



Monetary Policy and Financial *Instability*: An Integrated Micro-macro Approach

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■ Summary

- Interaction between FinStab and MonPol
 - Feedback mechanism
 - Combine micro and macro data/approach
 - VAR plus multi-period logit model
 - Part of small but growing literature that integrates FS and MP
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- Innovations
 - Nice data!
 - Use four composite bank distress events to proxy for FS
 - Focus on distress rather than credit risk proxy
 - Integrate FS proxy in VAR as LHS variable
 - MP shocks constructed s.t. they control for endogenous feedback from PD
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■ Findings

- Significant deterioration of FS in response to MP shock
 - Up to 35 (19, 17) percent of random variation in FS (Y, P) explained by MP shocks
 - No trade-off between FS and MP in “traditional” VAR (PD only on RHS)
 - Action only in automatic signals and FSA warnings
 - Impact of MP shock more severe if banking sector poorly capitalized
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- Paper's position in literature
 - Jacobson, Lindé, Roszbach, Exploring Interactions between Real Activity and the Financial Stance, JFS05
 - Pesaran, Schuermann, Treutler, Weiner, Macroeconomic Dynamics and Credit Risk: A Global Perspective - JMCB 2006
 - Castrén, Dées, Zaher, How do Global Macro-Financial Shocks Affect Corporate Sector Expected Default Frequencies in the Euro Area? ECB wp 2007.
 - DSGE with financial frictions
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■ Conclusion

- Nice data and innovations
- Well-executed (robust)
- Well-written
- Very relevant for policy
- Early contribution to growing field
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- Comments and questions
 - Tables and figures self-explanatory legends
 - Is RMSE in-sample or out-of-sample?
 - Do observation #s add up? (T.1 vs. T.A1)
 - PD in VAR from logit model or actual data?
 - If yes: Are PD forecasts from VAR consistent with those implied by the logit model?
 - If no: then there are no non-linearities in VAR
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- Comments and questions
 - Quarterly PD \ll Annual PD (Fig.1)
 - Why not consider big banks vs. small banks?
 - Consistent with Holod, Peek, Myhod
 - Why didn't you construct $D_I' = 1$ if $D_I > 0$ or $D_{II} > 0$
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- More comments and questions
 - What does model predict today?
 - Is not only financial statement data, but also macro data less informative for banks than for non-financial firms?
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■ Discussion

- What is financial stability?
 - How incorporate FS into MP model (DSGE dilemma), and vice versa?
 - Link between real economy, MP and banking stability (variables of interest)?
 - Interest margins / risk premia
 - Liquidity
 - Linkages (transparency of positions, institutions)
 - Default risk
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■ Discussion

- What must be in a FSMP model?
 - What models are best suited?
 - What has restricted development of models?
 - Availability of financial market data
 - Wish-list: real-time, more detailed, not end-of-quarter
 - How has crisis changed our wishes/needs?
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