

Progress on dynamic macroprudential policies

Discussion of

Is the system as resilient as people expect (and as policymakers say)?

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Progress on dynamic macroprudential policies

1. Measuring financial stability risks – what are policymakers aiming for?

- *Tucker -- Hard to know what stability policymakers are up to compared with monetary policymakers*

2. New governance for macroprudential policies – how effective?

- *Tucker – Central banks actively managing the credit cycle is, in the end, a case for ending independence of central banks*

Measuring financial stability risks

Adrian, Grinberg, Liang, Malik (2018), The Term Structure of Growth-at-Risk

- Growth-at-risk (GaR) - proposed transparent metric

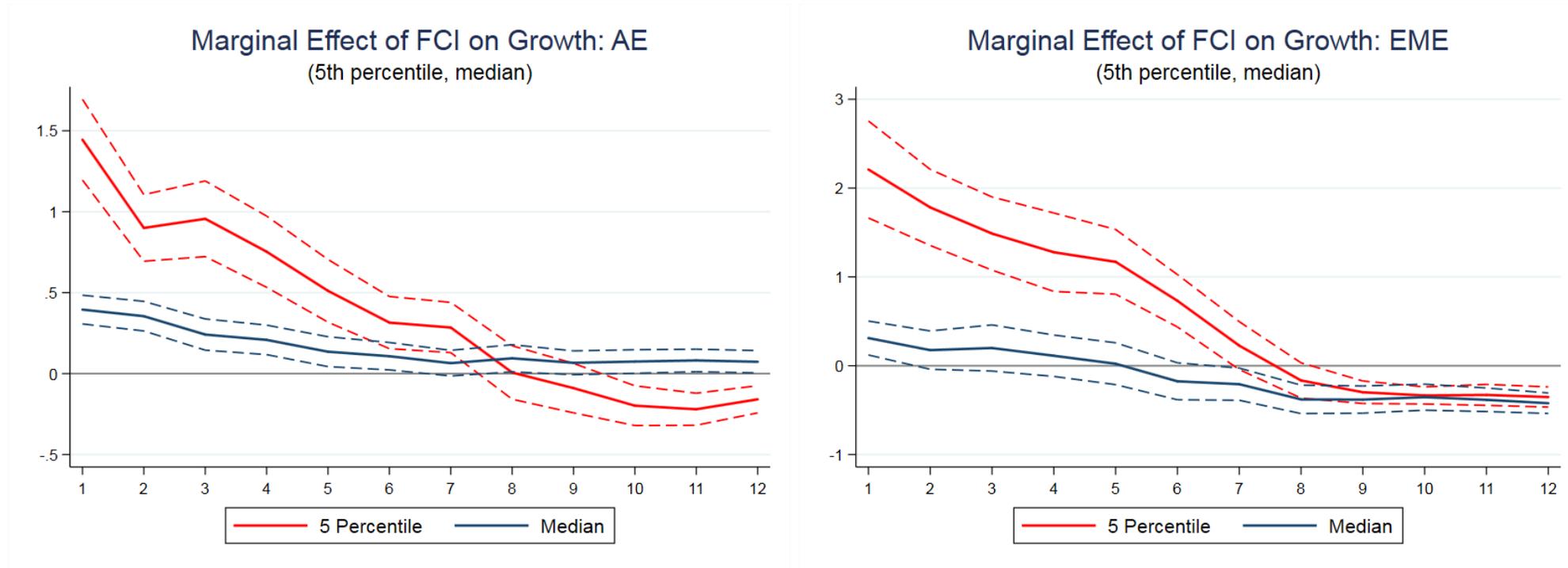
- Risks from financial conditions and vulnerabilities measured as a low percentile of the expected GDP growth distribution

- $$\Delta y_{i,\alpha,t+h} = \gamma_0^{(\alpha,h)} + \gamma_1^{(\alpha,h)} FCI_{i,t} + \gamma_2^{(\alpha,h)} \Delta y_{i,t} + \gamma_3^{(\alpha,h)} \pi_{i,t} + \gamma_4^{(\alpha,h)} \lambda_{i,t} + \varepsilon_{i,t}$$

α = percentile, $h=1$ to 12 quarters

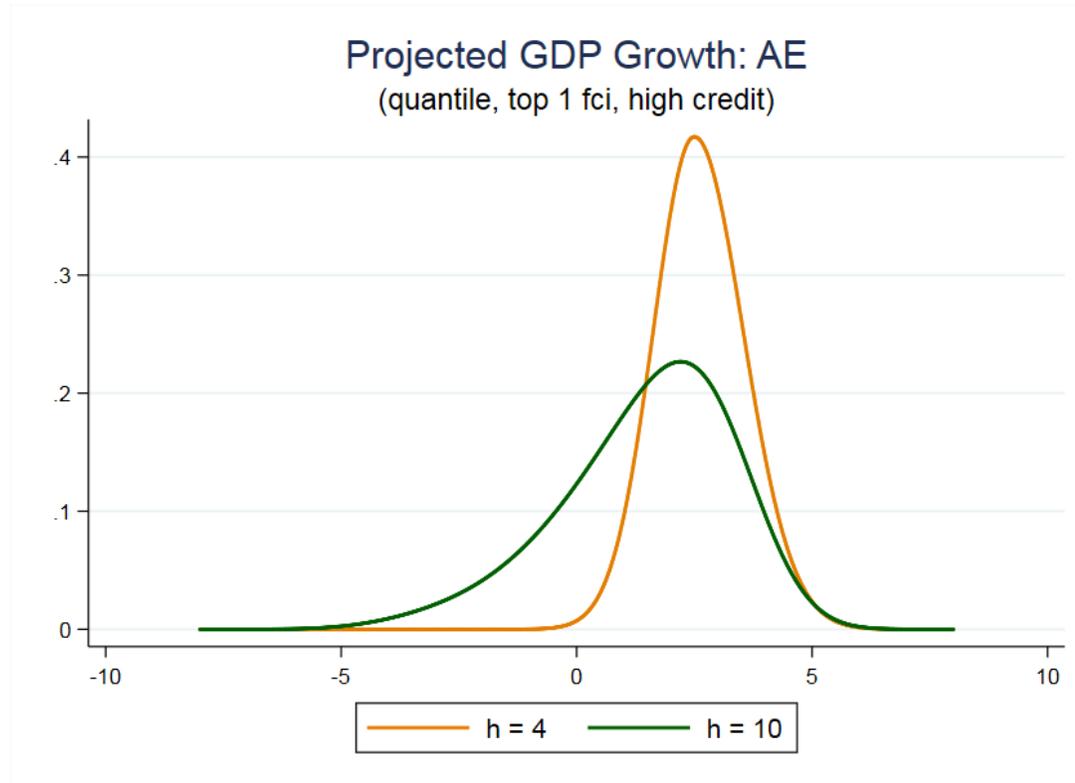
- 11 AEs (most 1973 to 2017) and 10 EMEs (most 1996 to 2017)
- FCIs based on risk spreads, equity prices, volatility, foreign exchange, etc., up to 17 variables, controlling for output and inflation
- Quantile panel regressions with country fixed effects, standard errors from block-bootstrap

Figure 1. Estimated coefficients on FCI for GaR and median growth, AEs and EMEs



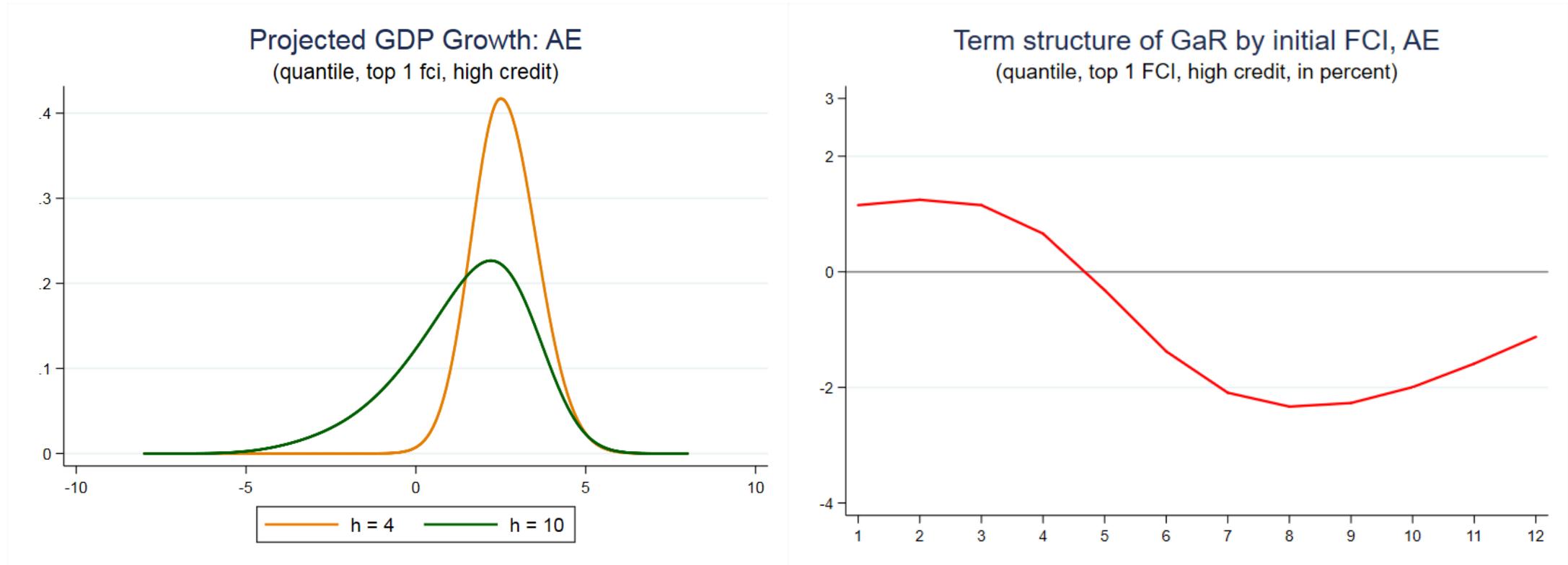
Positive effects on Median and GaR (5th percentile) in the near-term
... but negative effects on GaR in the med-term

Projected growth distribution changes over h



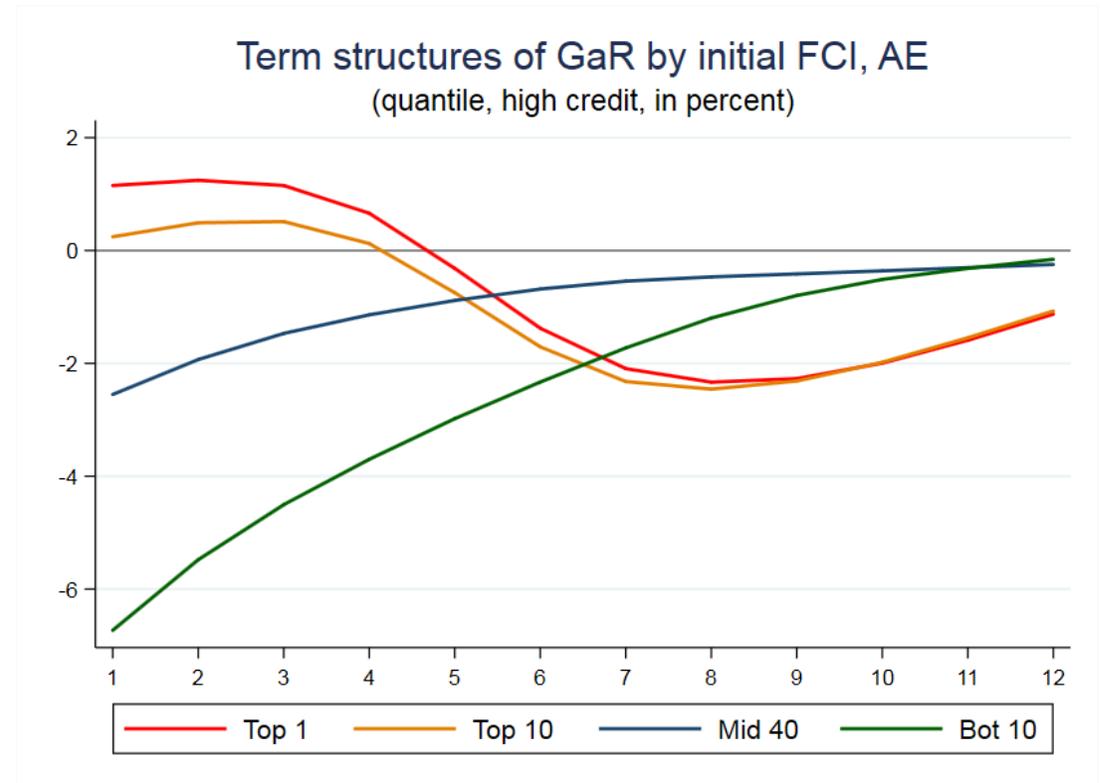
- Conditional on both high FCI and high credit
- Distribution shifts left over projection h=4 to h=10
- Downside risk increases while median and right tail little changed

Projected growth distributions and corresponding GaR (5th percentile)



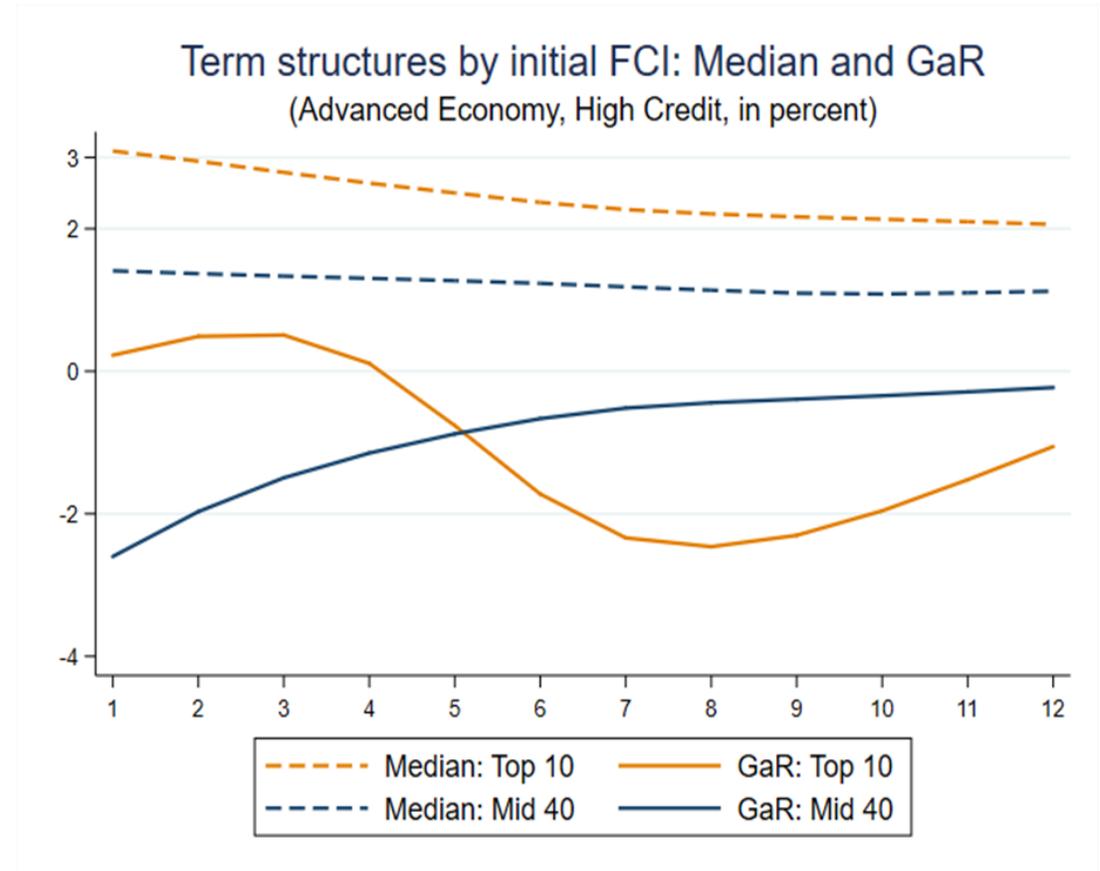
GaR term structures by initial FCI deciles

- GaR sorted by initial FCI deciles
- Typical approximated by Mid40
- Differences between high and typical are statistically different
- Inter-temporal risk tradeoff for initial loose financial conditions
- Also find a tradeoff for EMEs, but the slope is less steep



GaR and Median term structures by initial FCI deciles

- Higher risk is not offset by higher growth
 - GaR is high and falls substantially, while median growth falls less
 - Especially relative to typical
 - Lower risk, higher return in short run, but higher risk without higher return in medium term
- GaR puts financial stability risks in a common metric that is relevant for all macroeconomic policymakers



Progress on dynamic macroprudential policies

1. Measuring financial stability risks

- *Tucker -- Hard to know what stability policymakers are up to compared with monetary policymakers*

2. New governance for macroprudential policies

- Who is in charge? Are they able and willing to act?
- *Tucker – Central banks actively managing the credit cycle is, in the end, a case for ending independence of central banks*
- *But if elected politicians are in charge, I doubt they would be stick to the declared resilience standard given the popularity of loose credit*
- *Carstens – To achieve financial stability, the central bank cannot be the only game in town*

Governance for dynamic macroprudential policies

Country problems - not just technical risk-management, but political

- Macroprudential policies need to be forward looking
- Actions could be politically unpopular
- Actions may have distributional consequences and goals may conflict with other social objectives

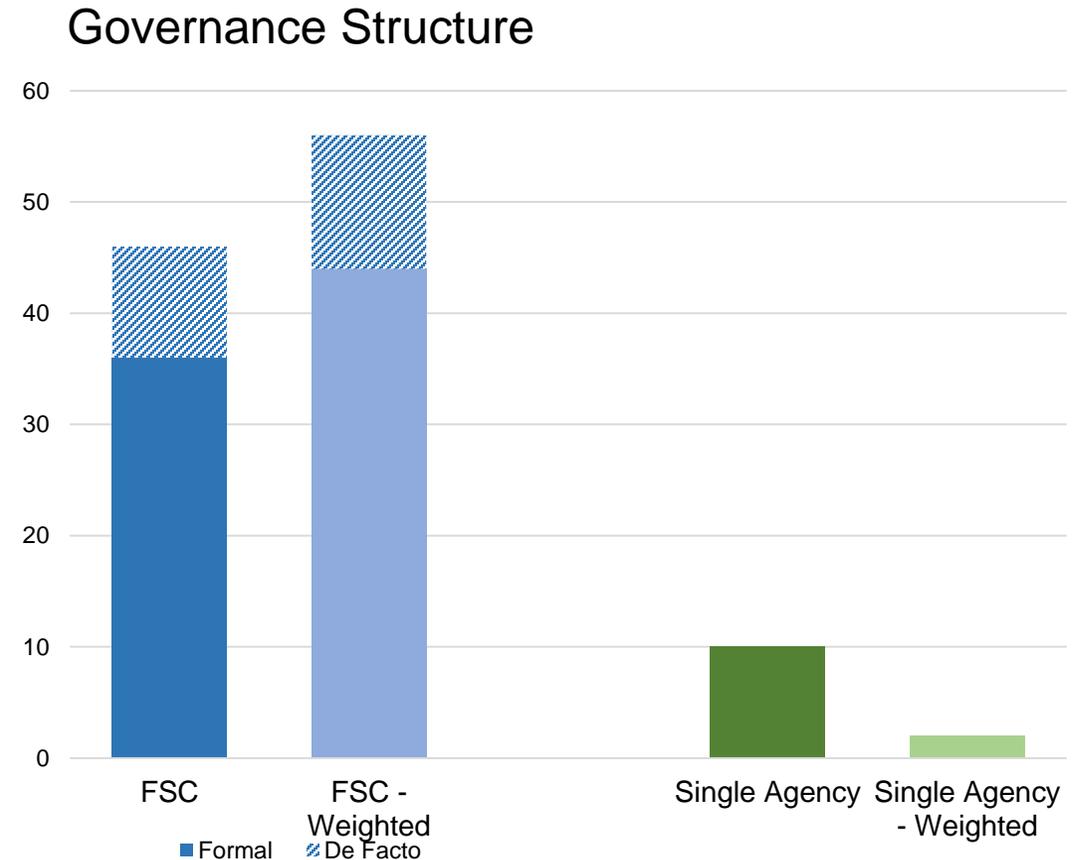
Considerations

- Time-consistency - Central bank (CB) can implement time-consistent policies because has some political independence. But could put independence at risk.
- Political legitimacy - Ministry of Finance (MF) represents elected government

Macroprudential Authorities

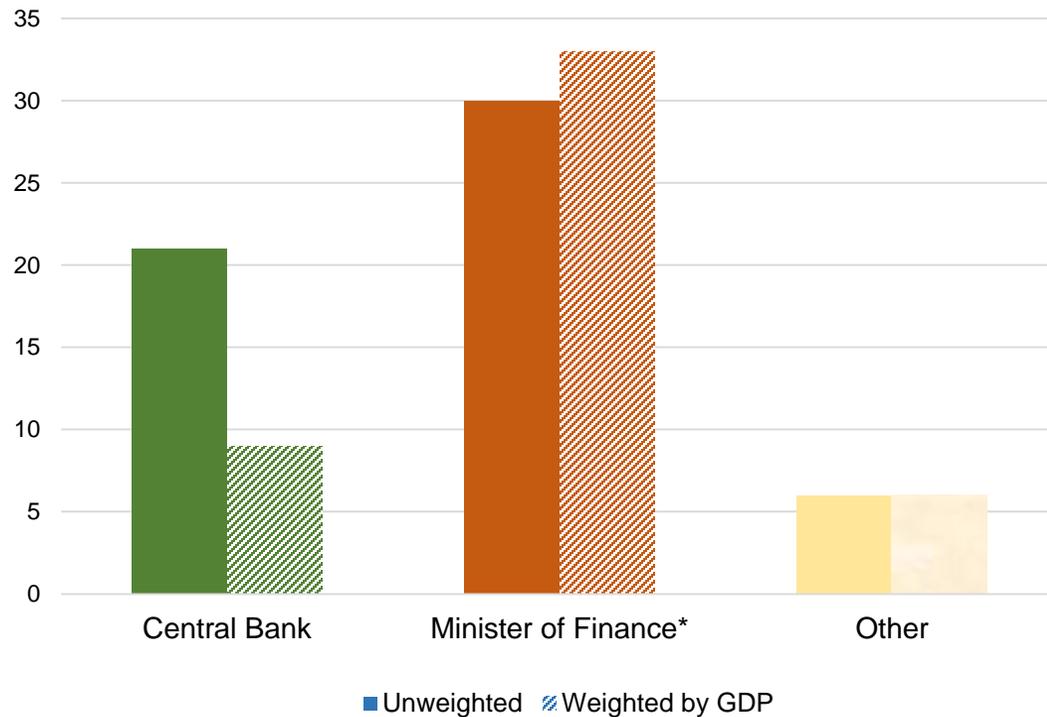
Edge and Liang (2017), New Financial Stability Governance Structures and Central Banks

- 58 countries, updated
- Multi-agency FSCs in most countries (46)
 - Most created after 2008
 - Larger countries
 - CB on all FSCs
- Single agency (10)
 - Smaller countries, CB is a prudential regulator
- Note: CB is a PR in 36 of 58 countries



FSC Leadership, Tools, Accountability

FSC Leadership



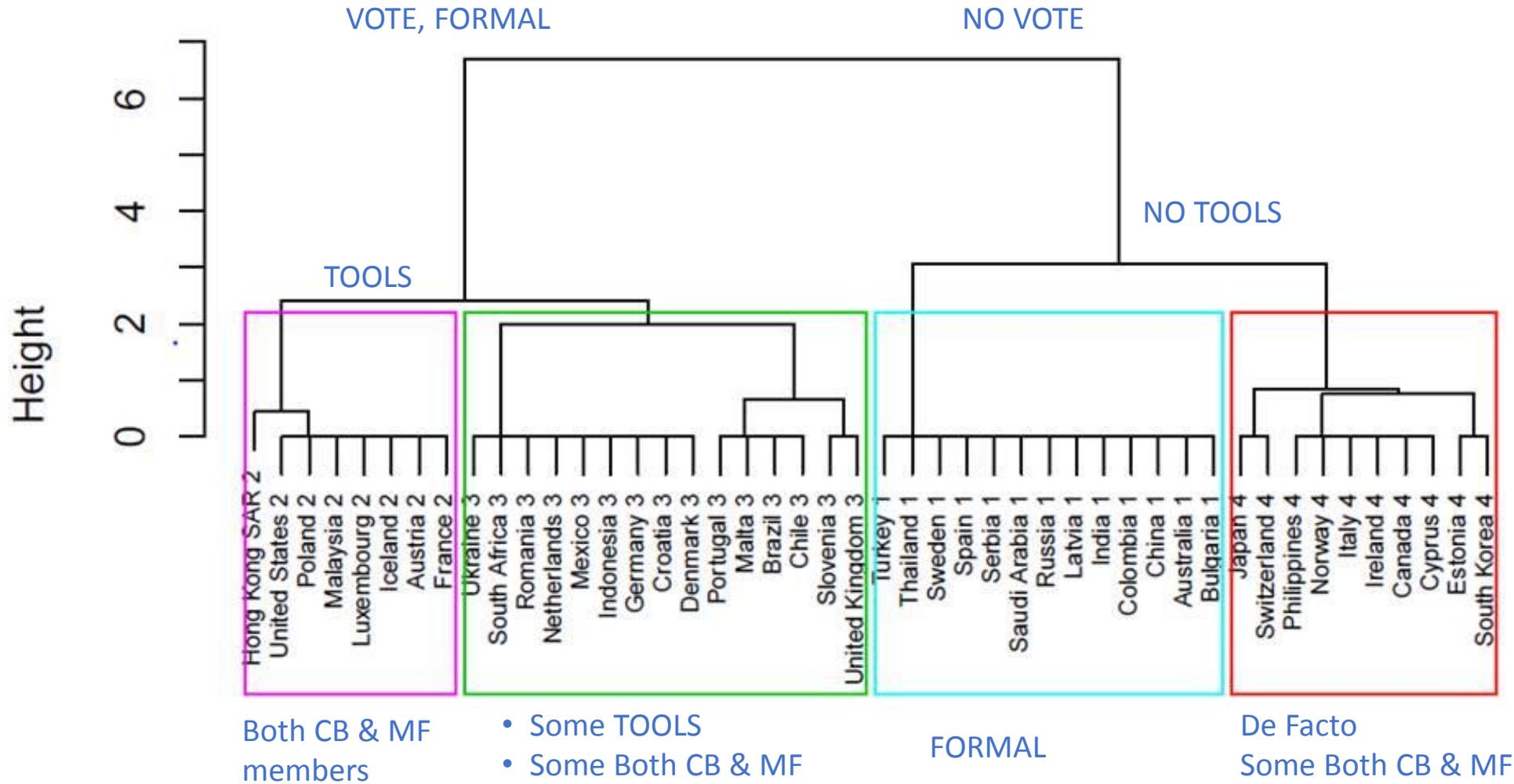
* Includes MoF and CB co-chairs

- FSC Tools (No. of countries)
 - Hard 3
 - Semi-hard, at most 7
 - Soft, at most 36

- FSC Voting process 24

- CB member tools
 - CCyB 22
 - LTV 16

Define FSC strength with Cluster analysis (representative)



- Variables:
- Tools
 - Vote
 - Both CB and MF members
 - Formal

Explaining FSC clusters with country characteristics

- FSC Clusters (representative)
 - 8 strongest
 - 15 moderately strong
 - Half are weak
- Characteristics of countries with strongest FSCs
 - Significant: Advanced, Higher per capita GDP, Stronger rule of law, CB more politically independent
- MF tends to be Chair
- CB does not have disproportionate votes or tools

Conclude: What progress on macroprudential policies?

1. GaR is a promising new common metric of financial stability risks -- downside risks to expected GDP growth from financial conditions and vulnerabilities
 - Can improve communication, coordination, and accountability
 - Need structural models for policy development
2. New multi-agency FSCs can improve communication and coordination
 - Strongest FSCs have more political legitimacy and less concentrated power in CBs
 - But risk of inaction