The Toolkit of Policies in the Brave New World of Debt

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The Assignment

- Leverage
- Monetary Policy
- Fiscal Policy
- Macropredential Policy
“Tool Box” of Central Banks
My Comments

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- Leverage
- Interest Rates
- Balance Sheet Policy
- Targeted regulations
- General/cyclical buffers
- Fiscal policy
- Financial Stability
- Economic Stability

- Monetary Policy
- Macroprudential Policy
Channels of Monetary Policy

Source: Forbes (2021), Unwinding Stimulus in an Uneven Economy. Comments at Jackson Hole symposium.
US Household Debt Composition (2021 Q2)

- Mortgage: 70%
- Student Loan: 11%
- Auto Loan: 9%
- Credit Card: 5%
- Other: 5%

My Comments

Monetary Policy
- Balance Sheet Policy
- Interest Rates

Targeted regulations

Macroprudential Policy
- General/cyclical buffers

Leverage

Financial Stability
Economic Stability

Fiscal policy
Tools of Macroprudential Policy

Two broad categories:

- **General / Cyclical Regulations**
  - Capital/reserve/liquidity regs on all exposures
  - Counter-cyclical capital buffer (CCyB)

- **Targeted Regulations**
  - Regs for certain exposures (housing/FX/foreign)
  - Vulnerabilities to mortgage risk (LTV/DSTI)

New literature: can reduce targeted vulnerabilities in institutions subject to the regulations

- But also meaningful leakages & spillovers

**Targeted regulations generate more “risk shifting”**

- By volume
- To riskier intermediaries (*Monday presentations*)
Spillovers at the Extremes: The Macroprudential Stance and Vulnerability to the Global Financial Cycle

- Chari, Dilts-Stedman, and Forbes (2021)

**Key question:** does macroprudential policy affect the sensitivity of portfolio flows to risk shocks?

- New measure of macroprudential stance, captures intensity and type of instrument
- Weekly EPFR data on portfolio investment

**Large and significant amplification effects at “the extremes”**

- No effect “on average” or during “normal times”
- Larger effects during “risk off” shocks
- Larger effects for targeted regulations on bonds (FX & housing)
Amplification Effects of Macroprudential Tools Across the Risk Distribution

Notes: Based on results in Chari, Dilts-Stedman and Forbes (2021), Spillovers at the Extremes: The Macroprudential Stance and Vulnerability to the Global Financial Cycle. Figure shows a graphical representation of the results from Table 5 on the marginal effects of a 1 unit \textit{ex ante} increase in the MP Stance when interacted with Risk at different points in the Risk distribution.
Final Thoughts

- Roles for both monetary and macroprudential policy
- BUT--careful attention to **which tools** in each category
  - Balance sheet policy vs interest rates
  - Generalized buffers vs. targeted regulations
  - New opportunities thanks to expanded toolkit
- Evaluate not just the direct impact on aggregate leverage/exposures but resilience of who holds the exposures
Brave New World

Source: https://www.cchsvoice.org/book-review-brave-new-world/