Comments on “Grafting Macroprudential Policies in a Macroeconomic Framework: Choice of Optimal Instruments and Interaction with Monetary Policy”
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General comments

- Pioneering work in a promising and exciting area of research

- Several interesting results for policy debate

- Many papers will build on, or at least cite, this work in years to come

- Overall, a great contribution to economic sciences
Key research questions

- The role of macroprudential policy in a modern macroeconomic model with financial frictions
- The relative performances of a capital requirement rule versus an LTV rule
- Appropriate macro-financial indicator variable(s) for macroprudential policy rules
- The interaction between macroprudential policy and monetary policy under both cooperative and Nash equilibria
The model at a glance

- A DSGE model with a monopolistically competitive banking sector that intermediates between depositors and borrowers, firms as well as households

- Banks face a quadratic adjustment cost of deviating from an exogenously imposed capital-to-asset ratio which is (partially?) transferred onto loan rates

- Monetary policy modeled via a Taylor rule with an interest rate smoothing term

- Macroprudential policy modeled as time-varying capital-to-asset or as time-varying loan-to-value ratios

- Two separate loss functions for monetary policy and macroprudential authorities
Main results (1)

- For a given monetary policy rule, macroprudential policies help reduce variability of output and the loan-to-output ratio at the expense of increased inflation variability.

- Capital rule more effective at stabilizing output while LTV rule more effective at stabilizing the loan-to-output ratio.

- LTV rule works best when linked to loan growth while capital rule works best when linked to output growth or loan growth depending on the nature of shock.
  - Rules linked to stock price are never best.
Main results (2)

- There is a tradeoff between the losses of monetary authority and macroprudential authority.

- Monetary policy maker is better off in all cases, with the cooperation case delivering the lowest loss.
  - The gain is however modest, even in the best case.

- In a cooperative equilibrium, optimal macroprudential policy acts countercyclically.

- In N.E. #1 (macroprudential policy maker has an upper hand), optimal macroprudential policy is procyclical, making optimal monetary policy highly countercyclical.

- In N.E. #2 (monetary policy maker has an upper hand), optimal macroprudential policy is countercyclical.
Specific comments (1)

✓ The use of a large-scale DSGE model makes it difficult to sort through the driving forces behind the end results

✓ The fact that a policy of active management of LTV ratio for firms leads to unstable result (footnote 12) suggests that the model may have some inherent problems
Specific comments (2)

✓ In terms of bank modeling, I personally prefer Angeloni and Faia (2009) or Gertler and Kiyotaki (2009) which have better micro foundation

✓ Though ad hoc, I like the idea of a loss function for the macroprudential policy maker used in this paper
  - The existence of the loss function however implies the existence of an optimal policy rule which may take different form than the ones assumed in the paper
Specific comments (3)

- That optimal macroprudential policy in N.E. #1 (i.e., when the macroprudential authority has an upper hand) is procyclical does not seem to make economic sense.

- Optimal monetary policy response to output gap is impractically high under the two non-cooperative equilibria.

- A quick improvement of the paper would be the addition of a formal welfare analysis, again à la Angeloni and Faia (2009)
  - Alternatively, may want to look at the output-inflation volatility frontier
  - Allow assessment of the added value of macroprudential policy to the economy, particularly when the responsibility authority is not a central bank.