Discussion of Menna and Tobal's "Financial and Price Stability in Emerging Markets: The Role of the Interest Rate"

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The Big Picture

- Post-2008 policy consensus:
  - Rapid credit growth may cause crisis
  - Crisis $\Longrightarrow$
  $\Longrightarrow$ high unemployment, low output
  $\Longrightarrow$ political economy consequences (populism etc)
- Central banks cannot mop up
- Central banks must prevent next crisis

Policy Questions

- How to define excessive credit growth?
- Tools to prevent it:

1. Macroprudential policy
2. Standard monetary policy:
   - "leaning against the wind"

Menna and Tobal (2017)

- SOEs: “lean against the wind” backfires
- If CBank increases interest rates...
  - Domestic credit contracts
  - Foreign credit expands
  - Capital inflows effect dominates
- CBank should *lower* interest rates

Comments

- Great insight!
- Policy implications very important
- Potentially influential paper
- Execution needs more work, different approach

Current Paper Structure

- Two periods model
- Period 1:
  - $DSGE$
  - Borrower, savers
  - Savers can borrow from abroad
- Period 2:
  - output high or low depends on period 1 credit

- Look for clean theory paper
    - Simplify model of period 1
    - Focus on key ingredients
- Separate insights for *open* economies
- from *emerging* economies

Insights for *open* economies

- When do flexible exchange rates allow to "lean against the wind"?
- Interact "leaning against the wind" with capital controls

Capital Controls

Table 1
Capital controls: mean, standard deviation, and correlations.

Statistic	All countries	Developed countries	Emerging countries	Low-income countries
Controls on capital inflows				
Mean	0.31	0.07	0.35	0.51
Standard deviation	0.07	0.03	0.08	0.08
Correlation with output	0.00	−0.07	0.07	−0.04
Controls on capital outflows				
Mean	0.37	0.10	0.40	0.60
Deviation	0.07	0.05	0.07	0.07
Correlation with output	0.00	−0.07	0.03	0.04
Correlation between controls on inflows and controls on outflows	0.31	0.19	0.32	0.43

Note: Sample 1995–2011, 22 developed countries, 36 emerging countries, and 20 low-income countries. All moments are computed country by cou
then averaged across countries. Second moments are computed using cyclical components, as defined in Section 2.

Source: Fernández, Rebucci and Uribe (2015)

Framework to evaluate "leaning against the wind"

- Why "leaning against the wind"?
  - monetary policy has broad effects
  - it “gets in all the cracks”, Stein (2013)
- Need costs from regulatory arbitrage in the model

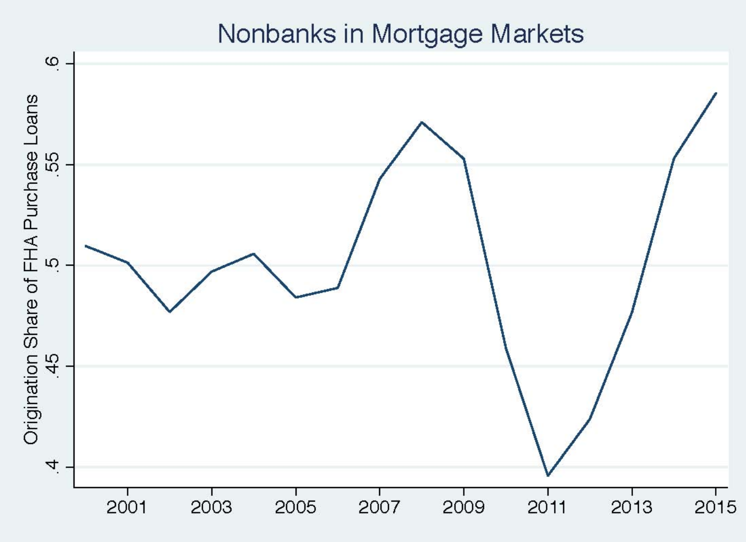
Insights for *EME* economies

- EMEs have larger informal sector
- EMEs have less developed financial sector, less shadow banking?
- Are EMEs more or less exposed to regulatory arbitrage?

Shadow banking is 1st order risk

- U.S. in 2006
  - 13 of top 15 subprime lenders were non-banks (Demyanyk and Loutskina 2016)
  - New Century, Countrywide, WMC Mortgage, First Franklin, Ameriquest, Option One, Accredited Home Lenders, American General Finance, BNC Mortgage...
  - All defaulted or were restructured post-2007

Non-banks are back...



Source: Gete and Reher (2017)

The new non-banks

- Quicken Loans, PennyMac, PHH Mortgage, Freedom Mortgage, Walter Investment, Caliber Home Loans, Nationstar Mortgage, Prospect Mortgages, Stearns Lending, Loan Depot...
- Are they a risk for financial stability?
  - Most are private
  - Fintech makes shadow banking easy

Conclusions

- Bright idea:
  - "leaning against the wind" can work differently in open economies
- Future work: characterize the result, relate to capital controls, add costs from regulatory arbitrage