

Leaning Against the Wind: An Empirical Cost-Benefit Analysis

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Discussion by:
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Summary of Paper

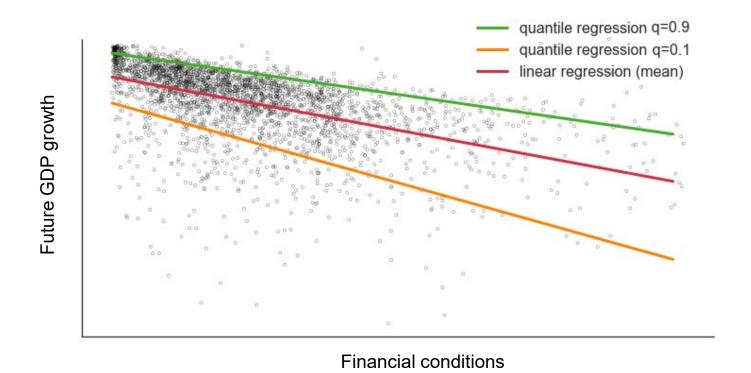
This paper proposes a new empirical approach to assess the costs and benefits of using different policy tools to dampen the buildup of financial vulnerabilities.

1. Look at future GDP outcomes conditional on:

(Loosening financial conditions) x ("Leaning against the wind" policies)

- Loosening financial conditions = {domestic, global financial shocks}
- Leaning against the wind policies = {monetary policy, FX interventions, capital flows management, 17 other macroprudential policies from Alam et al. (2019)
- Other "financial vulnerabilities" = {credit-to-GDP ratio, house price index}
- 2. Quantile regressions to look at tail GDP events.
- 3. Fit to a "skew-normal" distribution
- 4. "Loss function" to map these outcomes into policymakers' utility function

Quantile regressions



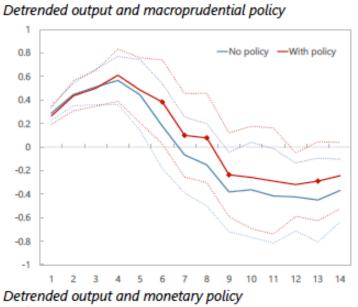
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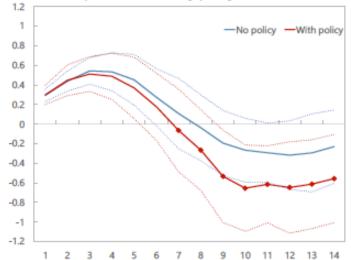
- Baron and Xiong (2017): tail risk for bank stock returns
- Adrian, Boyarchenko, and Giannone (2019): tail risk for GDP growth

Main results

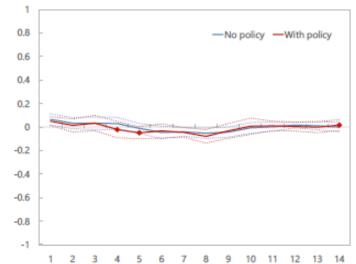
Figure 1. Response of Tail Risk of GDP and Inflation to Domestic FCI

Quantile regressions using the 10th percentile

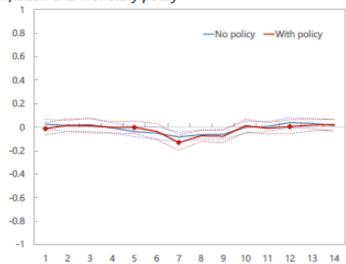








Inflation and monetary policy



Comments

1. Correlation vs. causation?

- Policy responses are endogenous

2. Can financial crises be accurately predicted?

- Yes: Aldasoro, Borio, Drehmann (2018); Richter, Schularick, Wachtel (2020); Greenwood, Hanson, Shleifer, and Sørensen (2022)
- No: Svensson (2017); Dell'Ariccia et al. (2020)

3. Which individual macroprudential policies work best?

- The paper lumps together all 17 policies in aggregate. Or decomposes into 2 groups (borrower-based or bank-based policies).



