Discussion of Svensson
“The future of monetary policy and macroprudential policy”

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Overview Svensson paper

Part I – Monetary policy

- Flexible inflation targeting: price stability and full employment
- Far away from original two pillar strategy: monetary and economic analysis

Proposal Svensson:

- Forecast targeting; also helpful for accountability
- Info on economy, economic activity and prices needed + info on transmission mechanism to assess impact on forecast inflation + employment
- Financial stability not a goal for monetary policy: yes

Comment: banking/financial system is important for monetary transmission (e.g. Shin (2018) – bank capital)
Part II – Macroprudential policy

• Different and separate from monetary policy: yes, Tinbergen rule
• Separate decision-making bodies: yes, but how to organise?
• Financial stability aimed at resilience, and not at financial imbalances: no

Proposal Svensson:

• Good and bad credit growth: can we distinguish?
• New idea:
  – interest cost to income ratio (two flow variables) instead of
  – price (stock) to income (flow) ratio
  – good idea?
Decision-making bodies

Decision-making

• Mon + fin stability are two sides of the same coin
• Overlap: central role of banking system for transmission + financial stability
• Both are macro: economic / financial system as a whole
• Both need independence from political cycle: time inconsistency

ASC (2014) paper:

• Not government or government agency
• Not micro agency - legal focus (Goodhart, Schoenmaker, Dasgupta, 2002)
• Central bank is both independent + macro-oriented (culture)
• BoE: with two separate bodies
Macro-prudential objective

Svensson:
• Only resilience, not imbalances -> financial cycle is not important
• If recession, interest rates low -> assumes bus + fin cycle are related

Tendency to look at structural side
• For example, lack of housing supply explaining house price growth
• Remember Greenspan: new economy explaining economic expansion
• “This time is different” fallacy (Reinhart and Rogoff, 2009)

Comment: financial system is very pro-cyclical and not related to bus cycle
• Need to dampen financial cycle
• Strong link to consumption (feedback on economy, Mian, Rao, Sufi, 2013)
Business and financial cycle don’t move in tandem

- Red line: business cycle (US)
- Blue line: financial cycle (credit growth + house prices)

Source: Borio (2014)
Simulations mortgage credit cycle with different levels of equity in banks

Source: Schoenmaker and Wierts (2017)
Relationship house prices and consumption

Source: DNBulletin (25 Jan, 2018)
Consumer expectations (back in 2011)

% positive minus % negative answers

Sources: CBS, European Commission
Homeowners and correlation house prices and consumption

Source: DN Bulletin (25 Jan, 2018)
Concluding remarks

Monetary and financial stability

- Yes, separate objectives
- But strong relationship: both dependent on financial system

Macroprudential policy

- Need to dampen financial imbalances (so need for macro approach)
- Sweden looks fine on static interest cost to income ratio indicator
- But interest cost to income ratio will not work in face of interest rate shocks
- Price to income ratio is fine: if we assume 5% interest rate cost scenario – then issue is: can we pay mortgage debt at 5% from our income?
References