Discussion of Gelain, Lansing and Natvik, "Leaning Against the Credit Cycle"

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Summary of paper

- Policy rate effect on debt/GDP?
- Increase in short run, small decrease in long run
- Debt is persistent, mortgages have long maturity; collateral constraints only binding at initiation and refinancing, not for old mortgages
- Response of nominal GDP quicker and larger than response of nominal debt
- Consistent with Svensson 2013, Alpanda & Zubairy 2014, Mason & Jayadev 2014, Robstad 2014, …
- Simple model, and medium-scale calibrated and estimated model (better fit)
- Positive policy-rate response to debt/GDP (Leaning Against the Wind, LAW) may lead to indeterminacy
- Stabilizing debt/GDP may require Leaning With the Wind, LWW, a negative policy-rate response to debt/GDP

Part of ongoing debate

- BIS: Use monetary policy to LAW (lean against credit growth and credit cycle, "financial cycle") for financial stability purposes
- Svensson 2014, 2015, 2016: Costs of LAW likely to be much higher than possible benefits (surprisingly, even more so when macropru is ineffective)
- Bernanke, Evans, IMF, Williams, Yellen, FOMC,… : Costs likely to be higher than benefits
- Costs of higher policy rate: Higher unemployment, lower inflation
- Possible benefits: Possibly lower credit growth, credit/GDP; in turn this may reduce probability and/or magnitude of financial crisis
- Svensson 2016: Policy-rate effect on probability and magnitude of crises much too small for benefits to exceed costs
- This paper: Even more so if policy rate *increases* debt/GDP

Comments

- Fine paper, good analysis, interesting results
- Policy-rate effects on debt/GDP small
- Impulse responses not hump-shaped, less realistic
- Details of amortization modeling
- Distinction between maturity and loan length
- Optimal policy: Should include probability and magnitude of crisis, not just some weight on stabilizing debt/GDP
- With small effects on probability and magnitude of crisis, optimal policy may be some small LWW, not LAW (Svensson 2016)

Comments

- In summary, don't use monetary policy for financial-stability purposes
- There is no choice but to use macropru.
- In this paper: LTVs should have large effects
- What matters for financial stability is *resilience* (loss-absorption capacity (captial) of borrowers and lenders, debt-service capacity of borrowers, …)
- For sufficient resilience, macropru is needed
- Monetary policy cannot achieve sufficient resilience

Policy-rate effects on debt/GDP small: Simple model

Figure 1: Contractionary Monetary Policy Shock
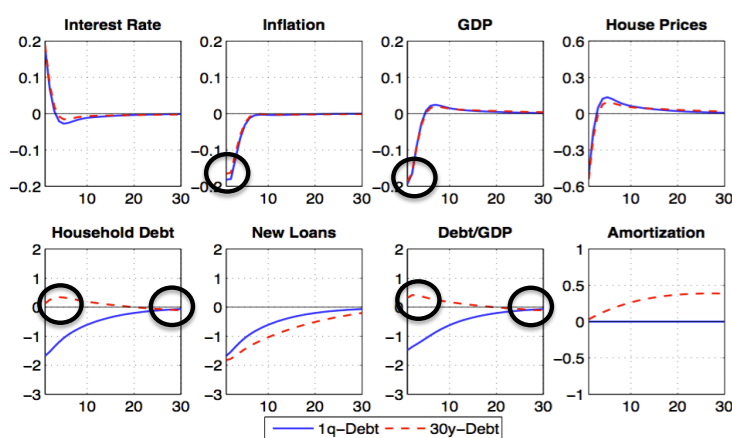
- Debt/GDP response small for persistent debt
- Can hardly affect probability and magnitude of crises
- Real-debt (and debt-growth) response also small
- Inflation, GDP impulse responses not hump-shaped, less realistic

Policy-rate effects on debt/GDP small: Calibrated & estimated model

Figure 9: Monetary Policy Shock - Impulse Responses
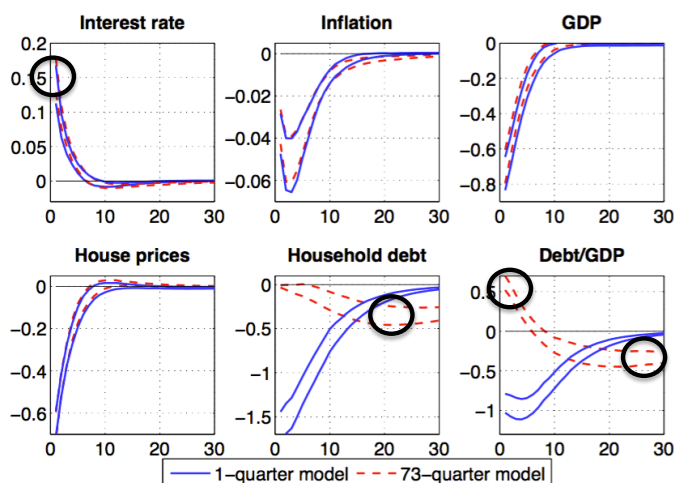
- Interest-rate shock somewhat smaller?
- Still small debt/GDP & real-debt response when persistent debt
- Can hardly affect probability and magnitude of crises
- GDP impulse response not hump-shaped, initial inflation response, less realistic

Details of amortization modeling

$$\delta_t = (1-\alpha)^\kappa + \frac{b_{b,t-1}}{\pi_t b_{b,t}}(1-\delta_{t-1})\left[\delta_{t-1}^\alpha - (1-\alpha)^\kappa\right]$$

- Amortization rate approximates annuity loan (higher amortization rate for old loans) (Kydland-Rupert-Sustek 2012)
- Also constant amortization rate; somewhat different results
- Maturity and average loan length not the same
  (30-yr mortgage, sell after 7 years)
- Alternative for Sweden (Svensson 2013):
  - No amortization, average loan length 7 years
  - 1/7 of the mortgage stock turned over each year
  - After 7 years, whole mortgage stock turned over, no long-run effects on mortgage stock
- In this paper, what if loan length is shorter than maturity?