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"Is a macroprudential reaction function emerging and is it sensible?"

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Discussion of Aikman, Bridges, Kashyap and Siegert (ABKS)

Is macroprudential reaction function emerging?

- If a reaction function exists, it most likely observable by examining:
  - countercyclical capital buffer (CCyB) and housing /household debt tools;
  - countries with relatively similar institutional frameworks.
  - the relationship between tool use and financial risk indicators.
- A range of empirical tests over data for 15 advanced economies:
  - If a reaction function is emerging, not strong or systematic (or sensible?)
  - Tool use is very uneven: only 9 used CCyB, 10 used some form of housing tool through 2019.

Reaction to the paper, and three discussion themes

Blunt reaction to the paper: Smart, honest and subtly critical. Strong!

1. Econometric results

   Identified reaction function is weak, with unexpected response omissions.

   Yes, disappointing: but the results are not surprising.

2. Can “a sensible reaction function” be estimated?

   Maybe with more time and more controls. But more modeling needed.

3. Holistic macro-prudential reaction function a work in progress.

   Agree with authors: frameworks currently in adolescence.

   - Plus still developing ex ante full policy cycle, with prior details on activation and deactivations.

   But, maybe other lessons?

   - Structural easier, and perhaps more effective?
   - Complicated by financial and regulatory structure, including NBFIs

Econometric results -1

CCyB should be tightened when risks are building up in financial sector to reduce capital loss and credit crunch when risks ultimately materialize.

Borrower resilience tools should tighten to avoid unsustainable debt buildups.

Authors find interesting mixed results using indicators that predict tool use.

- CCyB and housing tools *tend* to tighten after rapid non-financial credit growth, especially from housing.
- Macropru housing tools not systematically tightened to house price developments or HH debt service ratio.

Econometric results - 2

Why relatively weak results?

Long process in some countries to activate CCyB, with different use preferences.

- 40% of countries did not use CCYB, with some 2019 announcements for 2020.

Housing tool use concentrated in a few active countries and for different purposes.

Both features should make it difficult to derive strong econometric results.

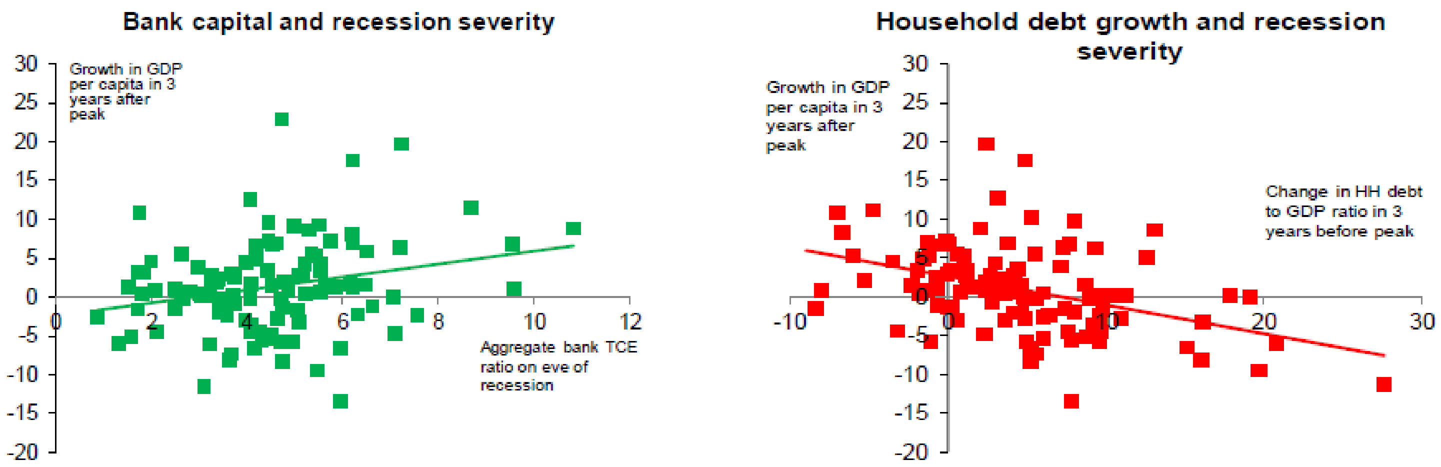
Some countries used other tools instead (e.g. stress testing), or mainly focus on enhancing structural stability of banks or households.

- Triggers for cyclical tool use not necessarily clear.
- Possible concerns about using tools when banks exhibit low profitability
- Political economy considerations?

Econometric results - 3

GDP at risk: Countries that activated CCyB or housing tools had relatively higher GDP at risk. But GDP at risk not a great predictor of tool use.

Figure 2.1: Correlation between the severeity of recessions and two key fault-lines



Suggestion: Improve econometric specifications to account for tool effectiveness.

Posit: Domestic bank capital (and banks) may have weaker relationship with GDP growth when relatively low share of banks relative to nonbank providers, household debt distribution across HHs is skewed toward lower risk HHs.

Sensible reaction function?

So far, policy makers seem more willing to respond to HH Credit Growth and Equity Market Volatility, compared to house price growth, corporate credit growth and HH debt service.

***Can* a sensible reaction function explain this? What are views of authors?**

Would be interesting to see authors model the decision rules that account for the structures of credit provision across countries and over time.

- Differences in the structure of regulation (fragmented, limited span of the tools)
- Likely effectiveness: Role of nonbank financial institutions in credit provision

Or perhaps it is still about framework adolescence?

- Data gaps
- Short time frame: Too few cycles, Too little time post tool activation

Holistic macro-prudential reaction function a work in progress

Tremendous progress so far. Advances with BIS, IMF, FSB/G-20, others.

FSB surveys progress “building and implementing macroprudential frameworks and tools”

- establishing regulatory frameworks for macro-pru oversight
- enhancing system-wide monitoring and use of instruments

This process shows that the building and monitoring phases for CCyB countercyclical capital buffer; housing tools, stress tests advancing well.

Challenges

- Assessing effectiveness of specific tools/ calibration
- Unfinished frameworks for ex ante guidance on when to implement, how to calibrate levels of tools, and when tools will be deactivated over the cycle.
- Improving communications – including on mix of instruments, decision processes
- Avoiding distortions/ industrial policy use.

Concluding comments

Aiken, Bridges, Kashyap, Siegert provide an honest and smart look at facts.

Some of the evidence might be easier to find with the passage of time, as frameworks grow beyond adolescence.

More can be done to yield a carefully calibrated benchmark for “is it sensible?”

Address in econometrics and discussion

- Are other tools are mitigating the use or effects of the tools tested?
- Do political economy (industry interests) reduce the willingness of even financial stability committees to activate / deactivate sufficiently?
- If banks have enough (and higher) capital, are CCyB changes less needed or effective?
- Are structural improvements (through stress tests, risk management frameworks) easier, more effective than tools adjusted over the cycle?

Thank you. Linda.Goldberg@ny.frb.org