Comments on the paper: “How do financial vulnerabilities and bank resilience affect medium-term macroeconomic tail risk?”

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The views expressed here are mine and do not represent the ECB nor the Eurosystem

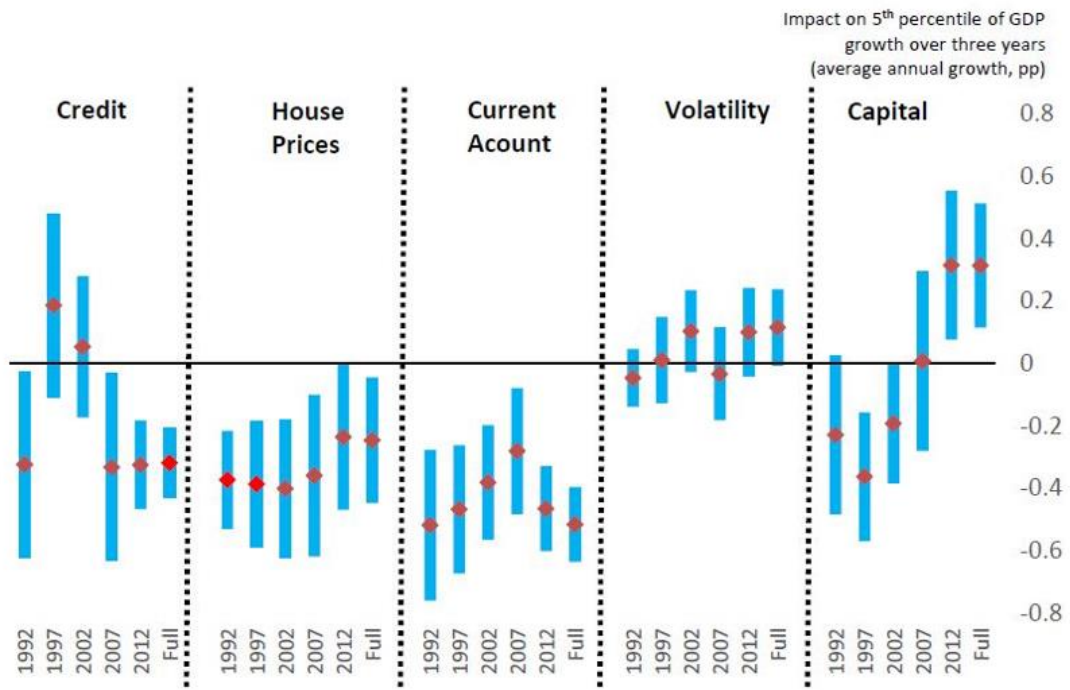
Main results

- Credit booms, property price booms and current account deficits downside risks to growth at horizons of 3 to 5 years.
- Downside risks can be partially mitigated, by increasing the capitalisation of the banking system.
- Their empirical framework can support cost benefit analysis given its flexibility in estimating the impact of vulnerabilities across the GDP distribution and at different horizons.

Weaknesses

- Real time analysis

FIGURE 7: Real time impact of each variable on 5th percentile of GDP growth at 3-year horizon

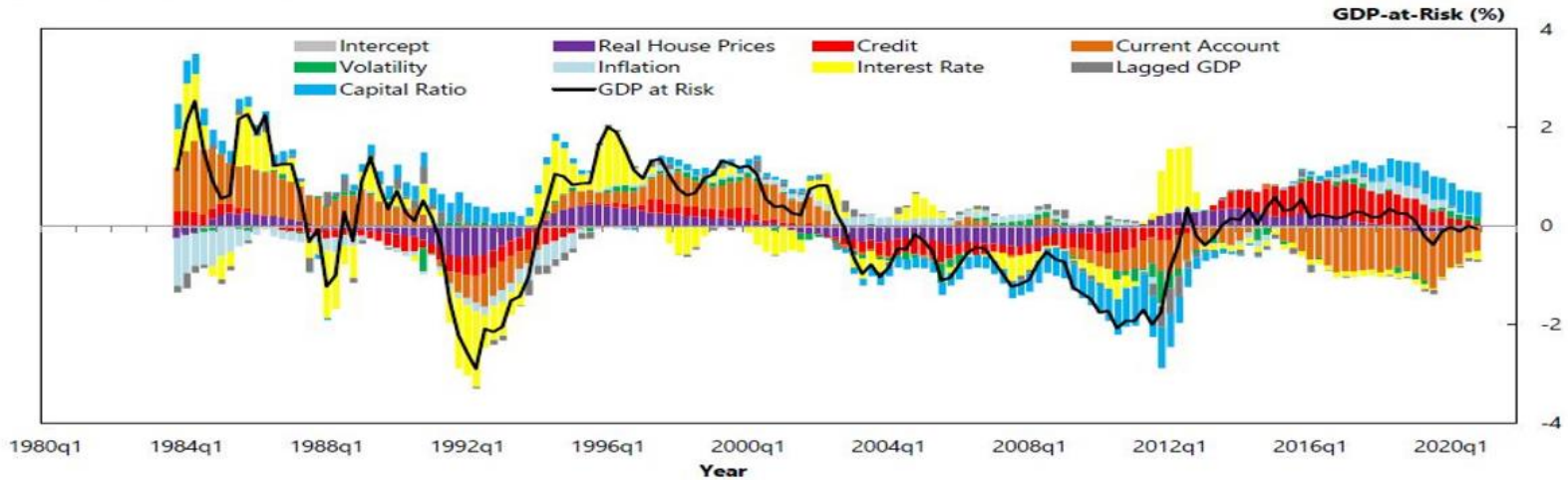


Note: The figure shows how the 12 quarter coefficients in our baseline model change if we restrict the vulnerabilities sample at each of the points on the x-axis.

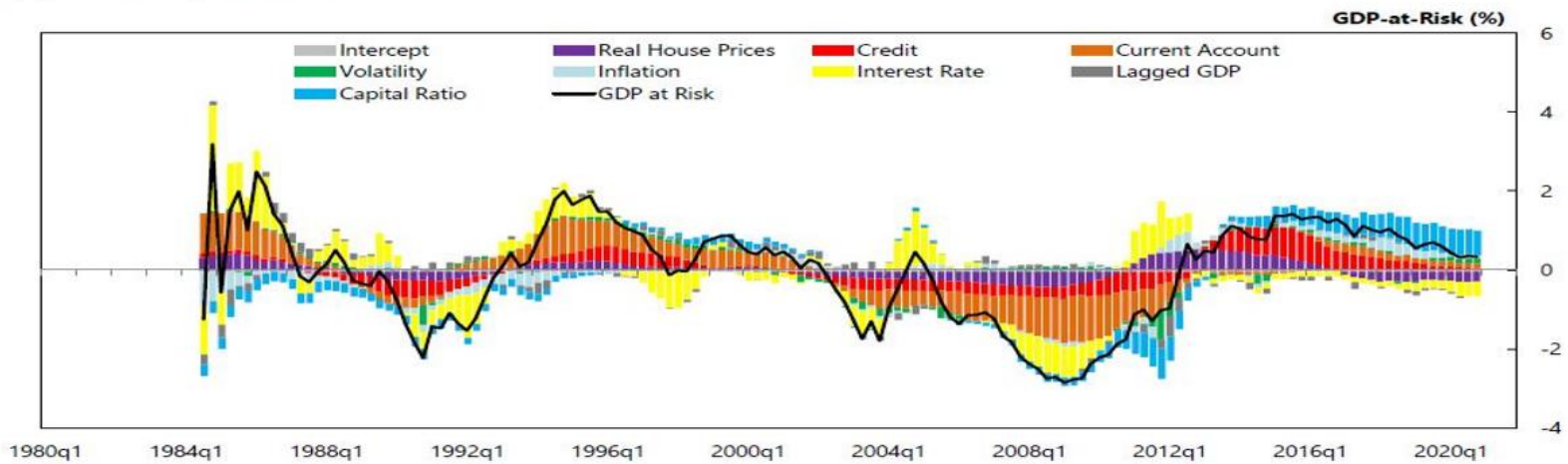
Weaknesses

- Role of the different disequilibria

(A) UK – 3 years ahead



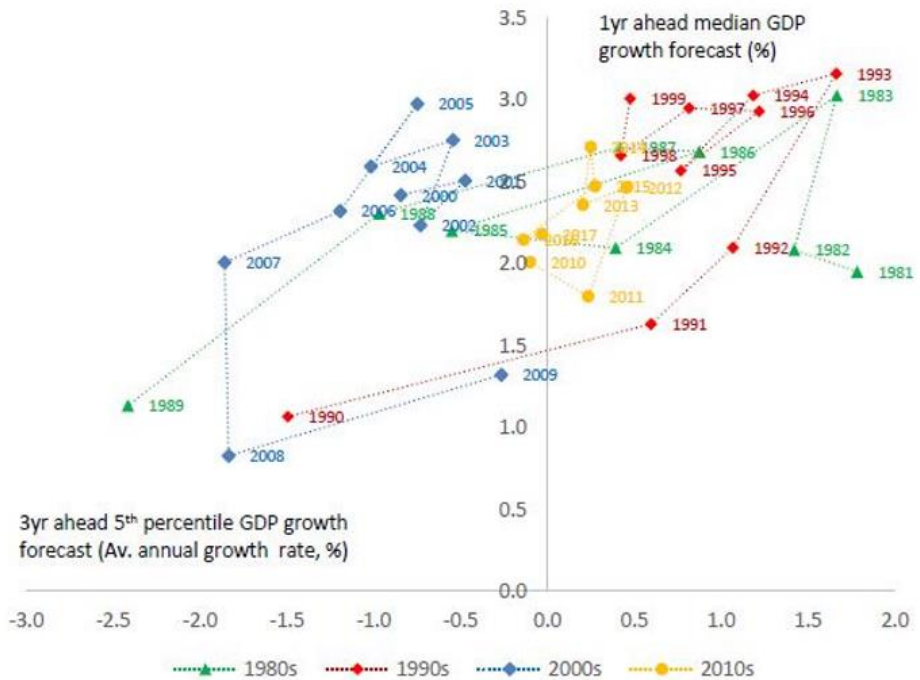
(B) USA – 3 years ahead



Weaknesses

- Costs and benefits

(A) Outturns



Real Time Analysis

- Gadea and Perez Quiros (2014). The failure to predict the Great Recession. The failure of academic economics?

$$E(y_t / CR_{t-1}) = \mu_1 + \alpha_1 CR_{t-1} \quad if\ \text{exp}ansion$$
$$E(y_t / CR_{t-1}) = \mu_0 + \alpha_2 CR_{t-1} \quad if\ recession$$

$$y_t = \mu_{t,S_t} + u_t$$

$$\Pr(S_t = j / S_{t-1} = i, \Omega_{t-1}) = F(CR_{t-1})$$
$$\Pr(S_t = 1 / S_{t-1} = 1, \Omega_{t-1}) = p + \delta_1 CR_{t-1}$$
$$\Pr(S_t = 0 / S_{t-1} = 0, \Omega_{t-1}) = q + \delta_2 CR_{t-1}$$

Real Time Analysis

a) For the sample of 39 OECD countries, between 1950.q1 and 2011.q2, we identify 149 recession periods. Out of these, only 45 coincide financial crises documented by Gourinchas and Obstfeld (2011), and 31 of them correspond to the recent crisis

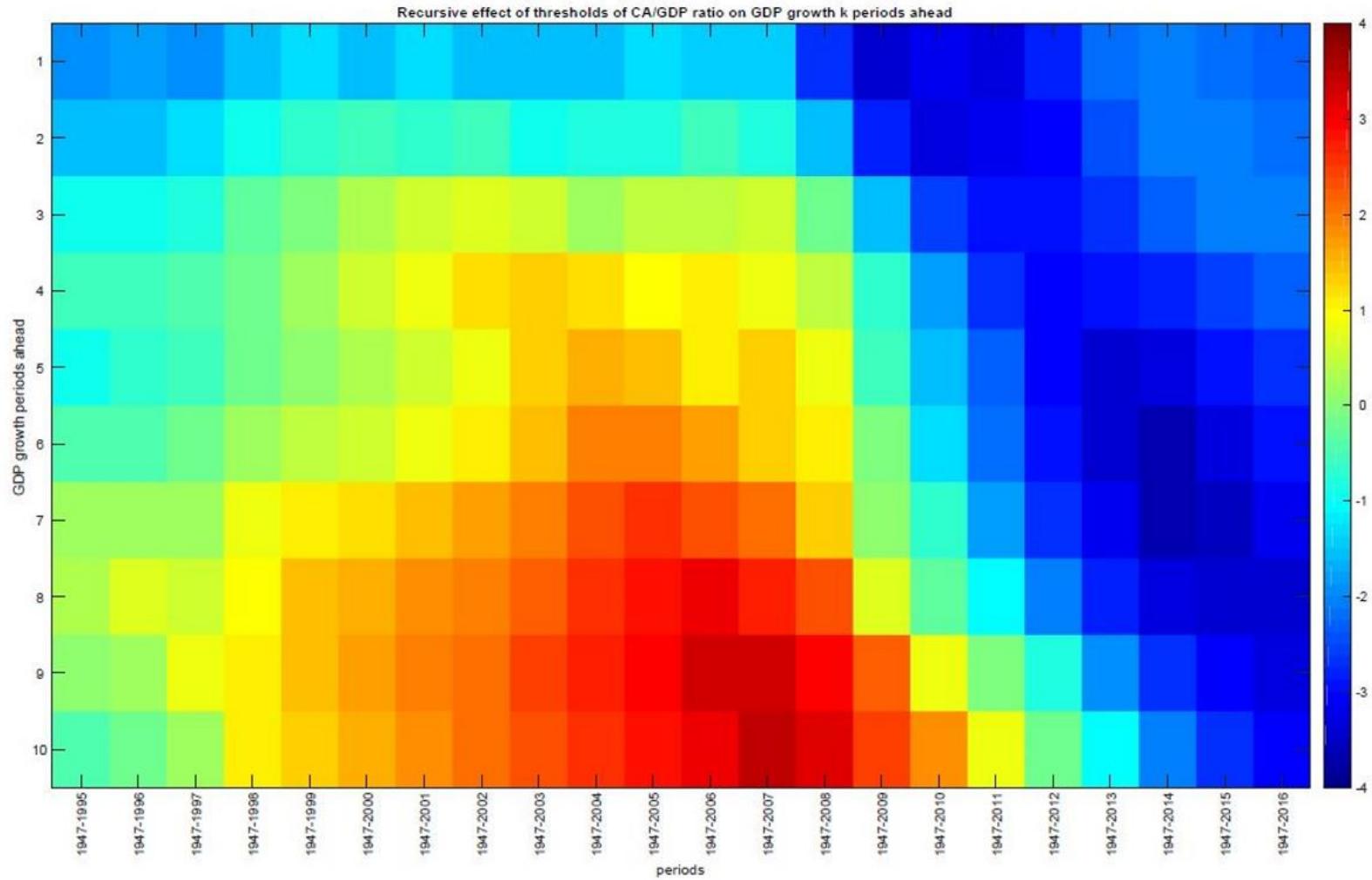
b) For this sample Gourinchas and Obstfeld (2011) identify 143 financial crises, of which only 45 correspond to a real crisis

c) Eliminating the last 31 recent crises out of the 230 financial or real crises (143-31 financial, 149-31 real), we find that only 14 cases (6%) are both financial and real

Definitely, too few coincidences to make a link

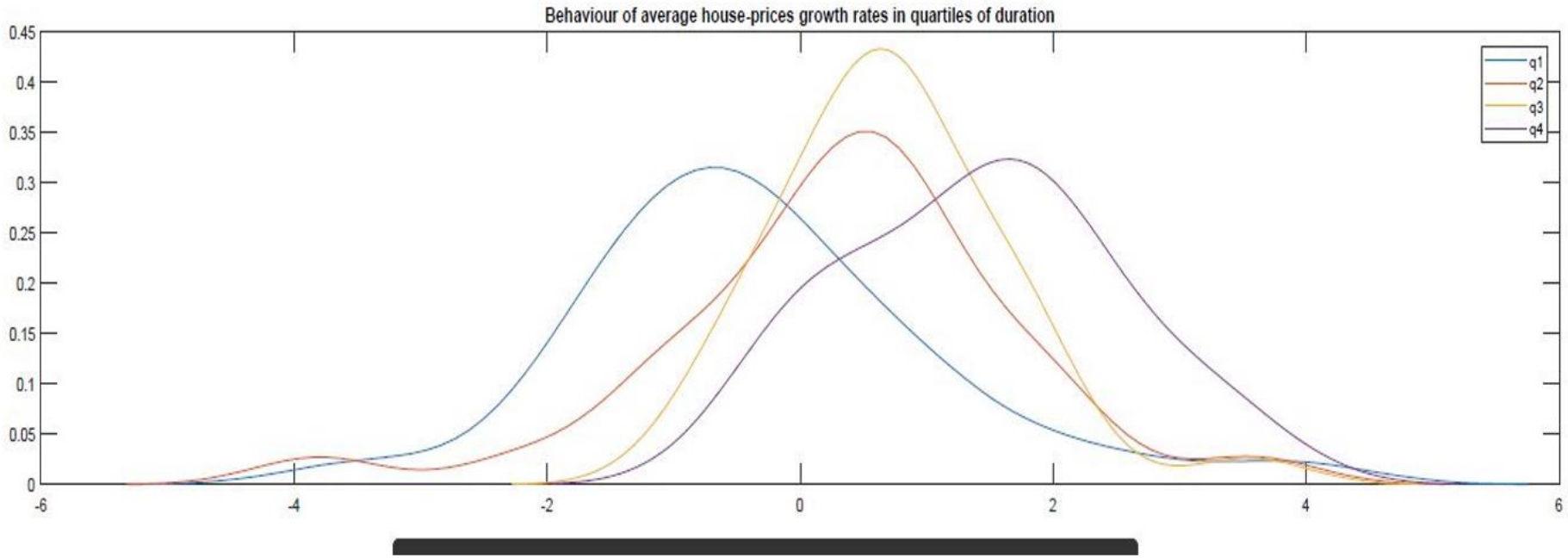
Role of disequilibria CA

$$\widetilde{y}_{t+h,i} = \alpha_i + \beta x_{ti} + u_{ti}$$



Role of disequilibria (HP)

- Gadea, Laeven and Perez Quiros (2019)



Costs and Benefits

- Why only CCyB? Why not to look at borrower based measures?
- Parameter stability (when you move CCyB you change the effect of all the other variables)
- Difficult measure risk vs average growth
- Proposed method: Gadea, Laeven and Perez Quiros (2019). Intermediate variable. Credit

Credit and recessions (GLPQ,2019)

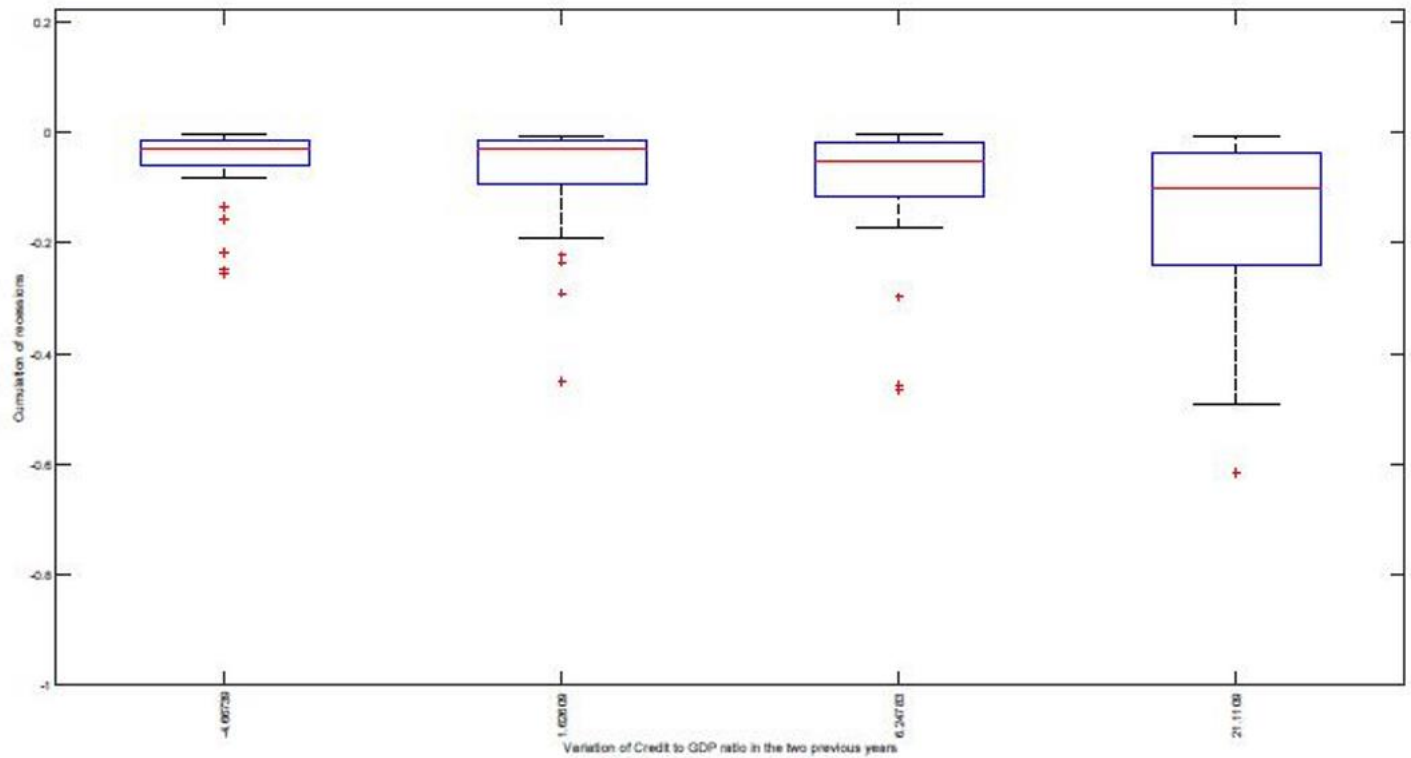
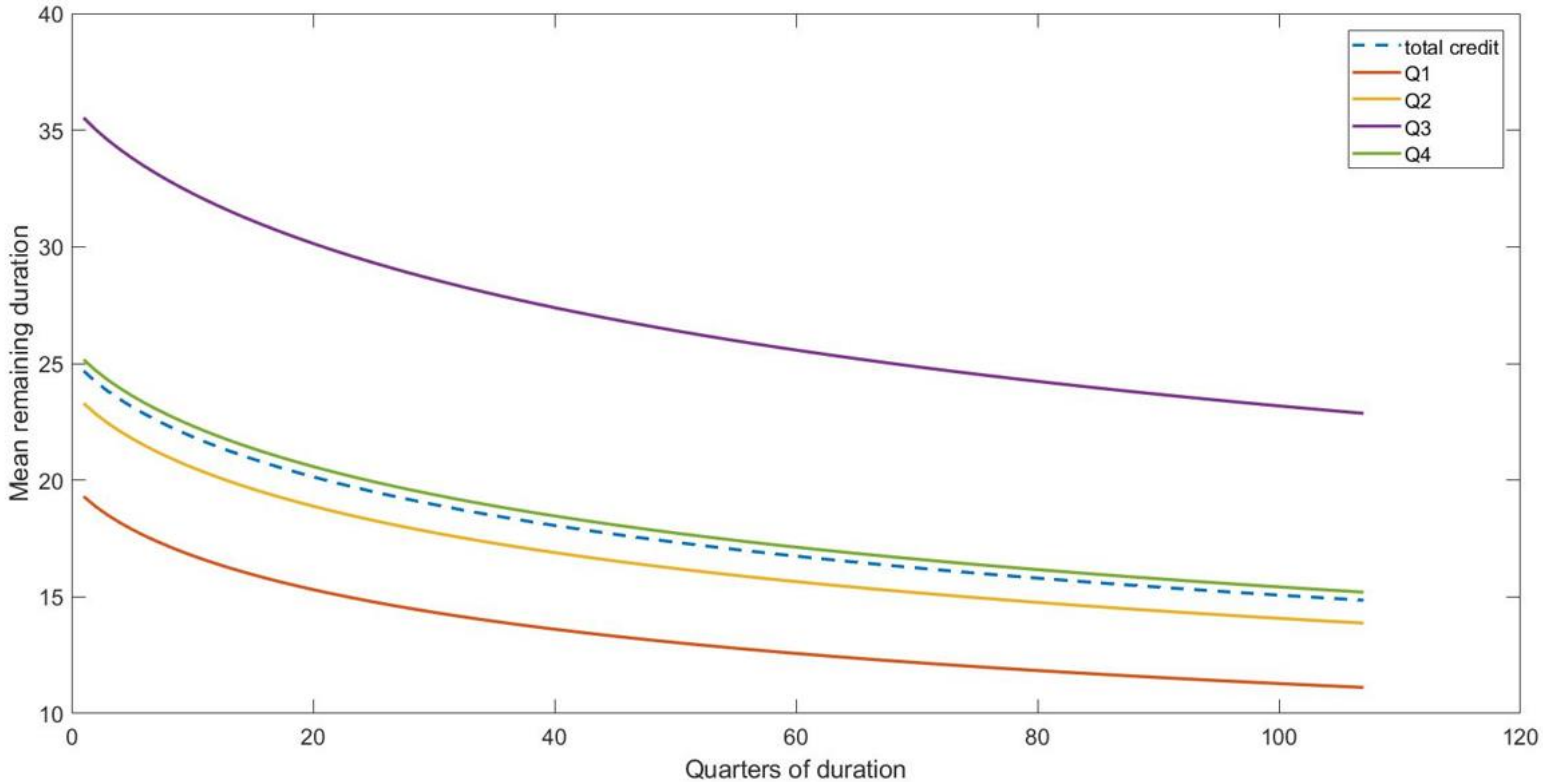


Figure 2: Boxplots of cumulation of the four quartiles according to the variation of Credit-to-GDP ratio in the previous two years

Credit and expansions (GLPQ, 2019)



To sum up

- Excellent paper that goes in the right direction (and glad that does not further in that direction)
- Addressing some of the weaknesses (even with just writing, nothing else)
- Important contribution to our knowledge about the effects of macro prudential policies.

- Due to its countercyclical nature, the countercyclical capital buffer regime may also help to lean against the build-up phase of the credit cycle in the first place. (Pablo Hernandez de Cos, Yesterday) Back