

The background of the slide is a dark blue collage of various Australian banknotes. Visible elements include the portrait of Queen Elizabeth II on a \$100 note, the portrait of a man on a \$50 note, the portrait of a woman on a \$20 note, and the portrait of a man on a \$10 note. The word 'Australia' is written vertically on one of the notes, and 'DOLLARS' is visible on another. The collage is semi-transparent and serves as a backdrop for the white text.

Systemic Risk, Banking Regulation and Optimal Monetary Policy

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Right time, right topic

- Financial intermediation channel with banks capital requirements
- Capital requirements result in larger interest rate cuts in downturns



Right time, right topic

- Financial side of the economy clearly matters, Eg
 - growth and financial development
 - banking crises
- This is a big hole in our models



Financial Amplification

- Standard framework
- Tweak the banking sector
 - systemic shocks to capital sector
 - minimum capital ratio



Simple financial sector

- No dynamics
- Deposits and capital are substitutable
- Banks are riskless



Where to from here?

- Expand analysis
 - Interest rate response takes time
 - Very large response of investment to risk shocks



Where to from here?

- Do welfare analysis
 - What is the effect of asset prices in Taylor rule?
 - Should the central bank use interest rates or adjust capital rule?



Modeling the Crisis

- Model: shocks to loan collateral and leverage matters
- Crisis: increase in risk aversion has been key
- Apportioning the 'blame'



Incorporating the Credit Channel

- A step in the right direction
- But there's a long way to go

