Comments on “Macroprudential Policy in Central and Eastern European Countries”

Evan Kraft

American University

DEC 20, June 13, 2014

Déjà vu all over again

- In the mid-1990s, when the first Dubrovnik Conferences on Economies in Transition were held, big topics were:
    - Lending booms
    - Exchange rate regimes
    - The new global financial architecture
- Has anything changed?

Macroprudential policy—a new game in town

- During the 1990s, perhaps as a by-product of the Washington Consensus, all kinds of “administrative measures” were discouraged.
- But, as the paper shows, after the Tequila and Asian crises some regulators and national authorities went against this current and started to implement measures such as
  - Chile’s taxes on foreign transactions
  - Hong Kong’s LTV limits
  - Malaysia capital controls
- Such measures grew in number and eventually received a collective name

An ambitious and very broad paper

- Chronology and typology of macroprudential policy measures
- Descriptive, graphical and regression analysis of conditions leading to adoption of macropru measures
- Analysis of effectiveness of macropru measures

Suggestions: history of thought

- A way to trace this evolution might be to look at the theoretical works that identified market imperfections justifying "administrative measures."
- Literature on
  - capital inflow bonanzas, exchange rate overvaluation, sudden stops
  - Credit rationing, time-varying lending criteria
  - Asset price bubbles
- Need to provide a better foundation for the use of non-price mechanisms, later known as macroprudential

A historical reversal

- Under the Washington Consensus, what we would now call macropru was a “no-no”
- Then in the late 1990s/early 2000s, macropru was seen as a set of tools for countries whose financial markets and institutions were too “backward” to use interest-rate based monetary policy.
- Now macropru is being implemented by the most advanced countries as well, and many would argue that financial stability should be addressed with macropru, while price stability should be addressed through monetary policy.

An illustration: why monetary policy alone couldn’t stop lending booms in CEE

- CEE countries often faced lending booms in times of low inflation, so raising interest rates was not justified by the inflation target
- Borrowers could respond to increases in domestic currency interest rates by borrowing in fx
- With high levels of credit euroization, central banks are pressured to keep the exchange rate stable

Who adopts macroprudential measures?

- Simple 1 x 1 plots are thought-provoking
- Endogeneity is everywhere: eg from capital flows to GDP growth to macroprudential measures
- Analysis mitigates this by using lags, by many of the build-ups occur over quite a period of time and the explanatory variables affect each other
- Furthermore, many countries applied multiple measures, so it gets hard to disentangle

A word of caution on interpretation

- The OLS and Probit models produce sensible results
- However, they are ultimately descriptive and should be taken with a big grain of salt

Importance of Euroization

- CNB staff tend to see Euroization behind every bush
- Some countries adopted hard pegs not because of Euroization, but because of earlier loss of monetary policy credibility
  - Estonia, Bulgaria, Bosnia
- Euroization (usually emanating from the liability side) was not a key driver of either monetary policy design or even macropru design in quite a few countries
- Probably only Croatia, Serbia only countries where Euroization really dominated the discussion of monetary policy design.
- Even countries with fairly high Euroization levels like Slovenia did not really put this at the center of their attention

Importance of Swiss Franc lending

- Comes to the table much later, purely asset-side driven
- Key part of credit boom in Hungary, Poland, Croatia
- But since CB cannot control exchange rate with Swiss Franc, implications are different.
- A curiosity: populist pressures to compensate “victims” of swiss franc lending have been very successful!

Effectiveness of measures

- One of the biggest problems is distinguishing effect of a particular measure when many measures were implemented simultaneously or with great degrees of overlap
- No theoretical guidance about lags
- Paper follows Lim (2011) methodology

Results

- Makes sense that credit to households is more amenable to macropru than credit to businesses
- There was discussion at CNB of differentiating credit growth tax for loans to households from tax for loans to businesses, but feasibility was unclear
- Grain of salt: one-by-one method suffers from problems of overlap mentioned above

The future of macropru

- Its here to stay but….
- The financial industry will always try to evade
- A big danger is stimulation of shadow banking
- The next lending boom may not look like the last one in CEE
- But right now, a lending boom sounds really good!