

Monetary and macro prudential policies in a low interest-rate environment

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THE PAPER IN A NUTSHELL

- ▶ Premise: vulnerability to interest rate hikes when household indebtedness is high.
- ▶ Analysis of macroprudential policy (MPP) in two contexts:
 - ▶ constrained monetary policy (ZLB);
 - ▶ high level of indebtedness.
- ▶ Method:
 - ▶ simulations of standard DSGE model calibrated to Sweden;
 - ▶ comparison of ZLB or not, high or low debt;
 - ▶ distinction between long-run and short-run effects.
- ▶ Results for MPP:
 - ▶ moderate long-term costs, regardless of initial conditions;
 - ▶ sizable short-term costs, especially for high debt and ZLB.
- ▶ Policy implication: MPP-monopol interaction is crucial (specific tool qualitatively not important).

THE PAPER IN A NUTSHELL

- ▶ Very topical for the current policy debate (monopol normalization amid indebtedness).
- ▶ Well-oiled modelling set-up for analysis of MPP interventions.
- ▶ Neat and clear-cut results.

FOUR COMMENTS

1. Heterogeneous agents and MPP (and modelling choices).
2. Purpose of MPP interventions (and solution method).
3. Policy implications: interaction between MPP and monopol.
4. Minor comments.

HETEROGENEOUS AGENTS AND MPP

- ▶ Heterogeneous agents help to track down consumption responses to aggregate shocks.
 - ▶ The TANK framework may be enough to track aggregate consequences of heterogeneity in MPCs in the face of monetary policy shocks.
 - ▶ Yet, exogeneity of borrowers/lenders distribution remains an important limitation for analysis of **MPP's welfare implications**.
 - ▶ Who becomes or remains a borrower in the aftermath of the MPP intervention is key to understand MPP effectiveness in managing aggregate risk-taking and in reducing systemic risk.
- Scope for analysis with **HANK-type models**.

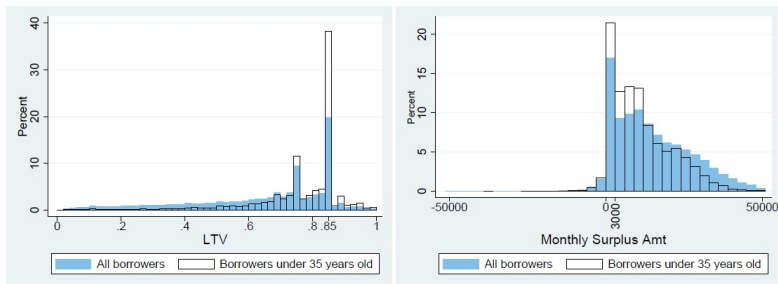
PURPOSE OF MPP INTERVENTIONS

- ▶ The purpose of MPP interventions (and related comparisons) in the paper is not clear:
 - ▶ Should MPP aim at active dynamic stabilization or at the creation of buffers to reduce financial vulnerabilities?
 - ▶ Should we do it more when debt is high? Is exposure to interest rate hikes the prime reason to eschew indebtedness?
- ▶ **Precautionary motives** of agents are paramount, and in that regard MPP tools have different effectiveness:

for instance, DSTI ratio seems to matter more in the literature (and seems more slack, too).

→ Scope for analysis with **global solution methods**.

PURPOSE OF MPP INTERVENTIONS



(a) The distribution of LTV 2011-2015

(b) The distribution of KALP 2011-2015

Figure 1: Distributions of constraints for new borrowers in Sweden, 2011-2015

From Grodecka, A. (2017, WP 347, Sveriges Riksbank) with Swedish data from Finansinspektionen.

POLICY IMPLICATIONS

- ▶ Interaction between MPP and monpol is indeed critical, but is it really a matter of ZLB?
- ▶ In recent times central banks showed ability to further provide ample monetary accommodation when needed, also when policy rates hit the ZLB:
 - ▶ forward guidance,
 - ▶ credit easing,
 - ▶ negative interest rates,
 - ▶ asset purchase programmes.
- ▶ Common ground: **responsiveness** of monetary policy is important in light of MPP (and viceversa) without necessarily incurring into indeterminacies.
- ▶ (On the side: optimal pace of interaction may be asymmetric. Should MPP be slower during normalization of monpol and fast during increase in monpol accommodation?)

MINOR COMMENTS: ASSUMING A ZLB

- ▶ The occurrence of the ZLB is assumed rather than obtained endogenously via recessionary shocks.
- ▶ This is quite consequential:
 - ▶ it abstracts from which shocks drive the economy to the ZLB;
 - ▶ the high-rate, low-debt economy is further away from the ZLB than the low-rate, high-debt one, so magnitude of recessionary shocks must necessarily be different to have same duration of ZLB.

MINOR COMMENTS: PERMANENT SHOCKS AND NONLINEARITIES

- ▶ High debt and low debt are two steady states.
- ▶ Higher LTV and lower deductibility are two persistent (yet not permanent) shocks.
- ▶ So the steady state around which the solution is linearly approximated downplays potential nonlinearities, at least in the “long-run” comparisons.

OTHER MINOR COMMENTS (1/2)

- ▶ There is a vintage structure of borrowing but not a vintage structure of collateral: an increase in the relative price of housing applies to the whole stock of housing. Does this play a role?
- ▶ What does the long-term borrowing set-up buy you?
- ▶ The model assumes a constant exogenous renegotiation fraction. Is it so in data? What would be the consequences of an endogenous fraction for monopol and MPP effectiveness?
- ▶ Extracting fraction of home equity possible and customary in the US, but in Europe?

OTHER MINOR COMMENTS (2/2)

- ▶ If the labor share of borrowers is not enough to match indebtedness, perhaps borrowing is too tight? Is the size of the housing supply (housing investment) big enough?
- ▶ And if the Iacoviello-Neri set-up does not manage to account for the recorded high indebtedness and we are to consider the one implied by the model as the “fundamental” component of indebtedness level, can the missing part be considered “non-fundamental” and discipline the MPP intervention in your simulations?
- ▶ Why not to have government consumption? It would avoid the 3/4 of private absorption trick for the great ratios and would account for the fact that not all production ends up as private consumption or investment.

Thank you.