

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

DIRK SCHOENMAKER

CONSTANCIO COLLOQUIUM

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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)



Overview Svensson paper (II)

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

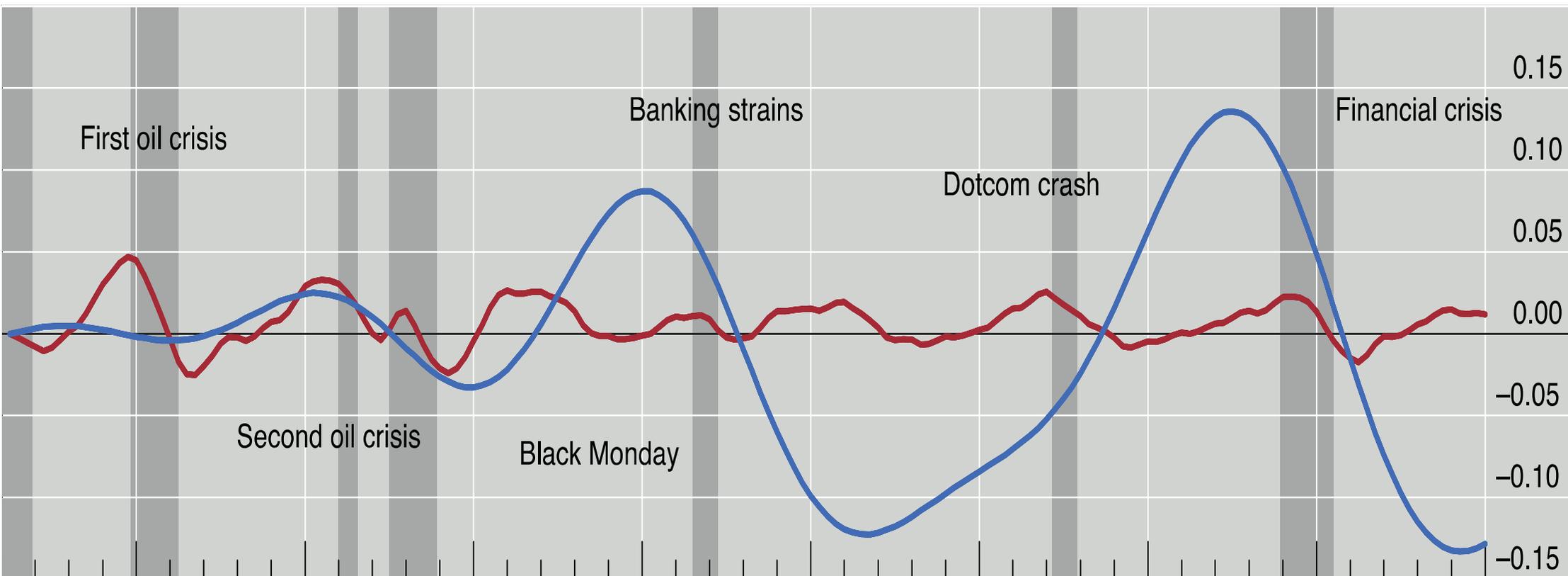
Tendency to look at structural side

- 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)

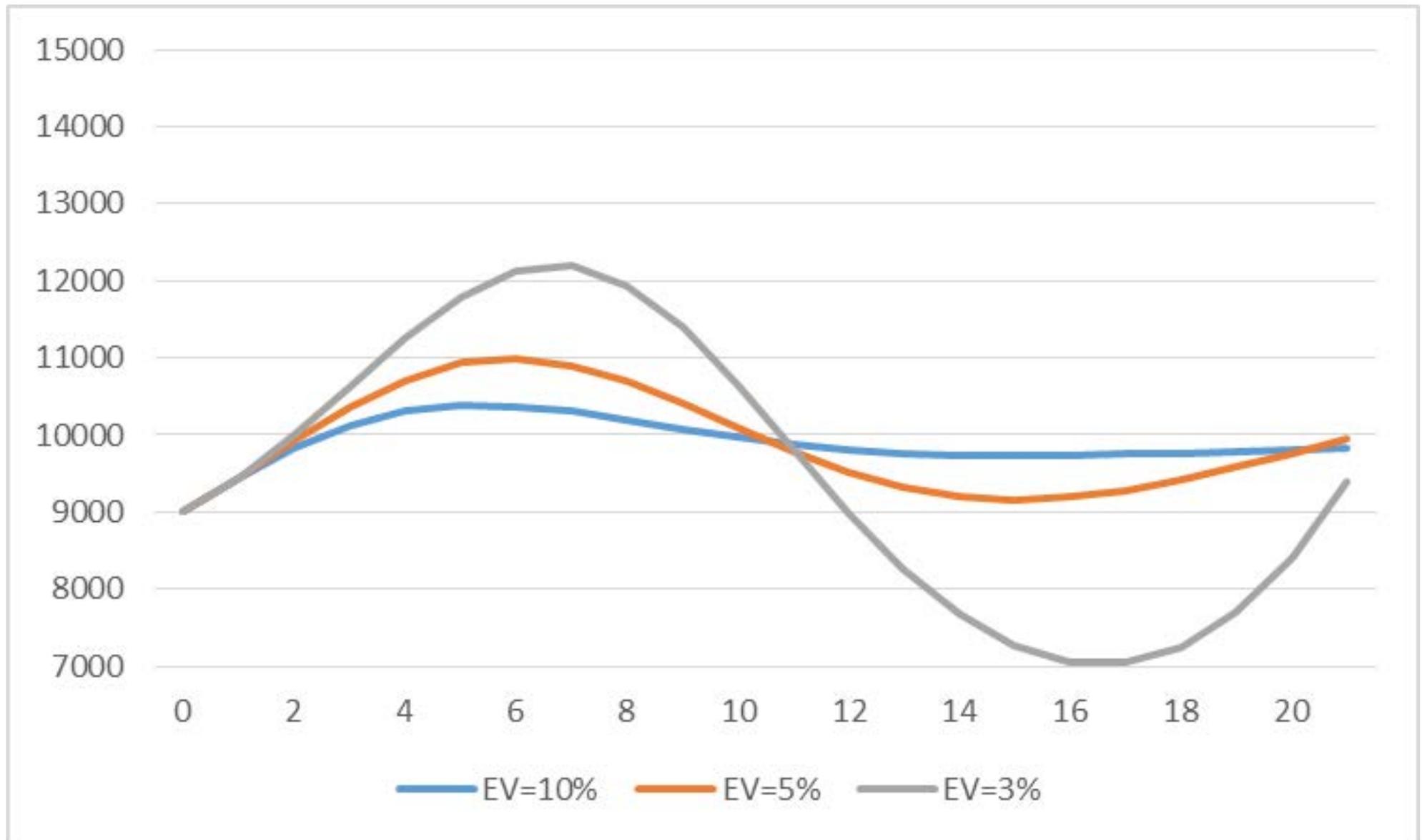
Business and financial cycle don't move in tandem



Source: Borio (2014)

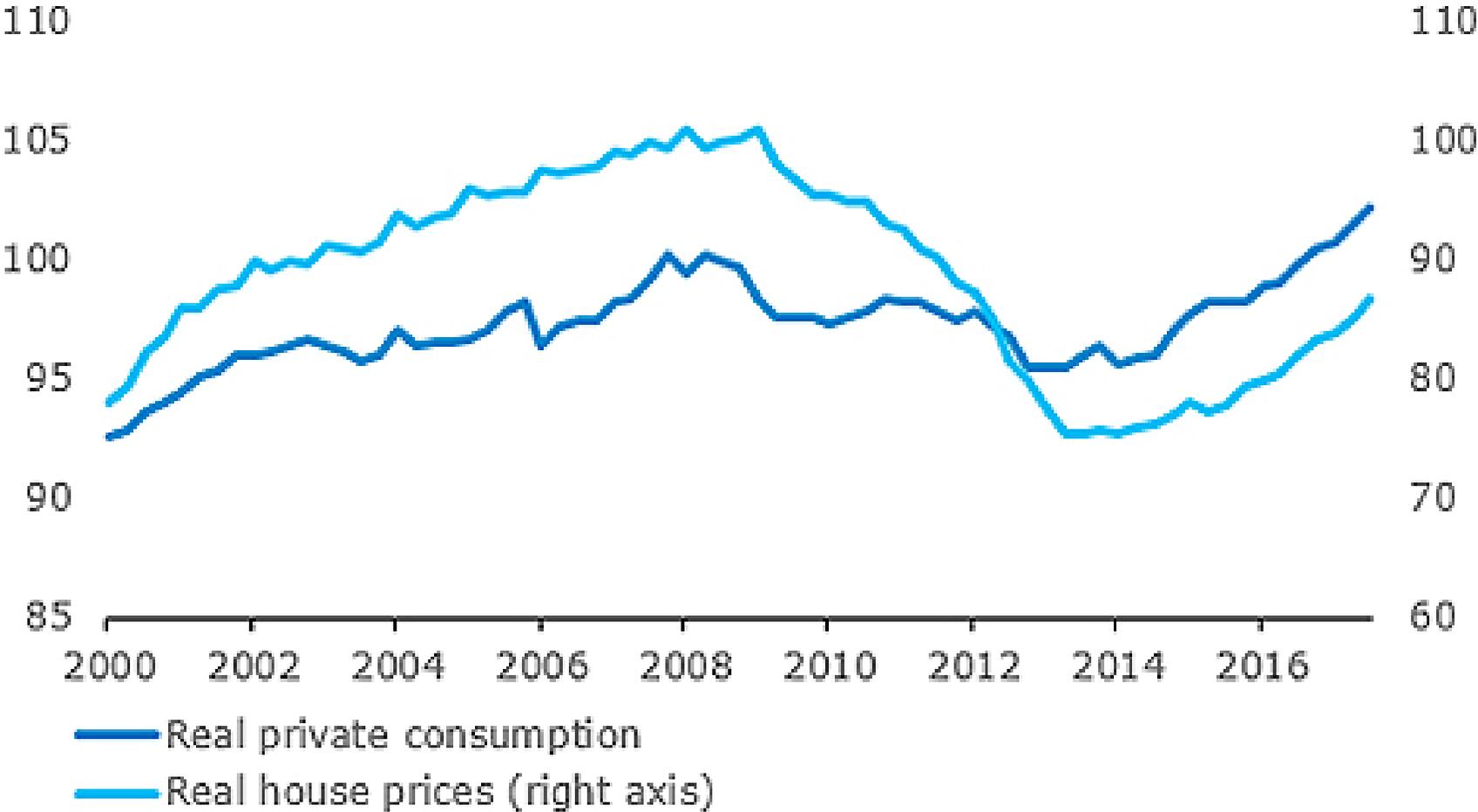
- Red line: business cycle (US)
- Blue line: financial cycle (credit growth + house prices)

Simulations mortgage credit cycle with different levels of equity in banks



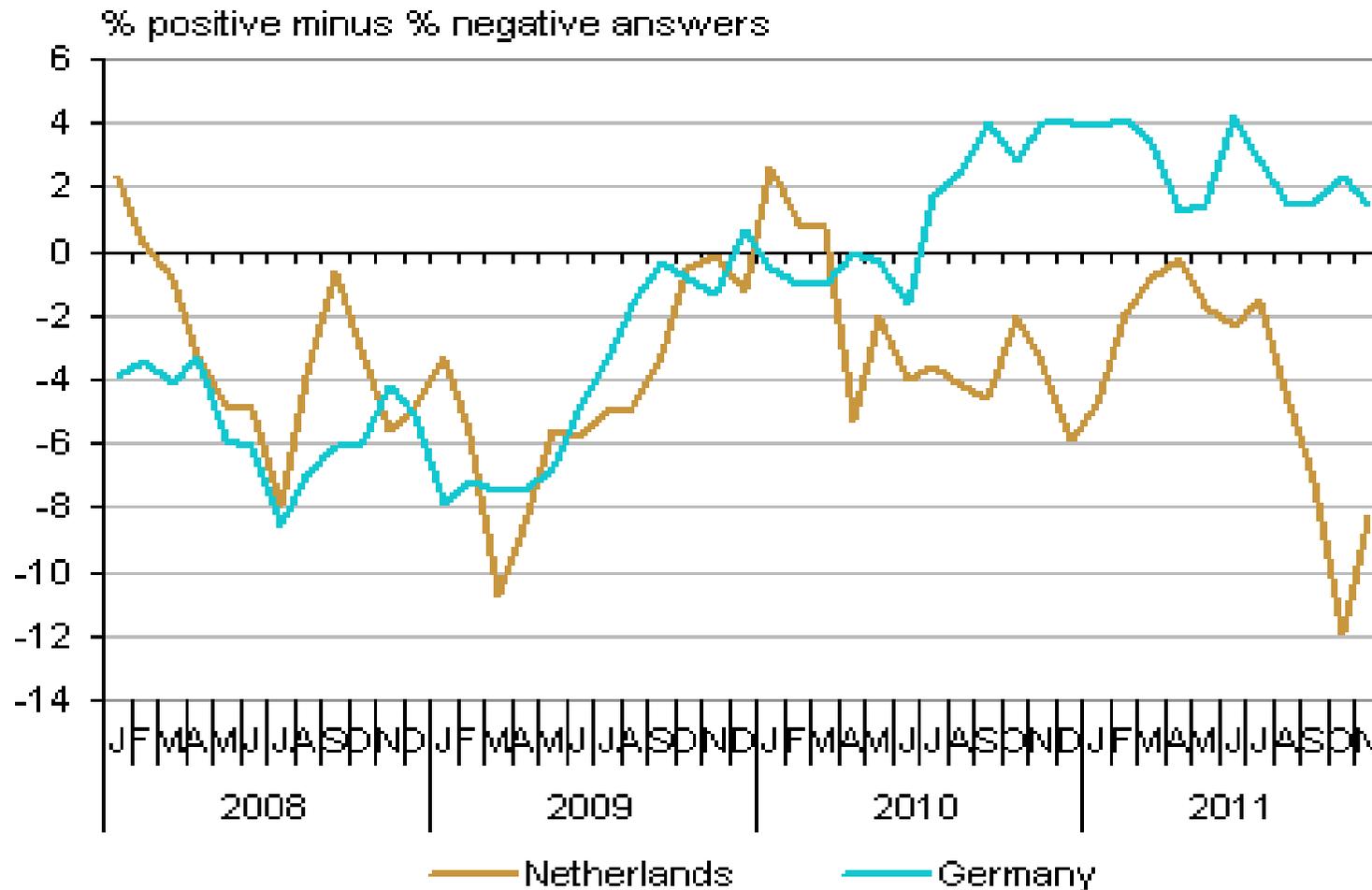
Source: Schoenmaker and Wiertz (2017)

Relationship house prices and consumption



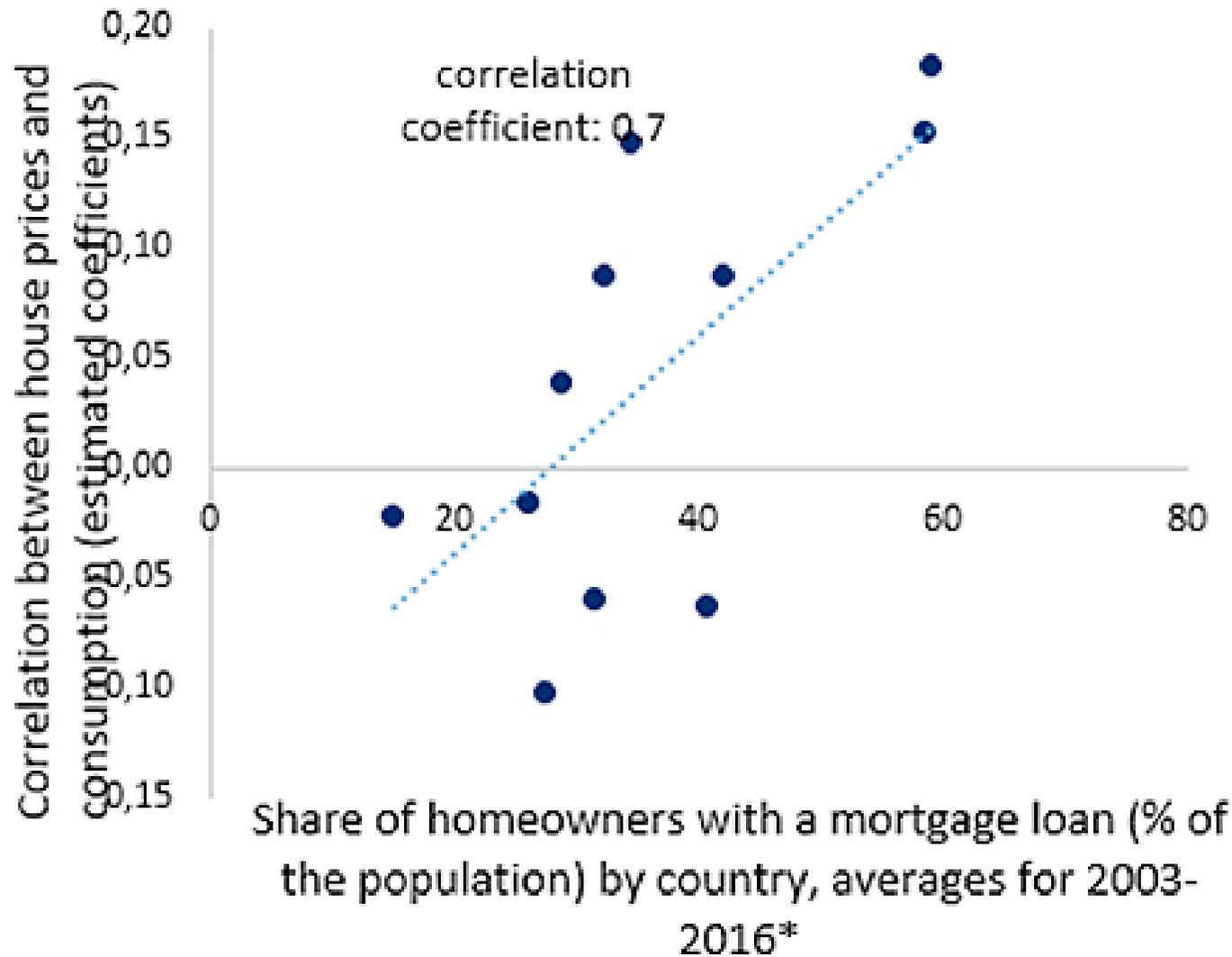
Source: DNBulletin (25 Jan, 2018)

Consumer expectations (back in 2011)



Sources: CBS, European Commission

Homeowners and correlation house prices and consumption



Source: DNBulletin (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?

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