Macroprudential Policy
Goals, Conflicts and Outcomes

By

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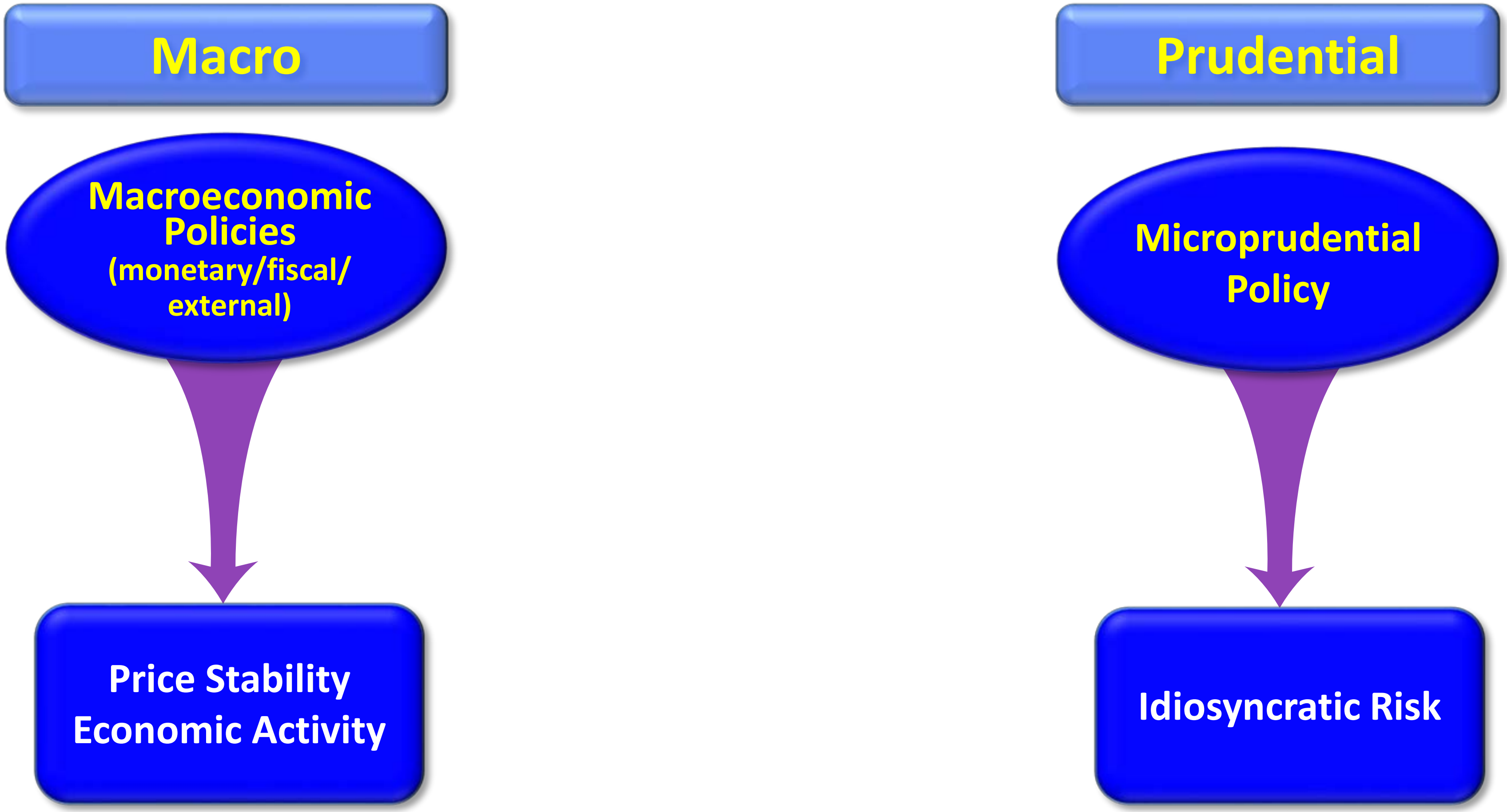
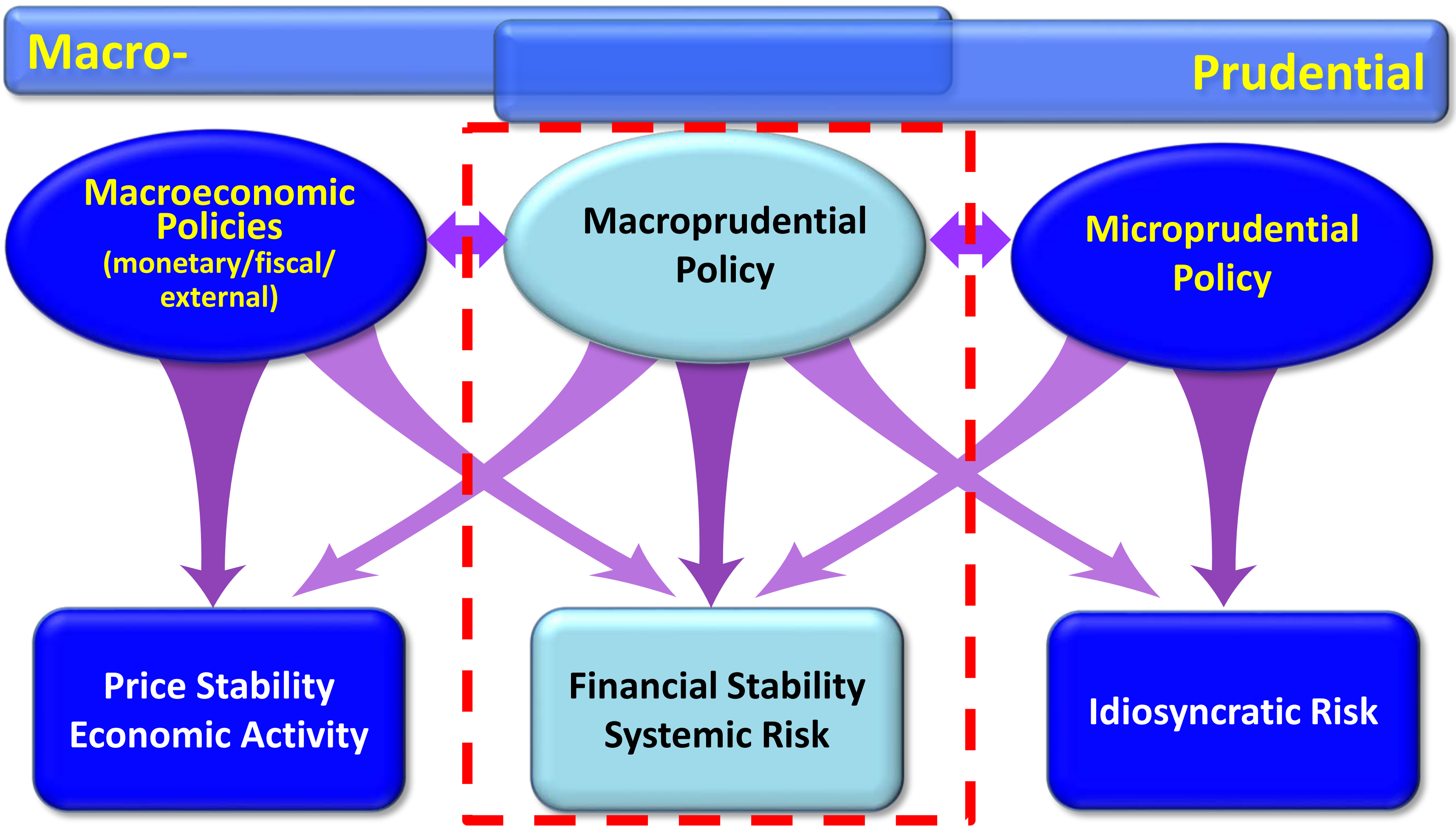
“Old” Framework of Macroeconomic and Prudential Policies



"New" Framework of Macroeconomic and Micro- and Macroprudential Policies



Why Exactly are MAPs Needed?

Finance is **Procyclical**, subject to booms/busts

- Runs often through asset values and leverage

Finance displays much **Interconnectedness**

- Contagion within financial system (e.g., TBTF)

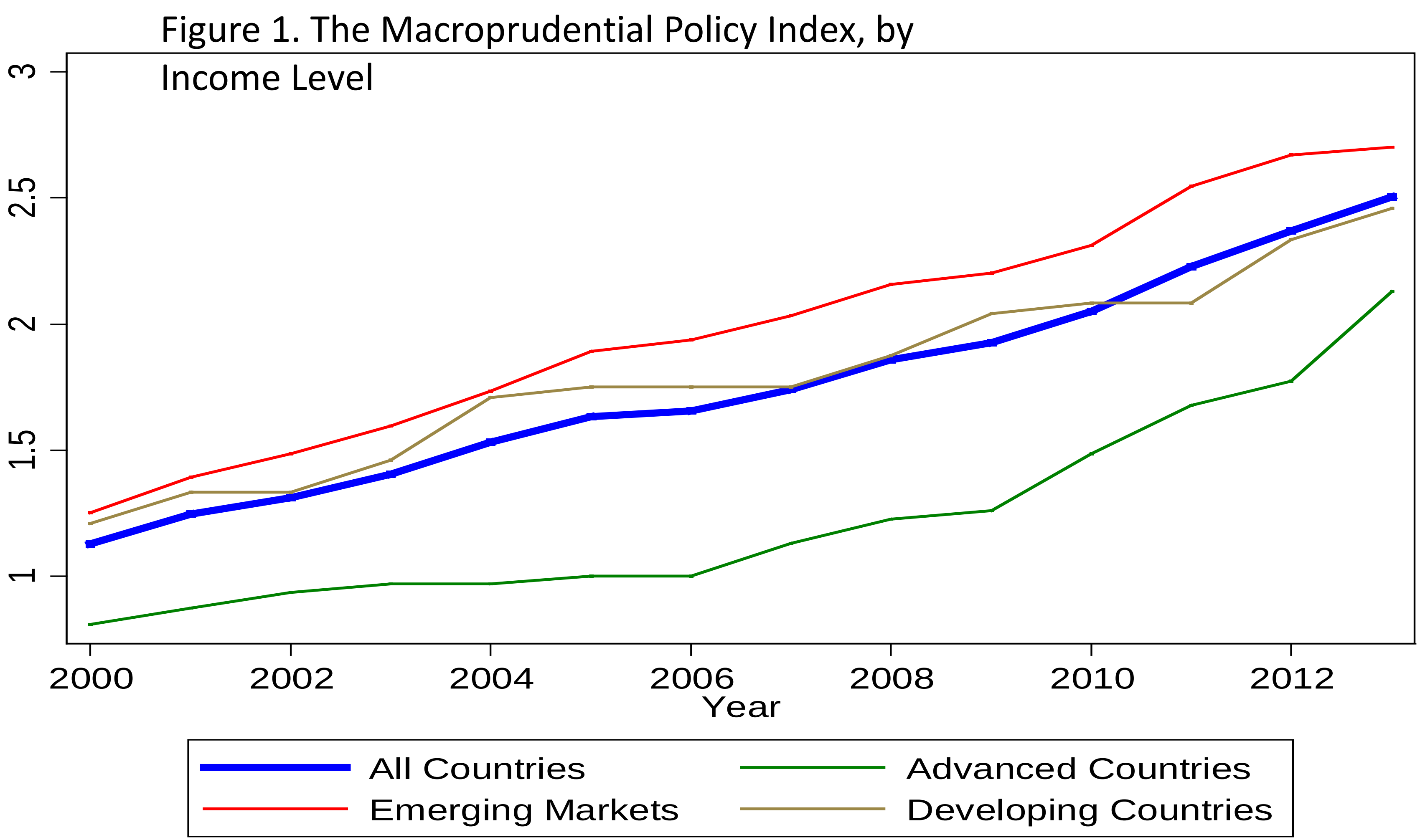
Procyclicality interacts with **interconnectedness**

Microprudential, monetary, other policies do not suffice→ Macroprudential Policies (MAPs)

But need to justify MAPs. Externalities or to compensate for other policy causes, e.g., tax deduct interest

More MAPs in Place Over Time
ACs Less Than EMs & DCs

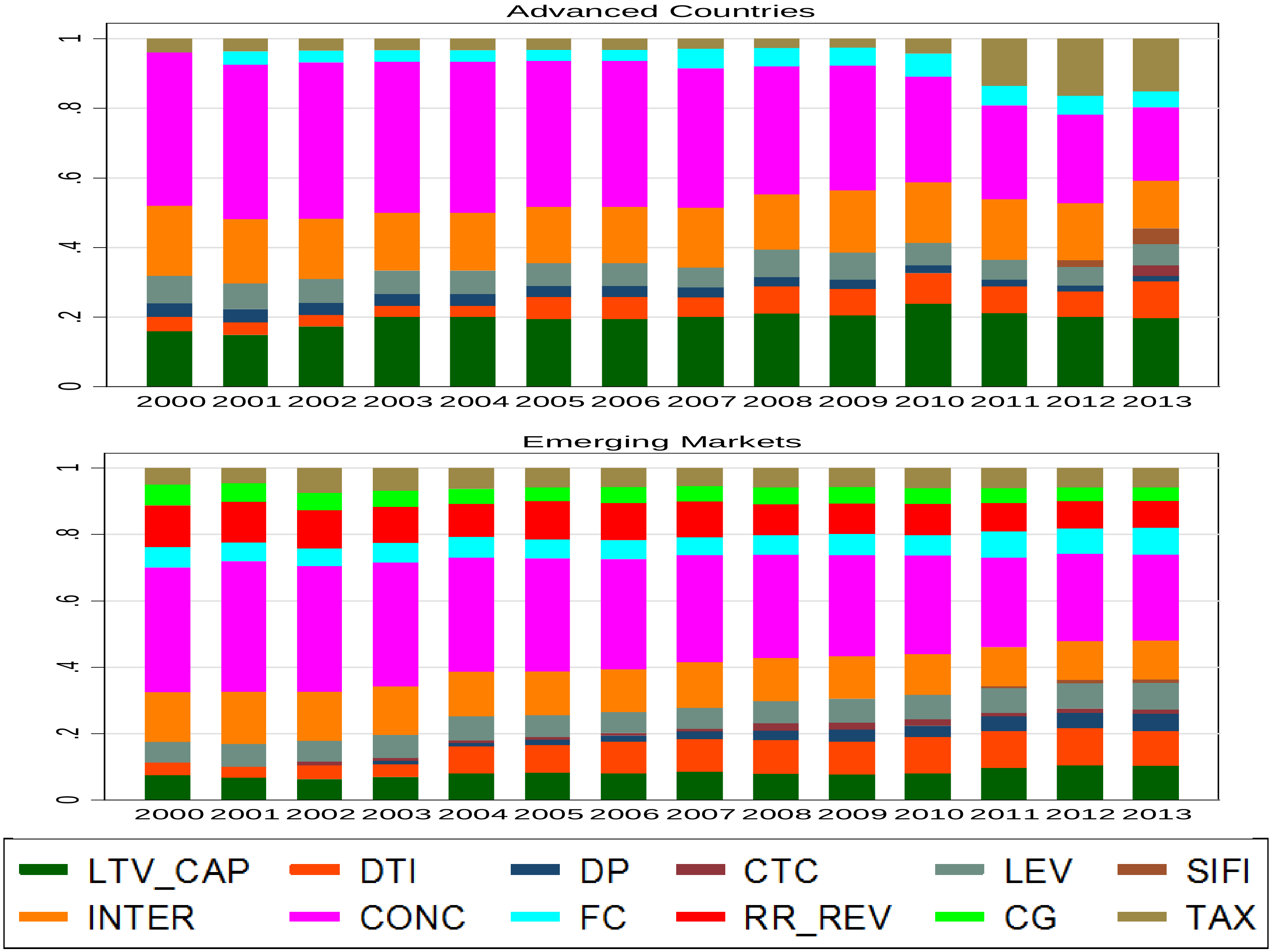
(% of country-year observations using any instrument)



What MAPs Exist, Are Being Used?

1. **Borrower- or activity-based**
   i. Loan-to-Value Cap (LTV)
   ii. Debt-to-Income Ratio (DTI)
   iii. Margin/Haircuts (minimum, cyclical)
   iv. Taxes/fees on turnover ("Tobin" taxes)
2. **Financial institutions-based**
   i. Time-Varying/Dynamic Loan-Loss Provisioning
   ii. Counter-Cyclical Capital Requirements, Leverage Ratio
   iii. Capital Surcharges on SIFIs
   iv. Limits on Exposures, Concentration
   v. Limits on Foreign Lending
   vi. Reserve Requirements
   vii. Credit Growth Caps
   viii. Levy/Tax on Financial institutions

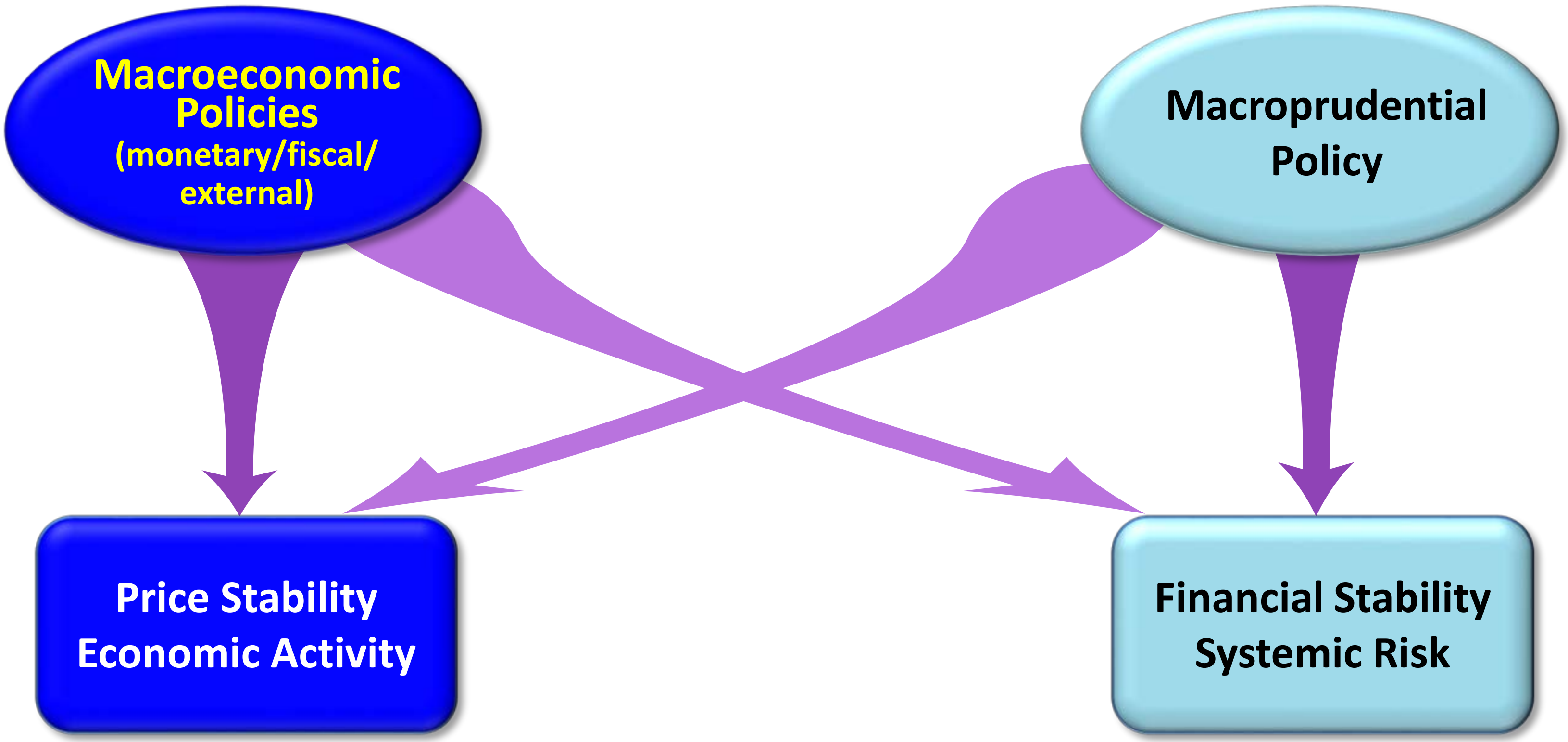
ACs Use More Borrower-based
EMs Use A Broad Set of MAPs



Empirical Evidence: Early Days

- Borrower-based ("LTVs"): Work for real estate, harder to circumvent. But politically "costly"
- Financial-institutions: Better known. But easier to evade, costly for intermediation
- All: Temporary cooling effect, but not always sustained, buffers seldom sufficient for bust
- Know too little on cost, side effects of MAPs
  - Rarely explicitly at externalities/market failures
  - Financial, economic, political costs and risks
- Partly due to limited data (and research

Macroprudential and Monetary Policy Clear Need to Consider Side Effects



Macroprudential and Monetary Policy (MAP and MOP)

- When policies operate perfect, no major challenges
  - Can complement each other, e.g., when business-financial cycles overlap
- But: constraints on one imply the other has to do more
  - With imperfect MAP, MOP has to do some ("getting into the cracks")
  - With constraints on MOP (fixed exch.rate, ZLB), MAP has to do more
- Both: clear mandate, decision-making, accountability
- MAP in central bank can improve coordination, but then safeguards against risks of dual objectives needed
- More work needed for clear-cut policy advice
  - Effectiveness, interactions among MAP tools, intermediate targets
  - Costs, side-effects of MAP and potential new distortions
  - Coordination issues, also with other policies (i.e., MIP, fiscal, crisis)