Would macroprudential regulation have prevented the last crisis?

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General Overview

- Objective: Answering the paper's great title Q: Would *today's* macroprudential regulation have prevented the last crisis *in the US*?
- New angle: Two step methodology

 - Identification of the key fault lines that arose prior to the GFC

 -Assess if/which current MaPs could have addressed these fault lines

- Key messages: Maybe with current MaPs…but the UK regulatory framework would have a better chance than the US one, since the latter lacks a necessary mandate and tools

Key Findings

- Two broad factors were crucial in the US GFC
  - Fragilities in the financial system associated with excessive leverage (broker-dealers) and reliance on short term funding
  - Lending boom to HH & associated high HH indebtedness
- MaPs might have prevented or materially dampened the GFC
  - CCyB of about 3-5% ⇨ excessive leverage
  - NFSR ⇨ liquidity shortages
  - LTI of about 4x ⇨ HH indebtedness

Outline of my comments

This excellent paper is already published in the March 2019 JEP, so I will focus more on potential sequel papers and EM aspects

1. Implicit premise that MaPs would have only had to address the identified fragilities is illustrative but incomplete
2. A bit too early to answer the paper's question (Today's faith in MaPs; characteristics of the next crisis)
3. Housing finance outside the US
4. Role of institutional designs / other comments
5. Summary and policy implications

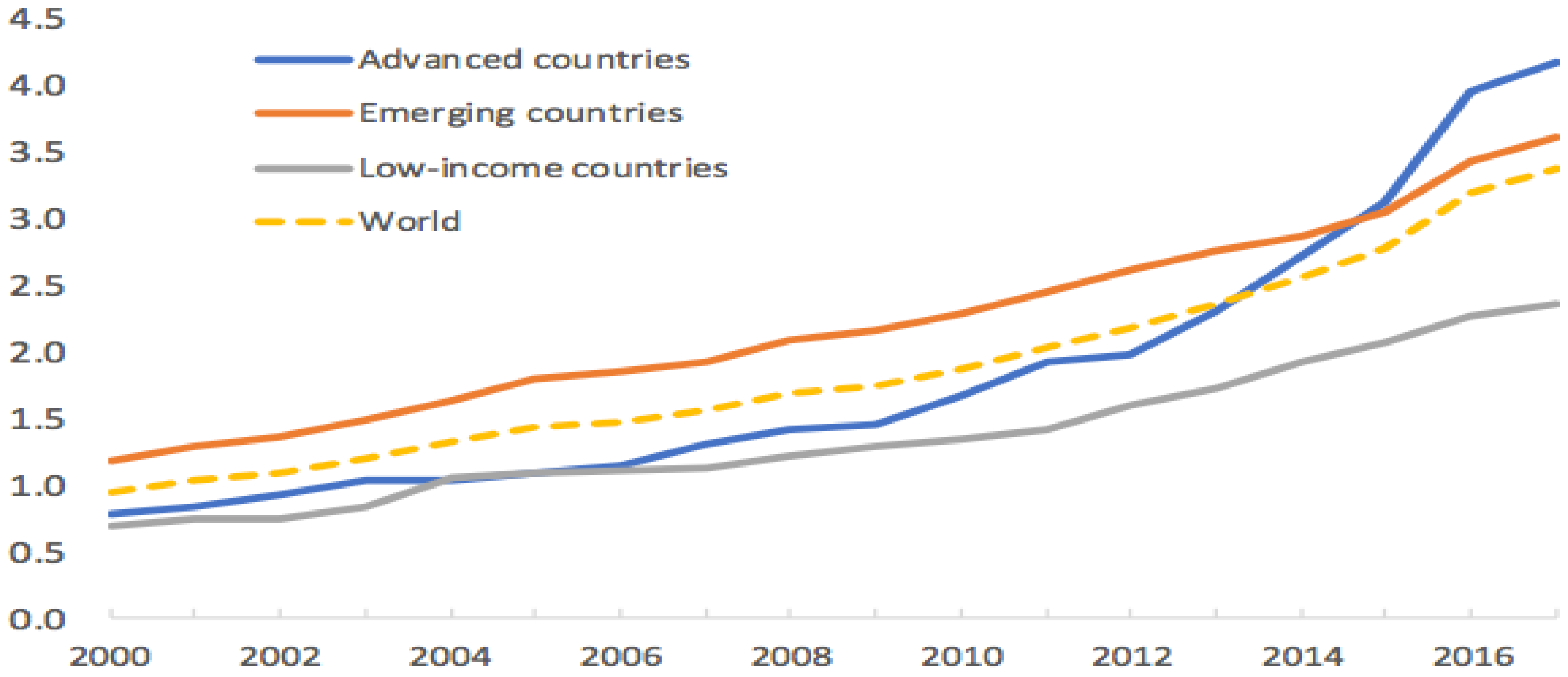
Comment #1: Counterfactual exercises are always difficult

- Premise that MaPs would have only had to address the identified fragilities (excessive leverage and HH indebtedness) is illustrative
- It is supported by a large empirical literature (using both cross-country and micro data) that has documented the impact of MaPs
- But, premise is incomplete. Having the MaPs would have triggered some market reaction/circumvention:
  - FX regulations on banks might mitigate vulnerabilities, but partially shift the snowbank of FX vulnerability to other sectors (Ahnert, Forbes, Friedrich, and Reinhardt 2018)
  - Circumvention of MaPs through cross-border bank lending (Cerutti and Zhou 2018)

Comment #2: A bit too early to answer the question – faith in MaPs

- The usage of MaPs has increased after the GFC and we have not seen a full boom-bust cycle after their implementation in most cases

Macroprudential policy index by income group



Source: Cerutti, Claessens and Laeven, 2017; 2018 Database update covering 160 countries

Comment #2 (II): Too early to answer regarding "Next Crisis"

Next crisis might come from different sources as the global financial system evolves

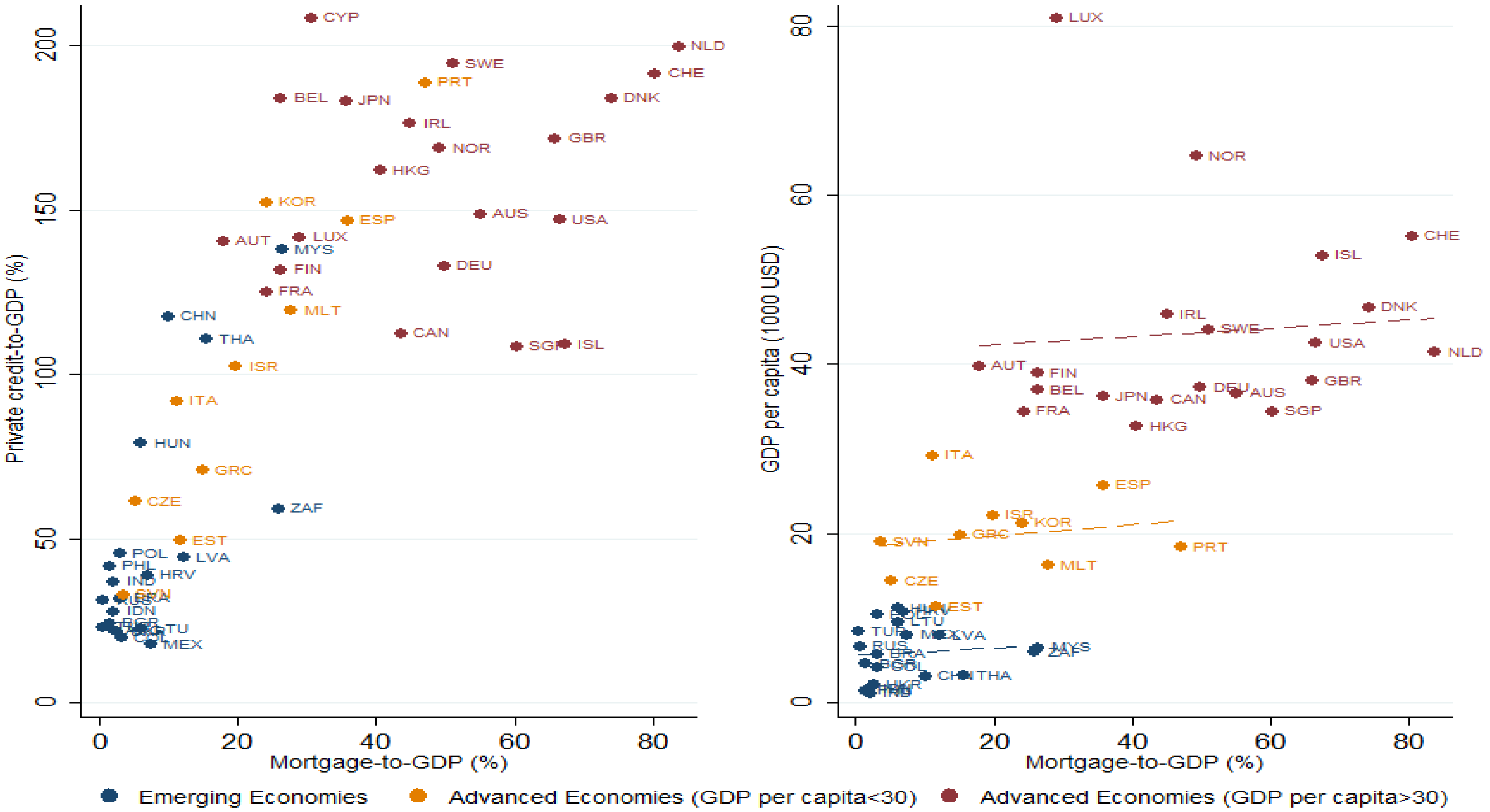
- Technology advances (Fintech)
  - More transactional lending

- It would not necessarily have its epicenter in the housing sector.
  - Record global debt levels (corporates, government, HHs)

- Change in funding models
  - Increase importance of portfolio debt flows (even substitution of bank flows in some countries/sectors)

Comment #3: Housing finance outside the US

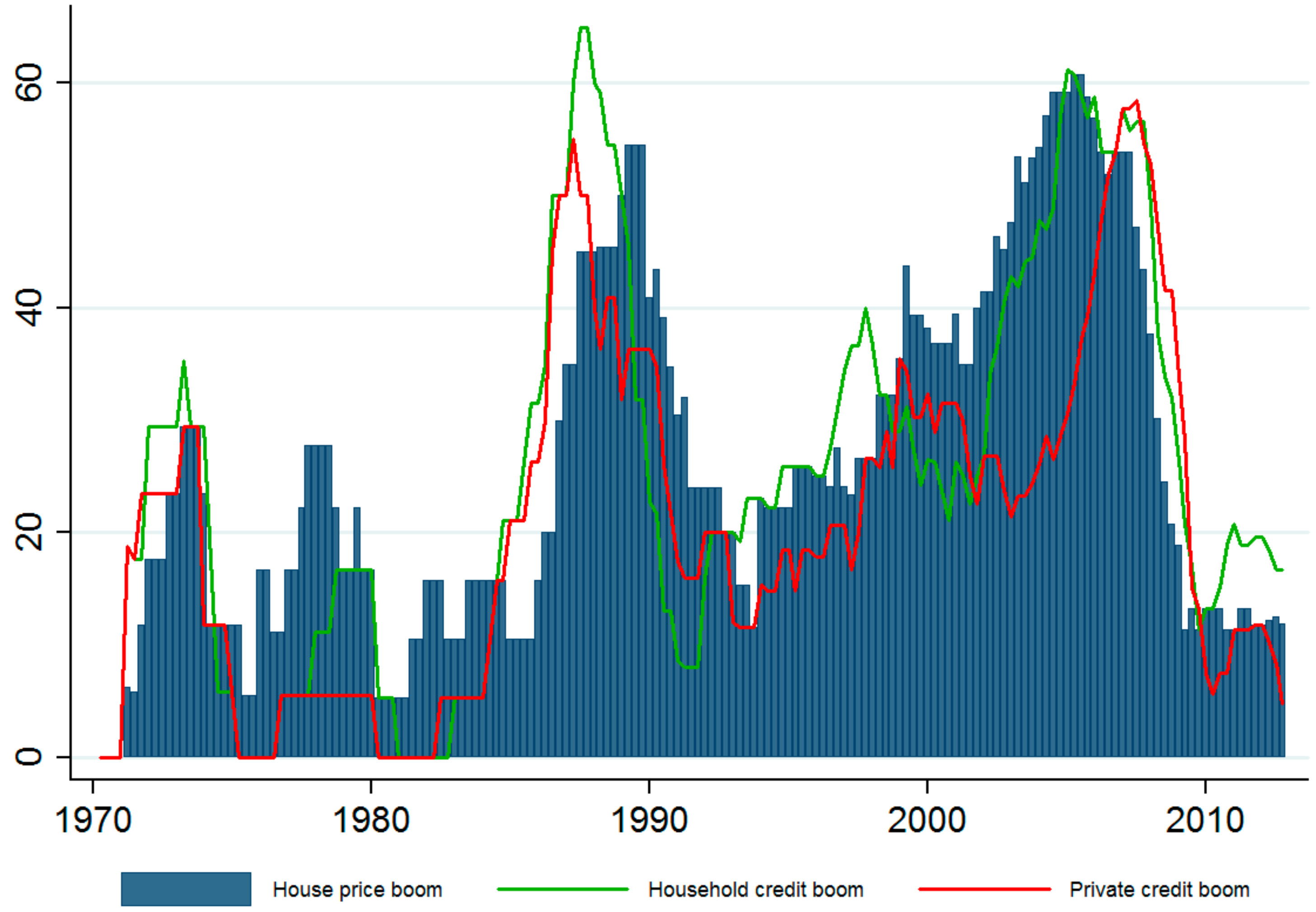
- HH indebtedness levels varies considerably across countries



Source: Cerutti, Dagher, and Dell'Ariccia (2015)

Comment #3 (II): Housing finance outside the US

Occurrence of House Price Booms and Credit Booms
(as percentage of countries in the sample)



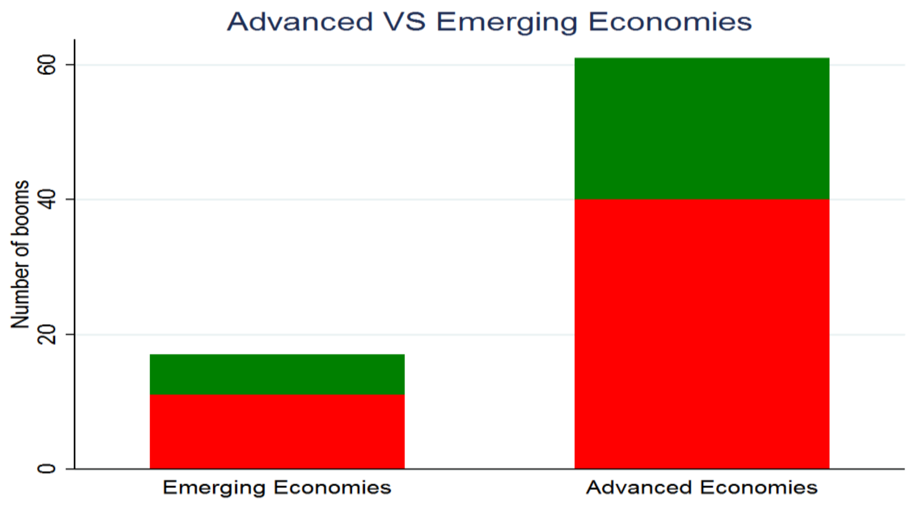
- Dealing with booms requires a mix of policies:
  - ❖ Macro-prudential
  - ❖ Regulations and policies that affect the supply of land/housing
  - ❖ Monetary and fiscal policies

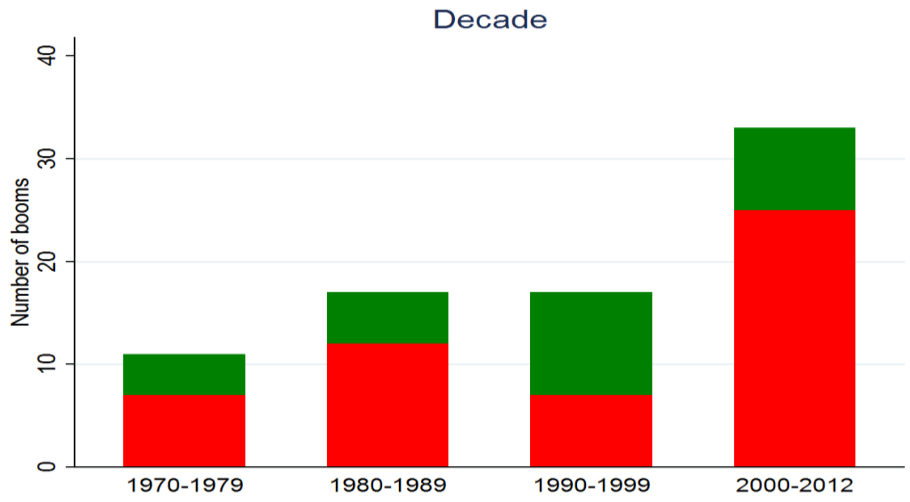
  (More than half of real estate booms occurred together with a private credit boom)

(Cerutti, Dagher, Dell'Ariccia, 2017)

Comment #3 (III): Housing finance outside the US

➢ Can we tell bad real estate booms from good ones?





- Definition: BAD boom is one that ended in recession
- Proportion (2/3) similar across EMs and ACs
- More bad booms during 2000s
- No clear relationship between duration and how it will end
- Housing booms with priv. credit booms more likely to end badly

(Cerutti, Dagher, Dell'Ariccia, 2017)

Comment #4: Institutional aspects

- It could be useful to know more about the importance of the institutional design for using MaPs effectively

- Paper compares “most powerful authority” (UK) vs weak framework (US).

  - What about the average institutional framework?

  - Do we need rule-based MaPs? Even having CCyB might not be enough if they are set at 0 (or very low)

  - What are the best practices to ensure counter-cyclical MaPs usage?

#5 - Summary and policy implications

- Very nice paper that lines up well how policymakers should approach the issue:
  - Identify the main fragilities & use available tools & request new ones if appropriate (non-bank sector?)
- Suggests scope for MaPs
  - But need to be pragmatic, targeting at specific markets/objectives.
  - Ensuring resilience can reinforce avoiding booms/busts
- But overall, MaPs still at early stage
  - Interactions with other policies. Adaptations. Costs. Political economy concerns. Rules vs. discretion.