Property Prices and Bank Risk Taking
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Summary

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- gives a very nice overview of the debate (especially theory)
- does a good job at linking evidence with theory
- discusses a broad range of policy issues (although somewhat semidetached from the preceding sections)

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Hence, I consider my job to

- raise some further issues that might have been underestimated in the discussion so far
- raise some questions regarding policy implications

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$\hookrightarrow$ Do we really need a special treatment of estate prices?

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Why are real estate prices special in terms of financial stability?

- Specific role in collateralising debt — what makes real estate a good collateral?
  - tangible
  - cannot easily be diverted
  - can rather easily be used for different purposes
  - little idiosyncratic risk
  - ownership rather easily transferable in case of bankruptcy

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  - intangible asset (R&D, IT, etc.) have gained relative importance in production of goods/services
  - credit constraints tighten
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$\hookrightarrow$ low interest rates on financial assets (backed by real estate)

$\hookrightarrow$ (rational) asset price bubble on real estate markets

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- Example 2: Bank Stability (...)
  - Giglio & Severo's argument implicitly assumes that firms can commit to use funds for purchases of real assets
  - delegated monitoring by banks as commitment device
  - (private) cost of finance lower for higher bank leverage
  - leverage can be higher for lower credit risk
  - risk is lower when more "good collateral" is pledged
  - firms excessively invest in "good collateral"

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$\hookrightarrow$ higher leverage for banks

$\hookrightarrow$ banks vulnerable to systemic shocks to collateral values

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Potential research questions may take this “Collateral View”:

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- ...which effect does the business cycle have on the valuations of cross-pledged collaterals and through this on asset prices/bank stability?
- ...how can regulation of banks change the incentives of borrowers to make overly use of real estate as collateral?

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Monetary Policy

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- CPI inflation target were more or less met over the last cycle, so what can monetary policy do about asset price bubbles
  - → steering CPI inflation as monetary policy objective is only a means to an end: to mitigate distortions due to frictions.
  - → when credit boom-bust cycles and asset price bubbles are major source of distortions (in terms of allocative efficiency, including but not limited to unemployment) it is very reassuring that inflation targets were met.

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  - → making provisions for bad times may not work for systemic crises, because where should the government safe these funds to be readily available in the crises. In a truly systemic crisis, all financial assets are potentially affected so that precautionary savings are eaten up before they are put to their use.
  - → Maybe the (second) best thing is to clean up the government's balance sheet and pay off debt in good times through a bunch of several taxes that aim at putting incentives right on the micro-level.

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- One set of instruments used for two goals: micro and macro-prudential ?
- What is so bad about variable rate mortgages: Hellwig (EER 1994) argued that it can be indeed a sign of wrong incentives (and of higher systemic risk) if banks and not bank customers are assuming interest rate risk.
- More risk sensitive weights in capital regulation: regulatory arbitrage may serve as a coordination mechanism and create systemic risk on its own. For example, if collateralized loans (mortgages) are less punished by regulator, every bank will grant more loans there and the financial system as a whole becomes less diversified and more exposed to the asset (real estate) market.

Thank you for your attention!