



Wishing for More: On Macroprudential Proposals

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Presentation to Bruegel, Brussels
October 13, 2009

Wishing for more: on macroprudential proposals



We would be better off if we could prevent boom/bust AND normal monetary policy is not sufficient to do so

- Could altering monetary policy do it?
- Could cyclically adjusted capital requirements do it?
- What else might we have to do it?
- If we don't have any smart ideas yet, might we be better off limiting finance?

Could altering monetary policy do it?

To alter monetary policy (IT informal/formal) to deal with asset price boom/busts, would have to do the following:

1. Identify bubbles far enough ahead of time
 2. Have instrument (interest rate/narrow money) that affects the asset prices
 3. Have the benefit pre-emptively outweigh the costs of deviating from price stability oriented monetary policy
- 1 is doable, 3 is questionable – but the real problem is 2

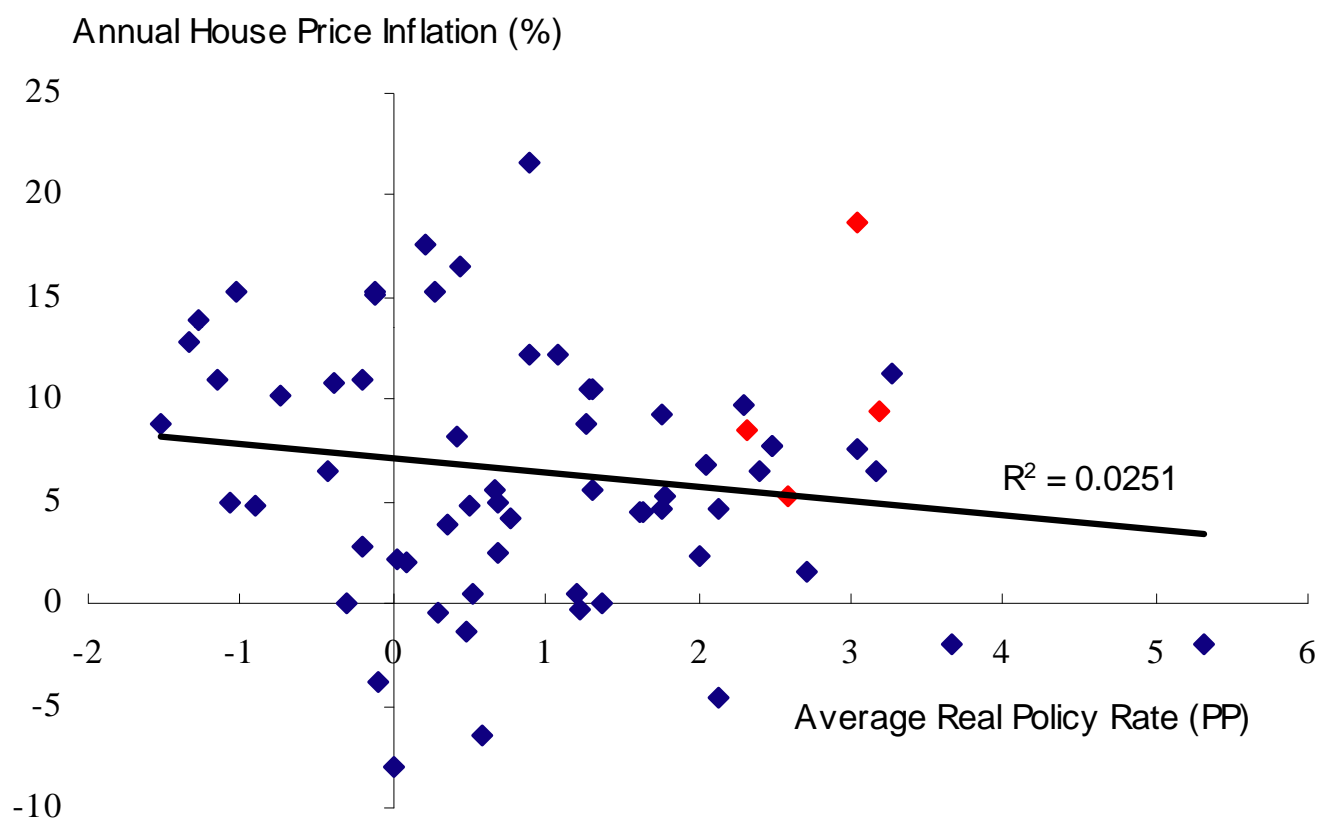
Could altering monetary policy do it?

BIS and others speak of 'leaning against the wind'

- No successful examples of so doing
 - In fact, unsuccessful examples (Japan 1990-91, US 1996, Oz 2003-04) are more readily available
- For small open economies, raising rates increases capital inflows (and maybe even for large not so open economies)
- There is no reliable relationship between available monetary instruments and asset prices in question
 - Posen (2003) shows cross-sectional evidence



Annual House Price Inflation versus Real Policy Rate: 2004-07



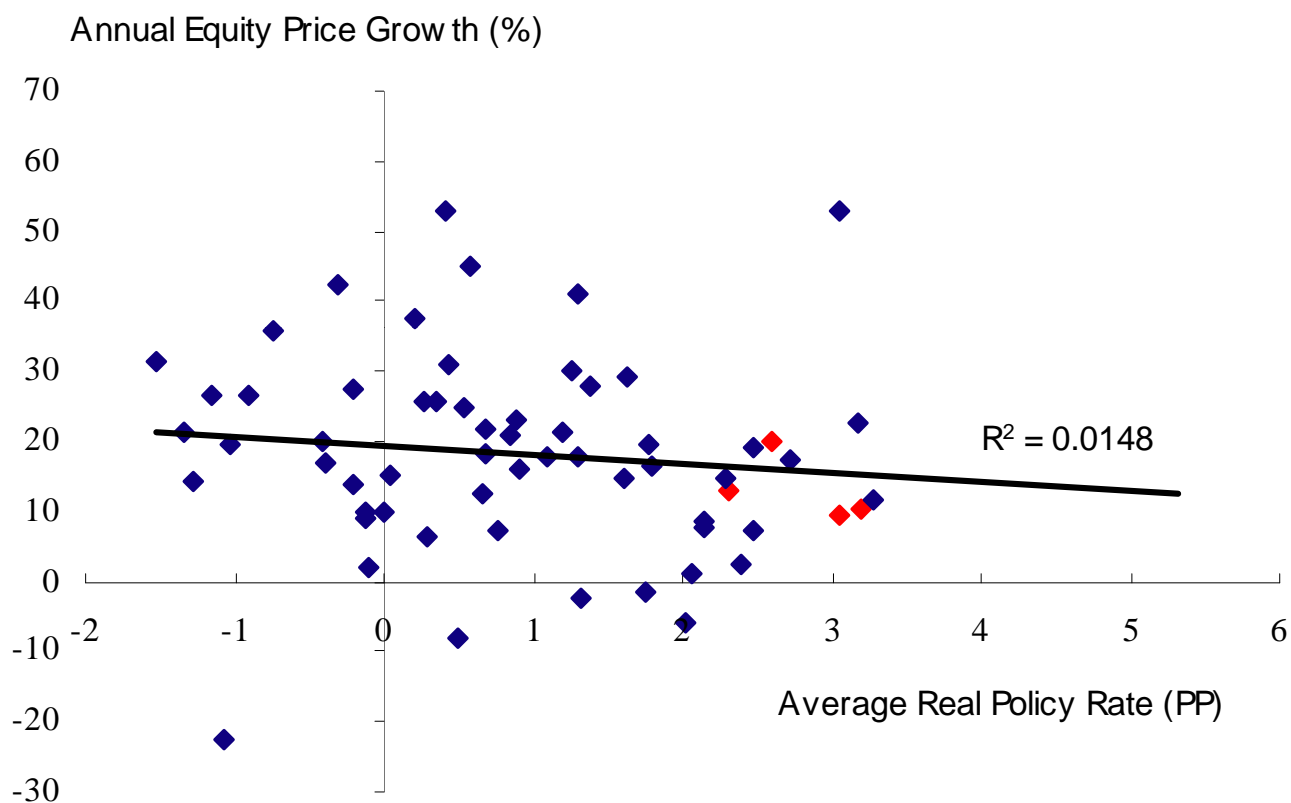
Countries covered: Australia, Canada, China, Denmark, France, Finland, Germany, Greece, Iceland, Ireland, Italy, Japan, Netherlands, Norway, Spain, Sweden, UK, US

Note: Red dots indicate UK observations

Sources: Thompson Datastream and Bank Calculations



Annual Equity Price Growth versus Real Policy Rate: 2004-07



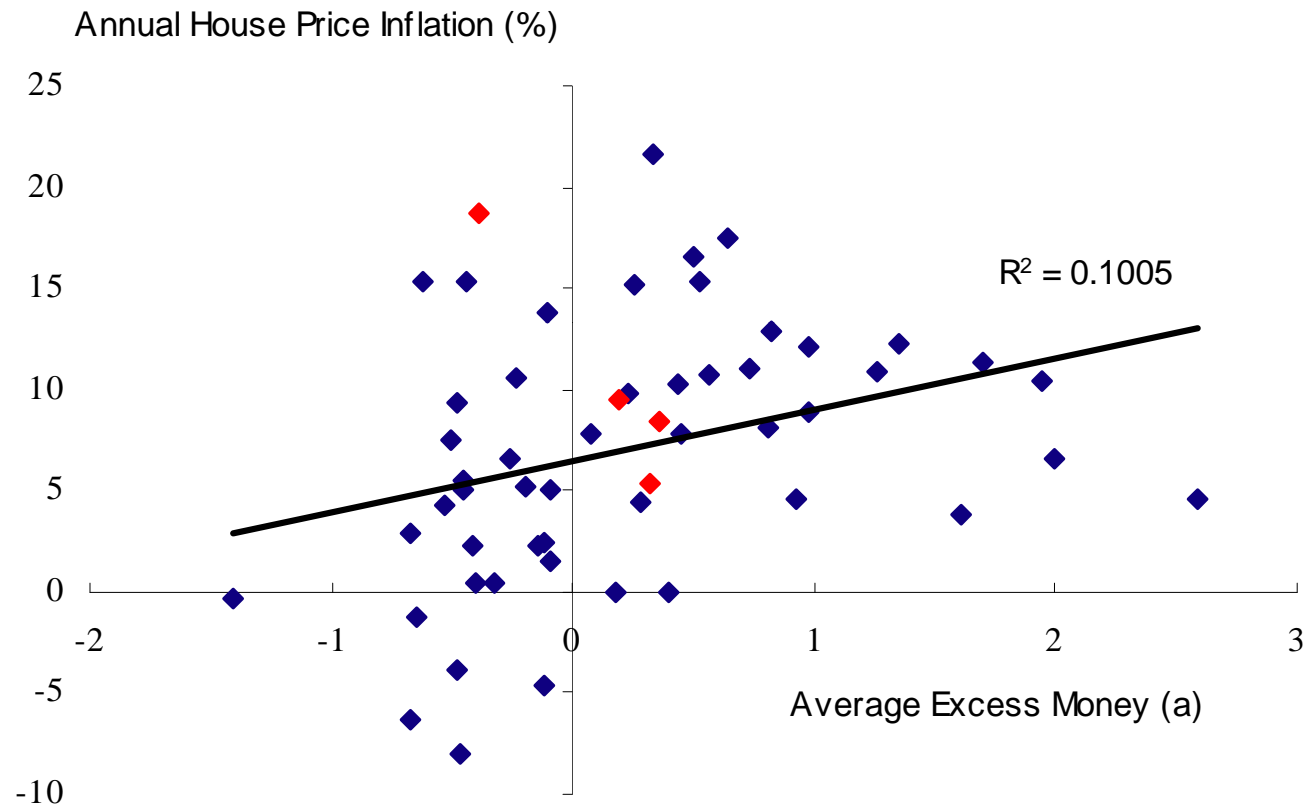
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Annual House Price Inflation versus Monetary Ease: 2004-07



(a) Annual (broad) money growth above average (of post 1981 average broad money growth) scaled by standard deviation of money growth

Countries covered: Australia, Canada, China, Denmark, France, Finland, Germany, Greece, Iceland, Ireland, Italy, Japan, Netherlands, Norway, Spain, Sweden, UK, US

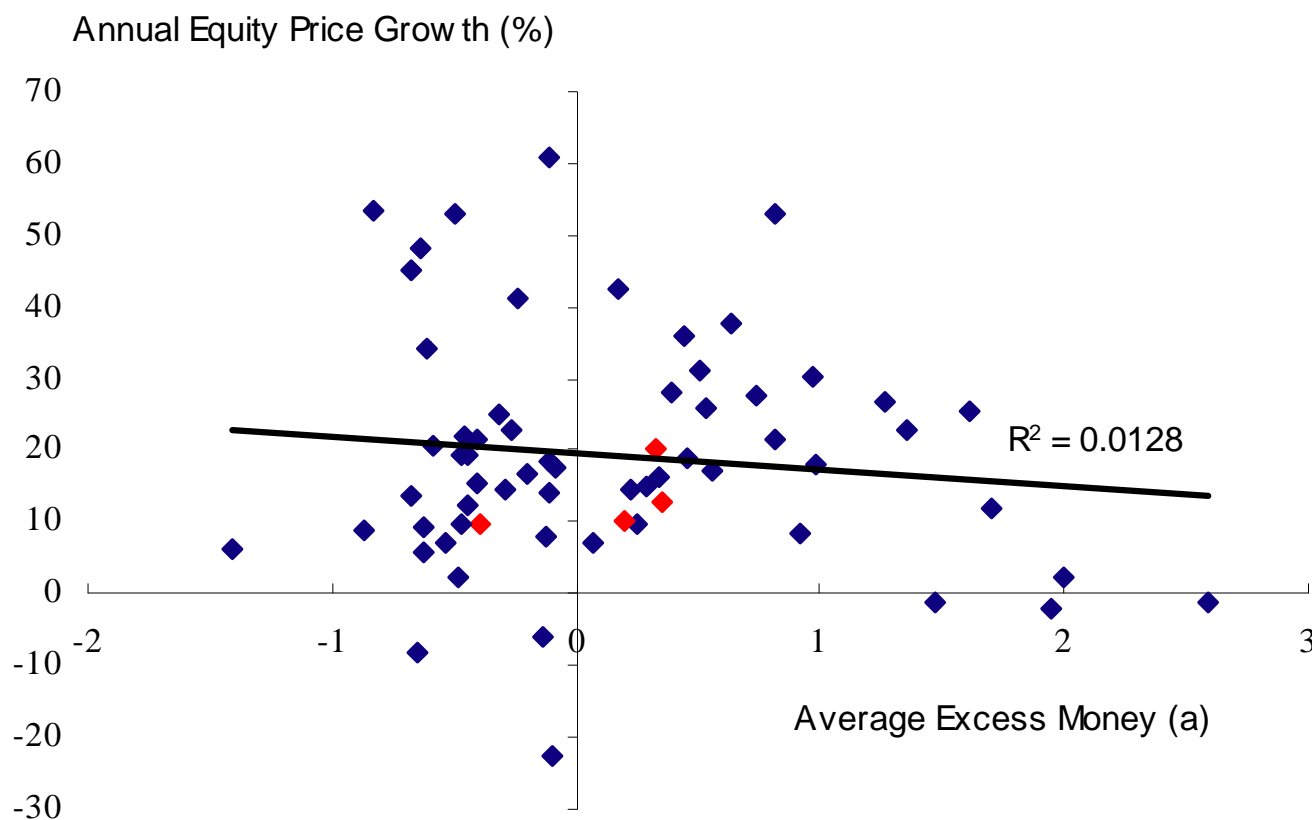
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Annual Equity Price Growth versus Monetary Ease: 2004-07



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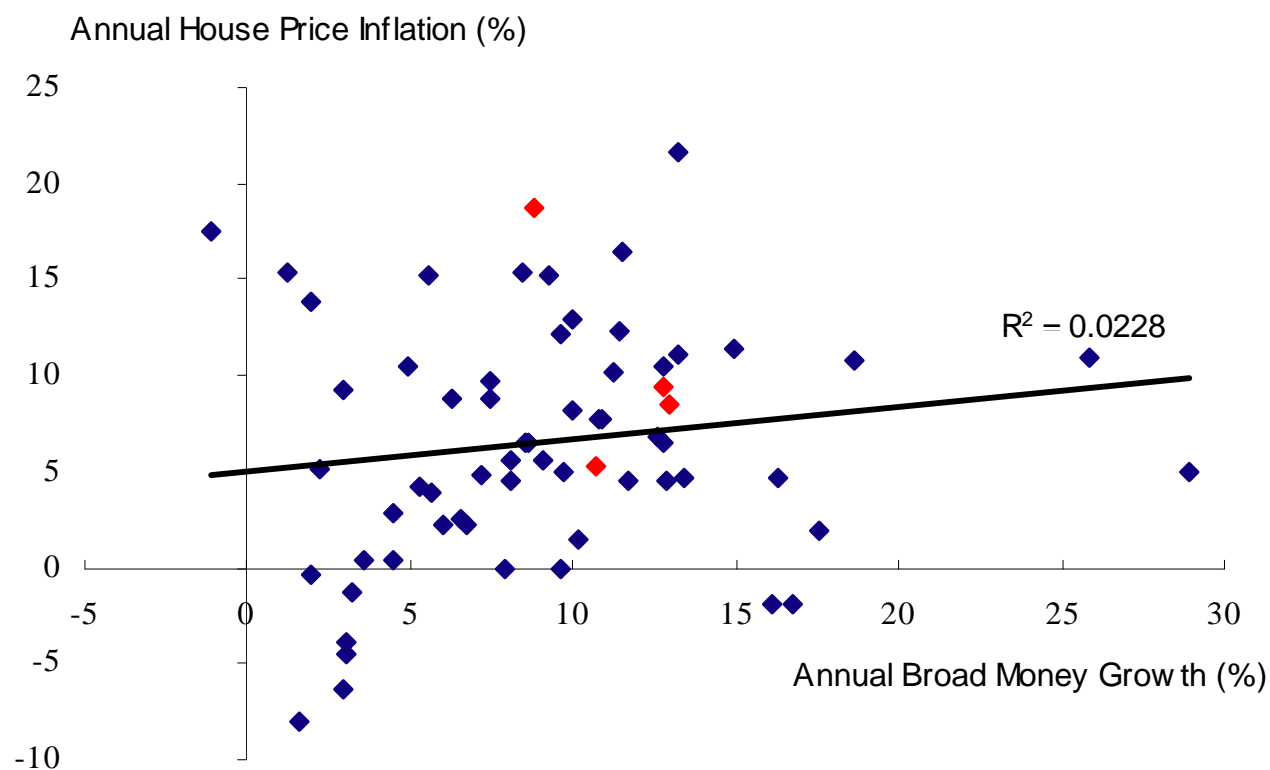
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Annual House Price Inflation versus Broad Money Growth: 2004-07



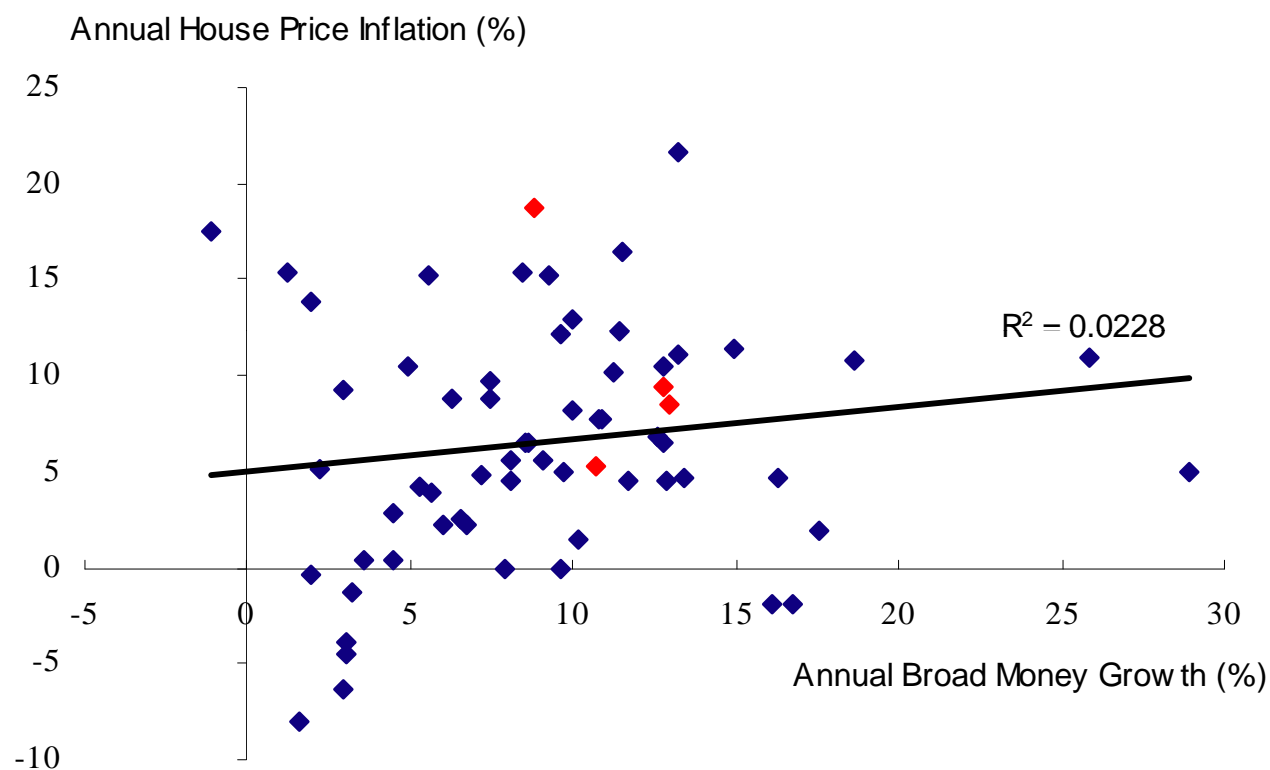
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Annual Equity Price Growth versus Broad Money Growth: 2004-07



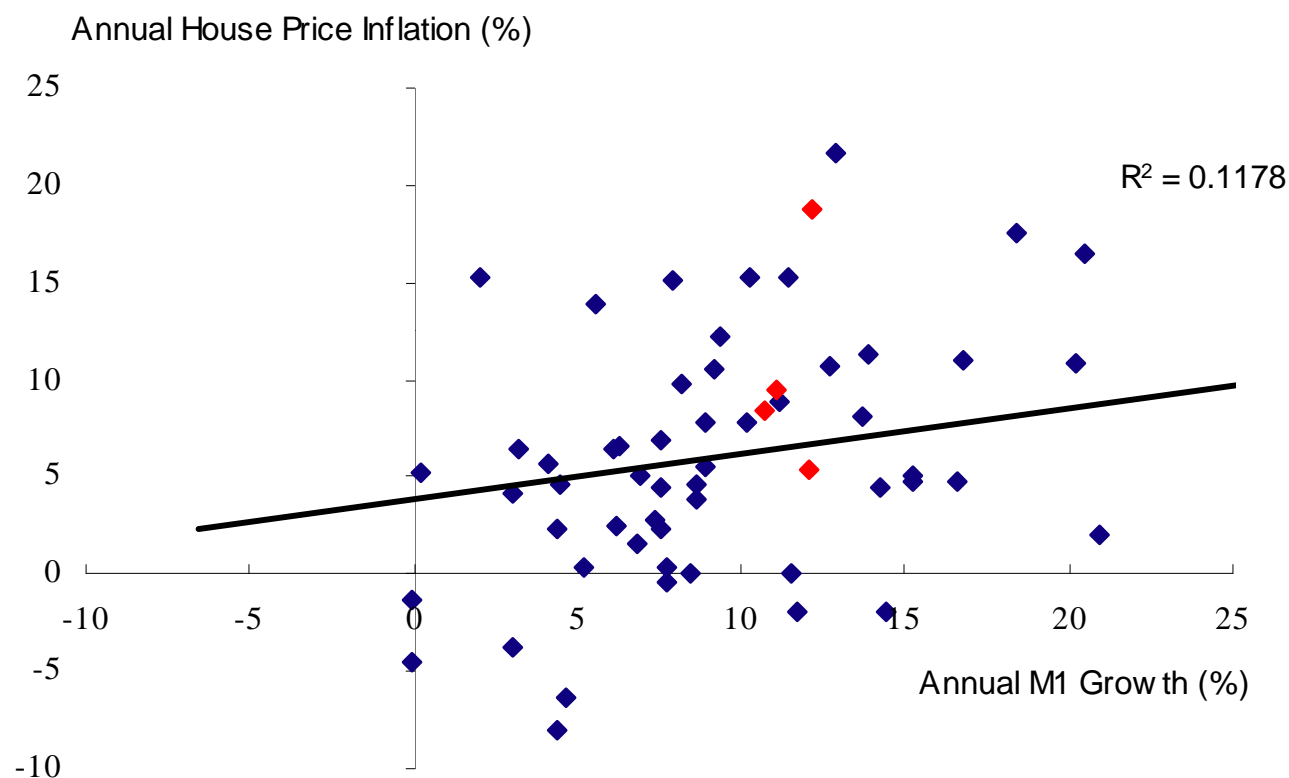
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Annual House Price Inflation versus M1 Growth: 2004-07



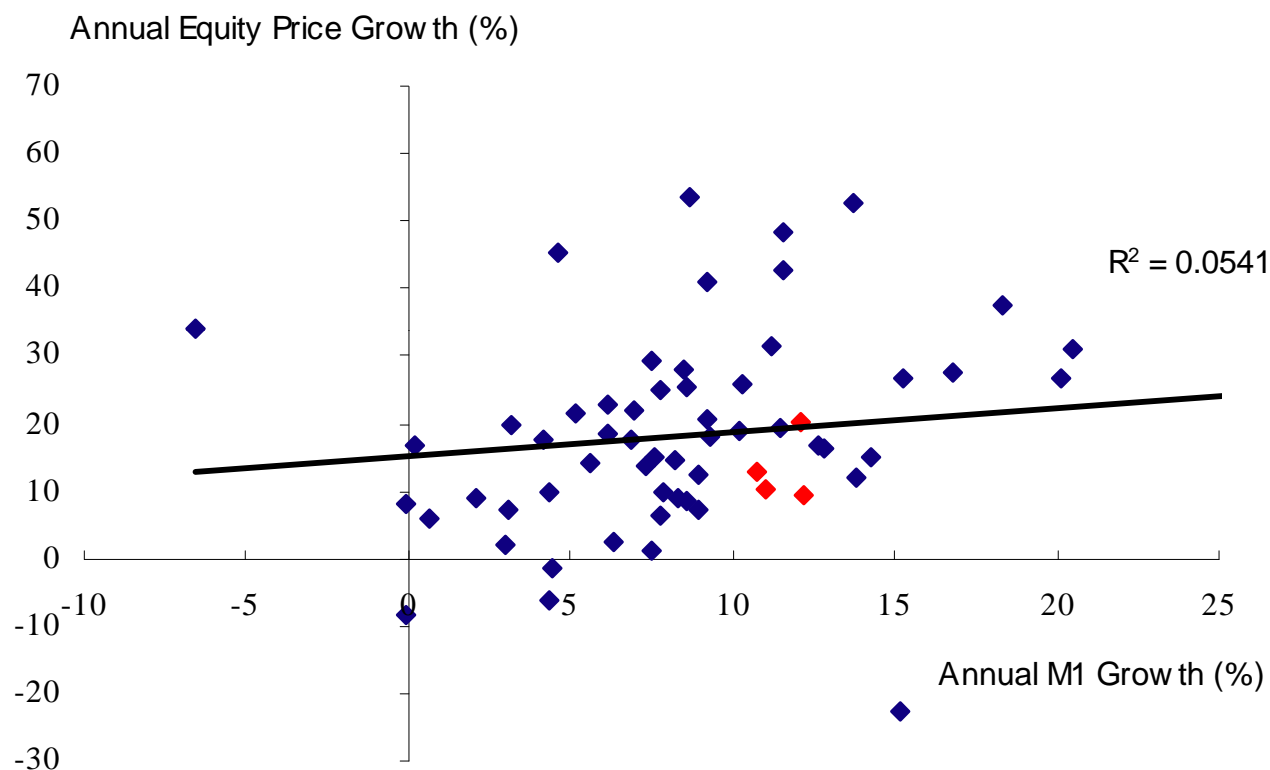
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Sources: Thompson Datastream and Bank Calculations



Annual Equity Price Growth versus M1 Growth: 2004-07



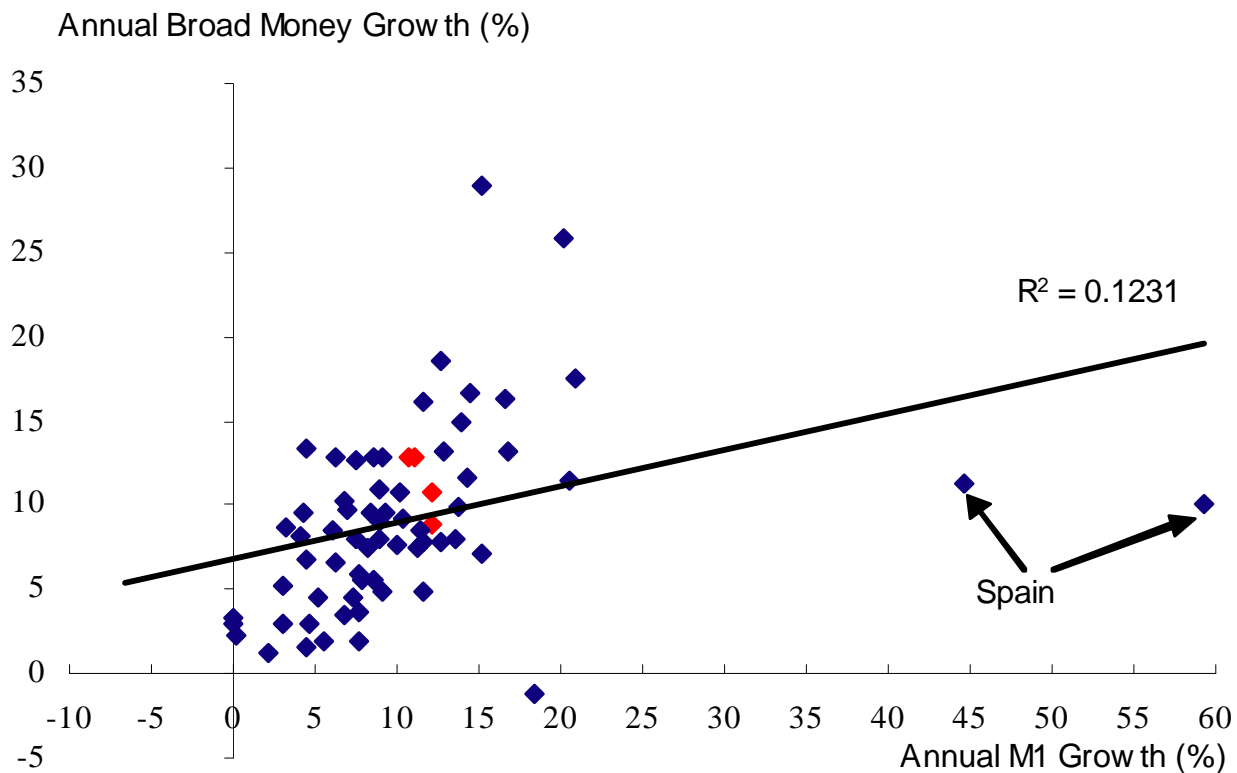
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Annual M1 Growth versus Broad Money Growth 2004-07



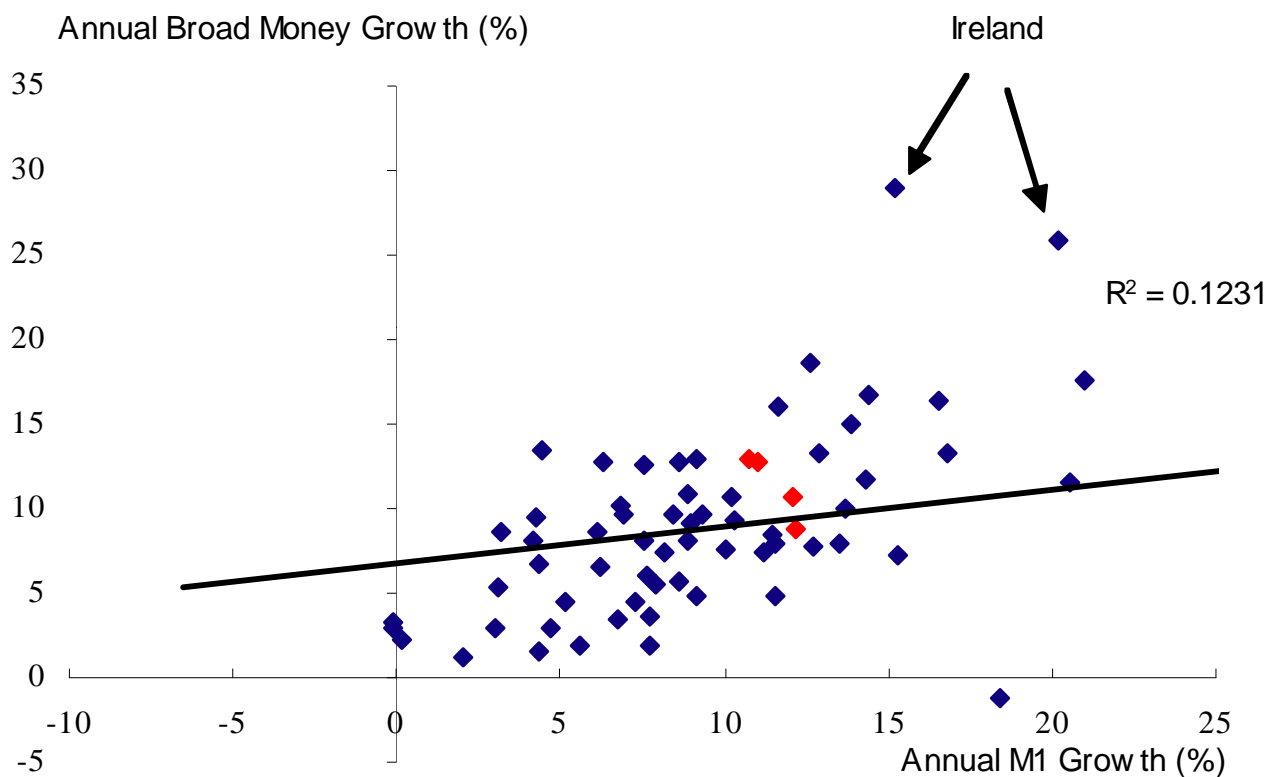
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Annual M1 Growth versus Broad Money Growth 2004-07



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Could cyclically adjusted capital requirements do it?

So we need a ‘second instrument’

- Main proposal on the table is dynamic provisioning, increasing capital over the cycle, and the like
- Spain did save its (big) banks from the worst of it
 - But unemployment still went to 18% after boom-bust
- General pattern that absent financial crisis, amplification of shocks is limited, so it is worth trying
- Still, it may not be enough to limit bank vulnerability instead of limiting the credit cycle

What else might we have to do it?

One possible avenue is to separate out real estate fluctuations from equity/other asset boom busts (work in progress by me and others)

- Costs to cutting off real estate appreciation are smaller than costs of cutting off new technology driven booms
- Impact of real estate busts is usually higher than of equity busts
- Much easier to benchmark and to regulate since there are legal restrictions on mortgages and titles, as well as turnover taxes or interest rate deductions, which could be cyclically adjusted
- Maybe can integrate with an inflation target since there is good macro-macro reason to get housing costs right in CPI as well

If we don't have any smart ideas yet, might we be better off limiting finance?

Still, all of macroprudential regulation is separate from whether we change the structure of finance itself

- We cannot measure - or we overestimate - the benefits of financial innovation and economies of scale and scope in banking
 - This may mean that limits on bank size are worth considering
- Face value, Volckeresque, point: It is 80 years since last terrible crash and 75 years since Glass-Steagall separation – maybe excessive reliance on market/self-discipline is just plain mistaken
- This would require international agreement and/or some form of clear ring-fencing across borders, if not all countries regulate to same extent
- If we get a bank failure driven second dip recession, there may be the right time to tackle these