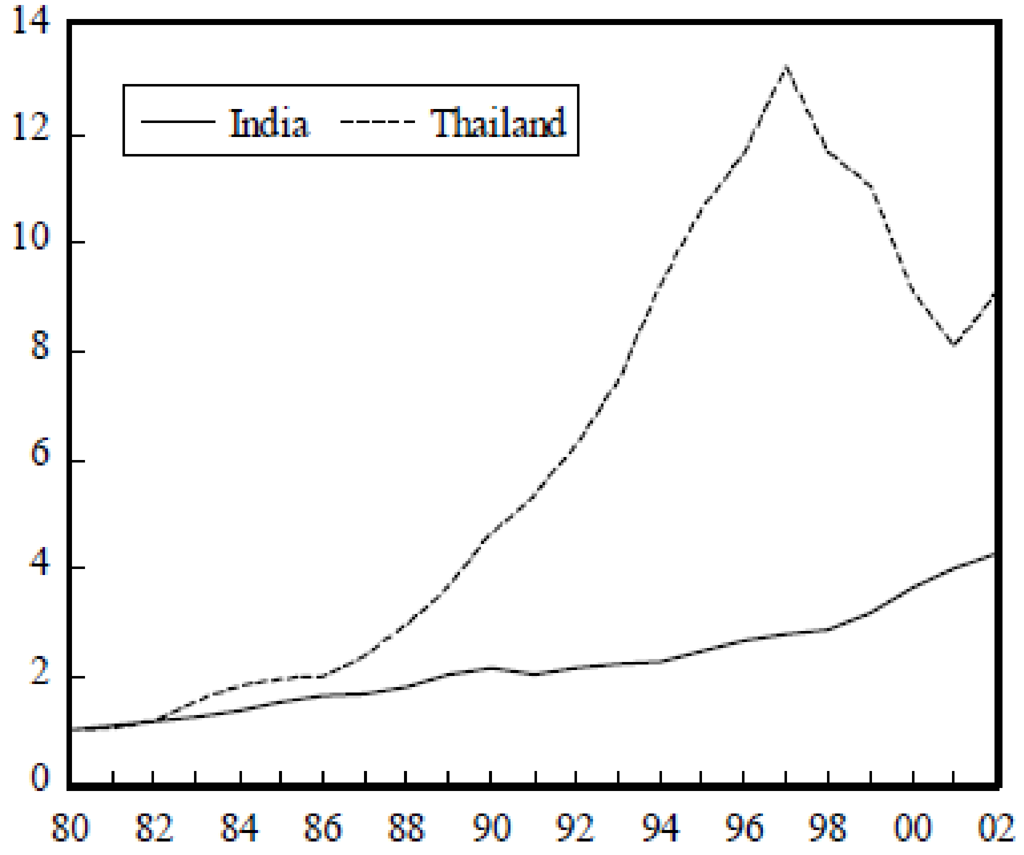


Macroprudential policy: be bold or be cautious?

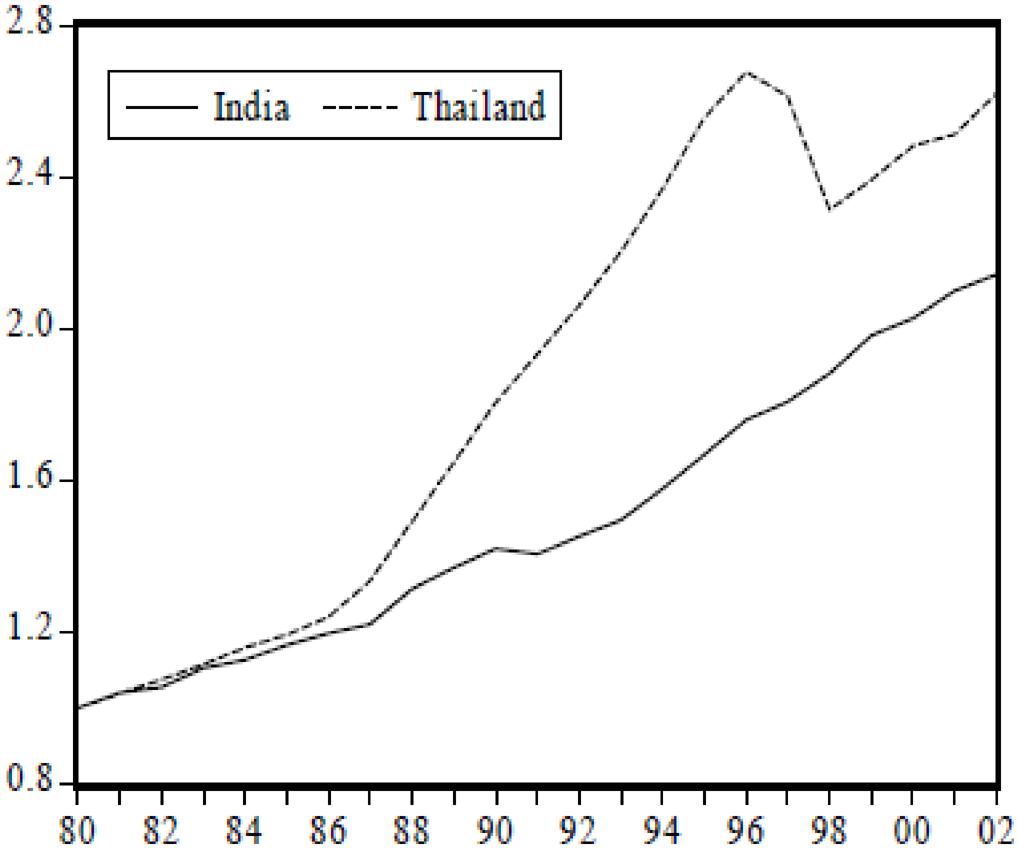


Stability vs. Growth

Real Credit

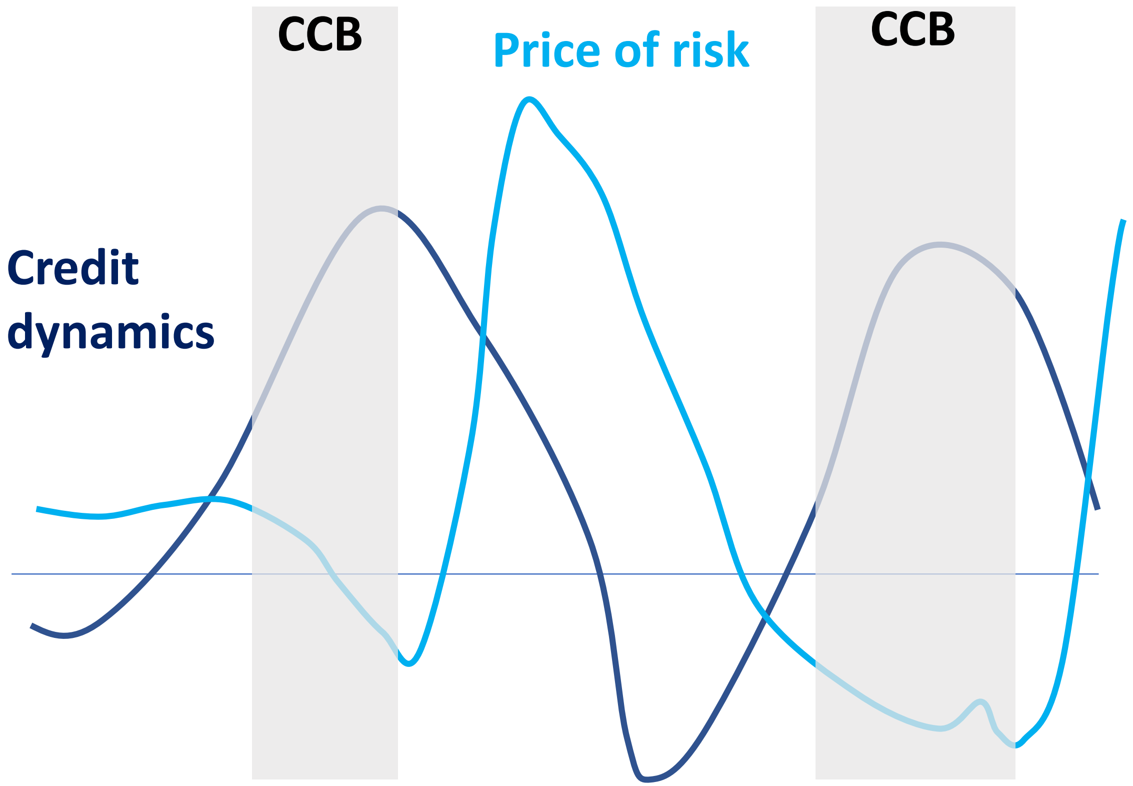


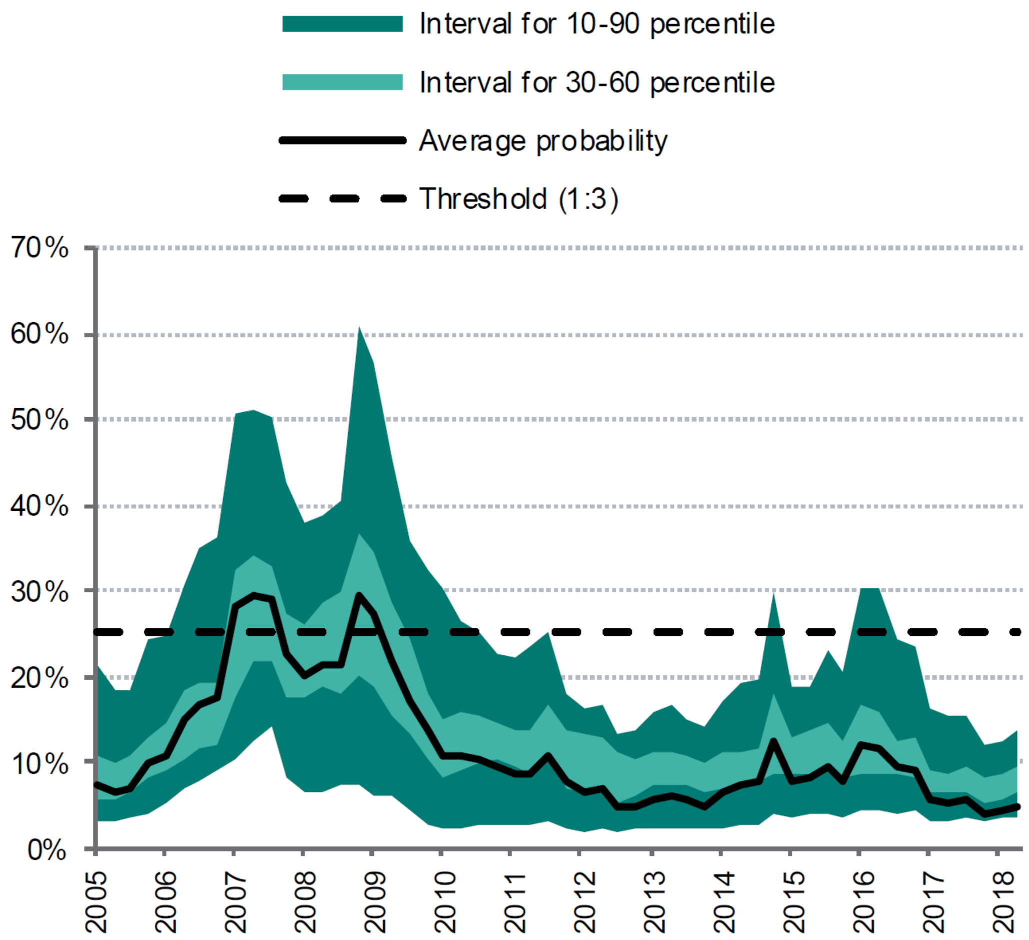
GDP per capita



Source: Ranciere, Tornell i Westermann (2007);
http://www.econ.ucla.edu/people/papers/Tornell/Tornell359.pdf

Countercyclical buffer: yes. Borrower-based measures (LTV, DTI)?



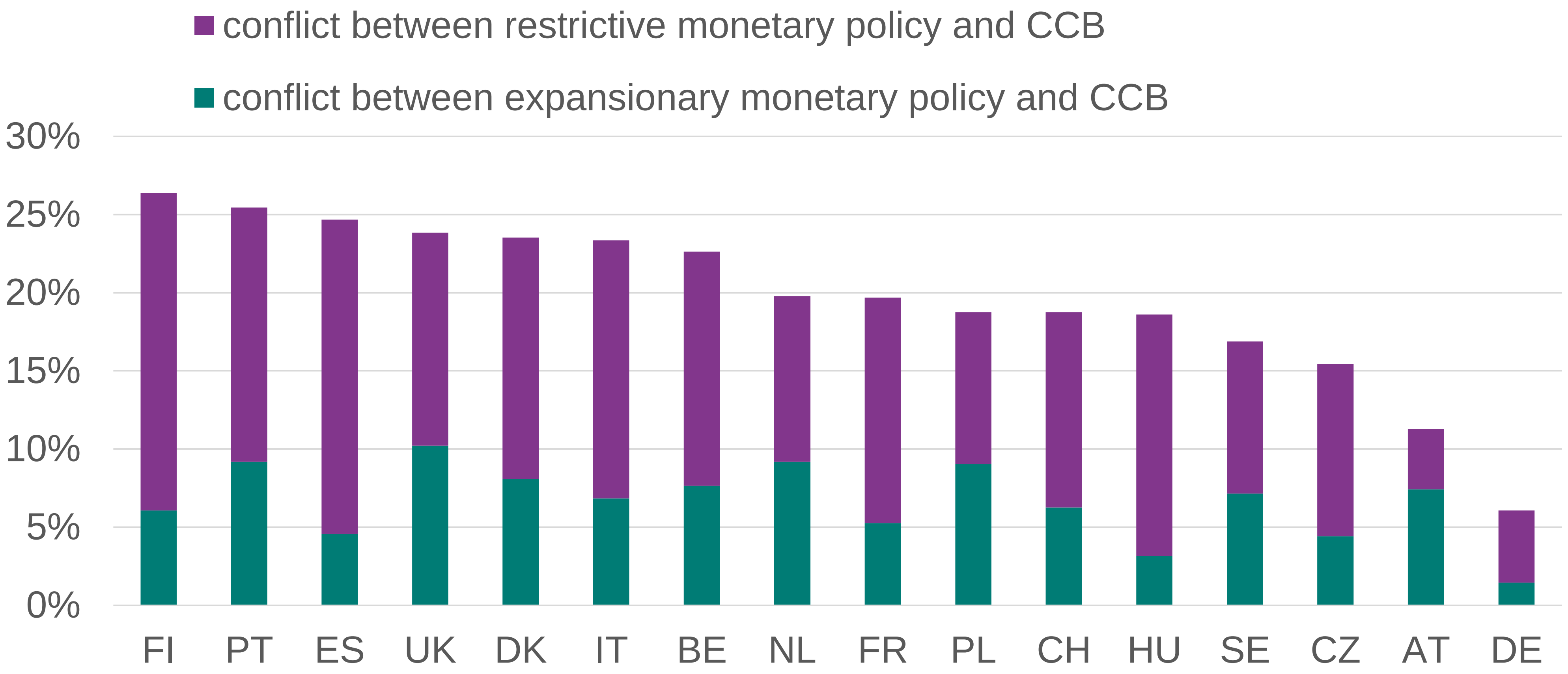


Source: NBP
https://www.nbp.pl/en/systemfinansowy/fsr201812.pdf

Theory and policy advice

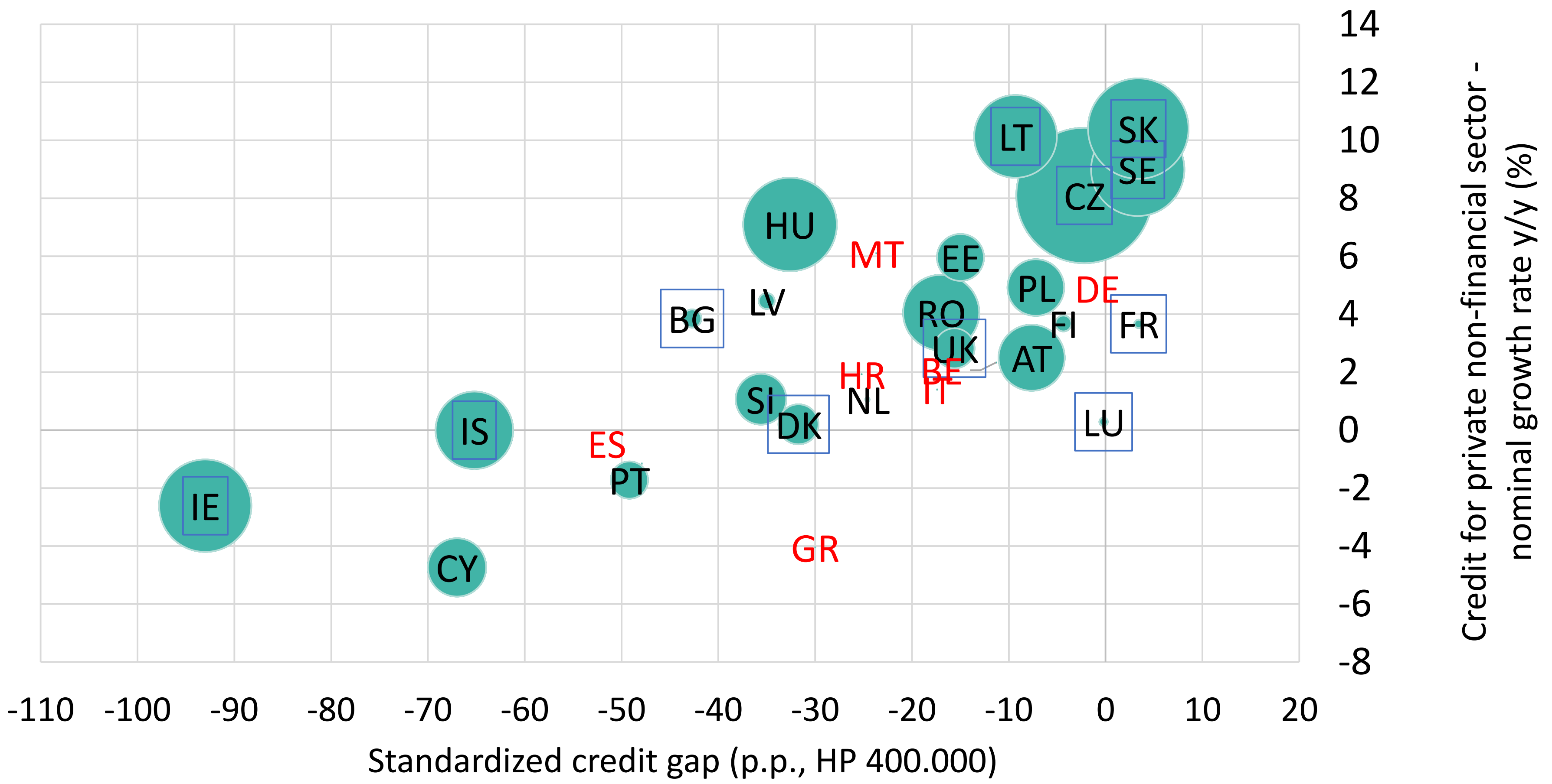
- What is a bubble: Rational bubbles vs. Irrational bubbles. Do we know bubble when we see it? Bubbles and innefficiency.
- Bubble frequency: Two-period lived vs. many periods (Gali 2018) vs. infinite (Guerron-Quintana et al. 2018)
- Credit & default or credit is sufficient? US vs. Europe

Conflicts between expansionary monetary and restrictive macroprudential policies have not been common. Will it change?



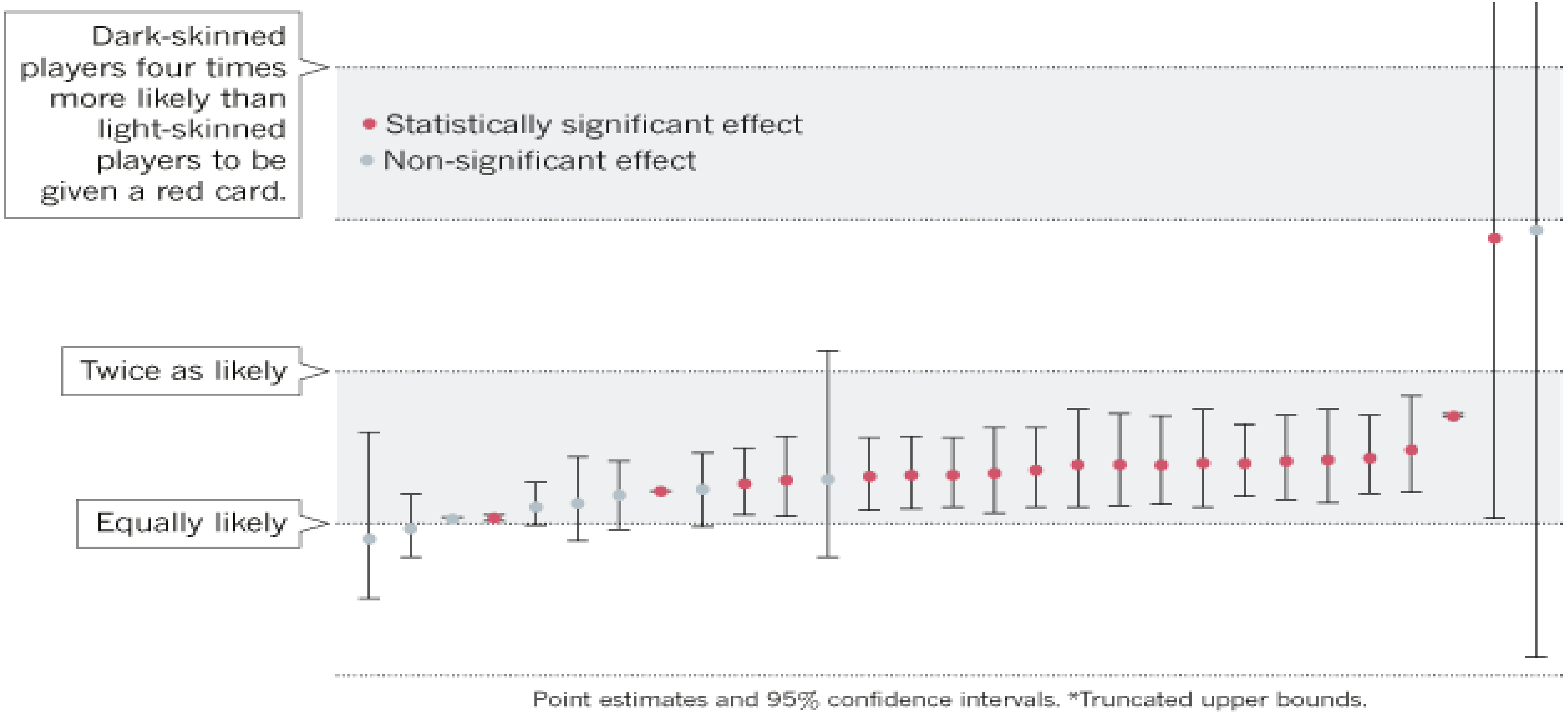
Notes: sample 2000-2016. Real interest rate gap indicates monetary policy stance. CCB is calculated as the average buffer calibration based on the credit-to-GDP gap and early warning models (EWI); CCB release along with credit gap/EWI (gradual) or CISS index (abrupt).

Macroprudential policy – different room for maneuver



Notes: data for 2017-2018. The macroprudential policy index includes collateral-based (LTV), borrower-based (DSTI, DTI/LTI) and capital-based (CCB, announced) measures. Size of the bubble reflects the tighteness of these measures. Countries marked in red have not introduced any of theese instruments. Countries in blue squares have introduced CCB.

Are football referees more likely to give red cards to players with dark skin than to players with light skin?



Source: Silberzahn, Uhlmann at al. *(2015);* https://www.nature.com/news/crowdsourced-research-many-hands-make-tight-work-1.18508

- How bold policy makers should be? Leaning, mopping and knowledge.

- Is there a bubble to lean against (monetary policy) and where is it (macropudential policy)?

- Globally there is little room to cushion next slowdown or crisis if they come soon.