A Theory of Macroprudential Policies in the Presence of Nominal Rigidities

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Comment by Martin Flodén
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Summary of Paper

- First very general framework
- Then four applications:
  - Deleveraging and zero lower bound
  - Sudden stops and zero lower bound
  - Fixed exchange rate and capital controls
  - Fiscal unions

Contribution

- The general framework?
  - Is it helpful for analyzing the four applications?
- Applications?
  - Do they address the core of macro-prudential considerations?

Objective of Macroprudential Policy?

- ESRB: **Mitigate and prevent systemic risk** in the financial system to ensure a sustainable contribution of the financial sector to economic growth
- BIS, G20 & IMF: limit systemic or system-wide financial risk, thereby **limiting the incidence of disruptions** in the provision of key financial services that can have serious consequences for the real economy
- Here: **Mitigate effects of a crisis** (?)

Deleveraging and ZLB (1)

- Three periods, two households, no uncertainty
- Prices fixed for all periods (NK-type model)
- Binding borrowing constraint in second period $\rightarrow$ deleverage

Deleveraging and ZLB (2)

- Prudential policy (borrowing constraint) in first period?
  - Too little ”consumption demand” in mid period
  - Inefficient because of fixed price over all periods
  - Interest rate can adjust, but restricted by ZLB
  - Cap or tax on first-period borrowing results in higher ”demand” in second period

Deleveraging and ZLB (3)

- Interpretation (?)
  - Ex post crisis management is sufficient as long as ZLB doesn’t bind
  - Macro prudential policy justified only if ZLB risks binding
- Are there other policies available?
  - Government borrowing and transfers in mid period?
  - Tax on savings from mid to final period?

Sudden Stops and ZLB (1)

- Three periods, two countries, no uncertainty
- Prices of non-traded goods fixed for all periods
- Binding borrowing constraint in second period
- Interest rate parity

Sudden Stops and ZLB (2)

- Prudential policy (borrowing constraint) in first period?
  - Too little demand for non-traded goods in mid period
  - Interest rate, and then exchange rate, can adjust, but restricted by ZLB
  - Cap or tax on first-period borrowing

Sudden Stops and ZLB (3)

- Conclusion?
  - Prudential policy only relevant if ZLB will bind
  - Can we think of a situation with a sudden stop and a binding ZLB?
- Other policies?

Summary of Comments