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Calibrating Macroprudential Policy to Forecasts of Financial Stability

S.A. Brave, J.A. Lopez

Discussant:

Valerio Pesic
University "La Sapienza", Rome (Italy)
valerio.pesic@uniroma1.it

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This paper …

… deals on a very relevant element of macroprudential policymaking … the possibility to establish an effective monitoring systems in order to achieve the financial stability … helping policymakers to facing "substantial challenges in implementing macroprudential policies, beginning with the identification of the current state of financial stability and extending to the implementation of the chosen policy in a timely manner" …

… therefore, the Authors aim to make an effective contribution for the definition of a decision-theoretic framework to address the implementation of a countercyclical capital buffer …

… more in particular, they provide a transformation of Financial Stability Indicators (FSIs) that can more readily be mapped to the objective functions and decision processes of macroprudential policymakers …

… contribution …

... working on the ratio of U.S. private, nonfinancial credit to GDP (or the credit-to-GDP ratio), the Authors provide how to implement the modeled transition probabilities between states of high and low financial stability as captured by common financial stability indicators, using Markov regime-switching models …

… they tested it upon calibrated examples using data as of 2007.Q4, 2011.Q4, and 2015.Q4 showing different results upon the time of implementation between the first period to the other two …

… moreover, by attempting to translate projected policy costs and benefits across reasonably estimated hazard functions of adverse events, the Authors try to provide for policymakers a concrete framework for assessing if and when to act …

... general comment …

… the paper is very nice and well written …

… it deals on very interesting and relevant topics: … the possibility to establish an effective monitoring systems in order to achieve the financial stability

… it represents an effort to provide an effective contribution for the definition of a decision-theoretic framework to address the implementation of a countercyclical capital buffer …

… comment (1) …

… Authors said to consider the credit-to-GDP ratio (which has been shown to have good properties with respect to monitoring financial stability) by a different figure from BCBS - the transformation of the gap between the ratio and its long-term trend, with a one-sided Hodrick-Prescott filter – but decomposing the ratio in growth rates so that they can decompose it into separate real private credit and GDP growth components

… Authors said that working with growth rates allows to avoid estimating the trend in the credit-to-GDP ratio, the real-time reliability of which has been a particular source of controversy …

Suggestions (1): I wonder if it is possible to better explain the motivation of that choice, trying to comparing advantages and disadvantages of that choice … I think that also the growth of GDP and real private credit (especially if considering a very long time period) can have similar problems

… comment (1) …

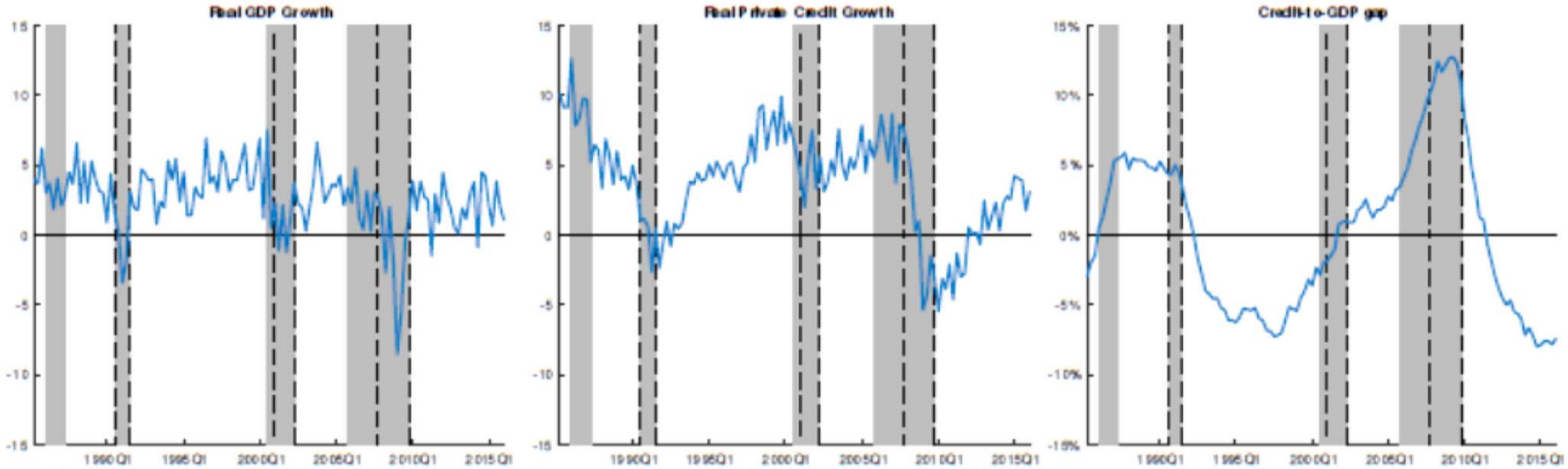

Figure 2. Real GDP and Private Credit Growth (percent annual rate) and Credit-to-GDP gap (percent deviation from trend)
Shaded periods reflect quarters with weighted average smoothed probabilities of the low financial stability state > 0.5.
Dashed vertical lines within the shaded periods denote NBER recessions.

Suggestions (2): It seems to me that the credit-to-GDP ratio works better

… comment (2) …

… the baseline model proposed is summarized as

$$\begin{aligned} Y_t &= \alpha_S + \beta_S X_t + \epsilon_t \\ \epsilon_t &\sim N(0, \sigma^2), \end{aligned}$$

$$Y_t \equiv \Delta ln(GDP_t) \qquad X_t \equiv \{\Delta ln(GDP_{t-1}), \Delta ln(C_t), \Delta ln(C_{t-1}))\}$$

Suggestions (1): Is there any problem of endogeneity?

… comment (3) …

… Authors considers four periods of low financial stability in their analysis to which they apply their model: 1986.Q1 − 1986.Q4, 1990.Q3 − 1991.Q1, 2000.Q3 − 2001.Q4, and 2005.Q4 − 2009.Q2.

Suggestions (1): I guess if during a very long period like that one, some relevant changes may be occurred hampering the significance of results (evolution of financial intermediation models, economic growth, etc.) … by this perspective, again, the ratio of credit-to GDP should result as a more robust measure

… comment (4) …

… Authors try to provide an objective function in order to be used by policymakers to implement macroprudential policy …

… they do it by a simplified model which translates projected policy costs and benefits upon a potential policy of interest …

… as Authors said "a variety of research questions remain to be addressed regarding the policy of interest, the adverse event to be avoided, the specification of the projected hazard functions and their associated financial stability measures"

Suggestions (1): I would suggest also to better consider the cost of banks' capital increase (e.g. credit contraction, reduction of GDP, etc.)

… minor comment …

… I would suggest to review the part containing the comment of the Figures and Tables leading it sometimes easier to understand …

… I could be useful to provide some more details about the results obtained ...

… the paper is interesting, but a bit complex: I would suggest to try review a bit the structure in order to make easier to understand it, especially when speaking about the calibrating of the model and policy recommendations …

… results obtained from different models do not seem to be always significant: I would suggest to consider it for some potential robustness checks

Conclusion

I would like to thank Authors … very nice paper, dealing on very interesting and relevant topics

… the possibility to establish an effective monitoring systems in order to achieve the financial stability … it represents an effective contribution for the definition of a decision-theoretic framework to address the implementation of a countercyclical capital buffer …

… I hope my comments can be of any utility in order to still improve it !!!