Macroprudential polices in financial markets

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What are Macroprudential Policies?

- The objectives
  - Managing the economic cycle (as traditional macro policies)
  - Controlling “systemic risk” and “financial instability”

- The instruments
  - Capital buffers
  - Leverage ratios, and the alike
  - …

- The spill-overs and externalities
  - Across agents and institutions
  - Across countries (ADEMU)
  - Across time

- The constraints
  - Time inconsistency
  - Political economy

Macroprudential Policies in Theory

- Starting point: Modigliani-Miller

- Financial frictions matter because
  - Prevent the efficient allocation of capital
  - Lead to boom/bust cycles
  - Quantitative and welfare implications from the transmission of shocks
  - Generate distributive issues and make agent's heterogeneity relevant

- The many faces of financial frictions
  - Imperfect information
  - Moral hazard
  - Collateral constraints
  - Limited liability
  - ..and Regulatory Arbitrage

- Transmission mechanisms of shocks under financial frictions
  - Who bears the risk
  - Interactions with other distortions (in product, labour markets)

Macroprudential Policies in Theory (II)

- The research
  - DSGE models with one friction/one instrument at a time
  - Ad hoc modelling (default, etc.)
  - Computation/estimation techniques with some limitations
- Transmission mechanisms of shocks under financial frictions
  - Who bears the risk
  - Interactions with other distortions (in product, labour markets)
  - The importance of agents' heterogeneity (wealth distribution, etc,)

Exploring unknown territories without cartography

Macroprudential Policies in Practice (I)

- The operational framework
  - Who is in charge?
  - Interactions with monetary and other policies
  - Interactions among instruments: Which ones and when
  - Crisis prevention versus crisis resolution (ADEMU)

- The "state of the art"
  - A list of elements and generic concepts
  - Not everything is neither fully understood nor precisely measured
  - A regulatory framework extremely complex in micro-supervision and poorly/incompletely designed as far as macroprudential policies are concerned

Macroprudential Policies: Lessons from ADEMU

- Contagion across countries
  - Transmission mechanisms (Fornaro and Romei, 2018, Molteni 2018)
  - Limits to banks' holdings of sovereign debt

- Financial imbalances and crisis
  - Leverage bounds (Boháček)
  - The importance of aggregate shocks and non-linearities (Fernández-Villaverde, Hurtado and Nuño, 2018)

- Institutional mechanisms to controlling financial imbalances
  - Perennial question about monetary and macropru policies.
  - National and supranational institutions to make macropru policies operative

Final comment

- Leo Tolstoi: "*All happy families are alike, each unhappy family is unhappy in its own way*".
- Each financial instability episode, boom/bust cycle have different trade-offs between ex-ante efficiency and ex-post welfare costs.
- The future of macroprudential policies without cartography and without a fully operational framework.