Capital requirements and macroeconomic stability in light of monetary tightening

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Discussion

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What is the paper about

Capital regulation affects monetary policy

- very timely analysis!
- capital regulation helps to keep banks healthy
- then MP can focus on doing its job of targeting inflation!
- paper identify another reason to build up capital buffers
  $\Rightarrow$ possibility of cost push shocks!

DSGE analysis complementing stress tests

- shows how DSGE models can inform macroprudential policy
- they provide exactly what is missing in stress tests

  $\Rightarrow$ cost vs. benefit analysis over financial cycle
- of course, DSGE lack granularity and detail of stress tests
- but they capture dynamics over time in a consistent way
- complement stress tests to reduce blind spots
- examples
  - MartinezMiera-Repullo (2017) on “private credit”
  - this paper about cost-push shocks

Comments

What exactly is the channel

- very rich model, what exactly is effect of MP on banks?

- two conflicting forces:
  1. MP tightening increases banks' margins
     - see current record profits of big banks
     - leading to "windfall" taxes in many jurisdictions
  2. output gaps lead to loan losses

  MP needs to balance those when banks are not doing well

- what about borrower health?
  - MP tightening may lead to financial stress when debt is high
  - "financial dominance" as in Boissay-Borio-Leonte-Shim (2023)
  - how relevant for bank loans?
    - banks are good at granting forbearance (avoid costly defaults)
  - maybe this is more about non-bank credit (eg, bonds)?

- paper could relate more to the literature on these issues

Clarify Policy implications

- should we have separate buffer to provsion for MP actions?
  - do we need a “systemic MP buffer” for GSIBs?
- or higher CCyB top of range/ neutral level?
- timing:
  - tighten cap req when financial stress materializes
  - in case MP must tighten…
  - OK, but wouldn’t we like to loosen then?
    - to avoid procyclical capital requirements
  - need to clarify interaction with other buffers
- given role of interaction with indebtedness:
  - is a buffer to build resilience the right tool?
  - maybe borrower-based measures are more targeted

Make model more directly applicable to policy

- calibration/estimation without financial cycle moments
  - 15 pre-set parameters
  - 13 calibrated parameters (long-run averages)
    - eg, calibration target for average bank default rate
  - 26 estimated parameters (business cycles moments)

- can we make this more macroprudential?
  - matters how bank default rates change over financial cycle
  - and even that might not reflect financial stress (TBTF)

  eg, target fraction of years with high credit spreads

- worthwhile because model has huge potential for policy
  - even rich DSGE still simpler than regulators' "internal models"
  - for example, great complement to stress testing

- transparency is key in communicating macropru to markets
  - can rely on market prices as indicators during financial stress
  - eg, banks' market capitalization and credit spreads

Conclusion

- take seriously interaction of MP and macroprudential
- use a well-known class of DSGE policy models to evaluate
- find that macroprudential can create room for MP to act
- a very relevant result
  - not only today but also during financial cycles in general
- can further sharpen calibration and results!