MONETARY POLICY AND ENDOGENOUS FIANANCIAL CRISES

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MAIN PAPER MECHANISM

- Very interesting paper with a neat novel twist
- Standard New-Keynesian model
- Two types of firms:
  - Productive
  - Unproductive
  - All firms born with the same amount of capital

FRICTIONLESS MODEL

Unproductive firms lend all their capital to productive firms

FRICTIONAL CREDIT MARKET

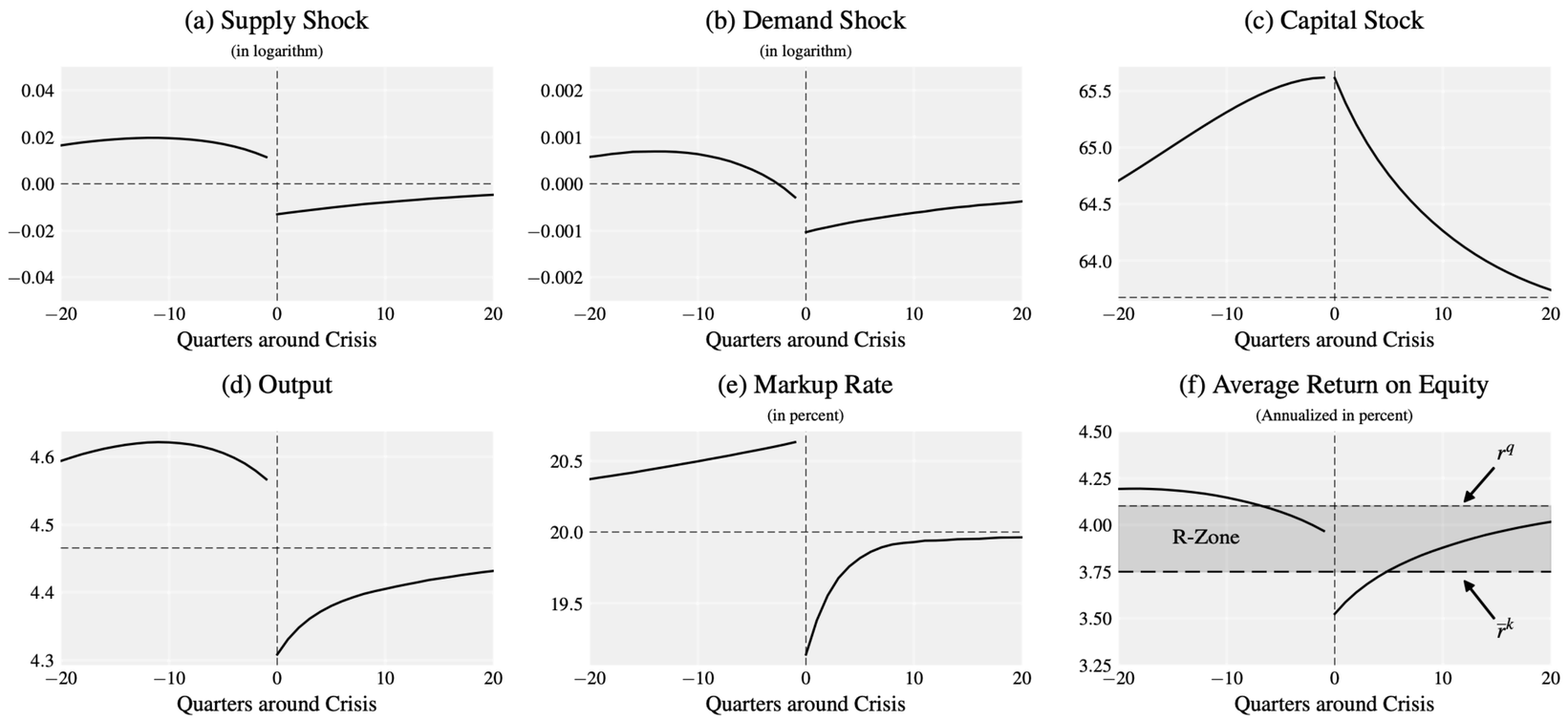
1. Two source of credit market frictions:
   A. Firms can default and they can seize part of the capital.
   B. Creditors do not observe firms' productivity

Frictionless equilibrium can arise

No trade of capital

ENDOGENEOUS FINANCIAL CRISES

Figure 3: Average Dynamics Around Crises



Notes: Average dynamics of the economy around the beginning of a crisis (in quarter 0) in the TR93 economy. To filter out the potential noise due to the aftershocks of past crises, we only report averages for new crises, *i.e.* crises that follow at least 20 quarters of normal times. In panels (a)-(e), the horizontal dashed lines correspond to the average values in the stochastic steady state. In panel (f), the upper horizontal dashed line corresponds to the deterministic steady state value r^q, the lower one to the crisis threshold $\bar{r}^k$, and the shaded area in–between to Greenwood, Hanson, Schleifer, and Sørensen (2022)'s "R–zone" —the region where the credit market is fragile.

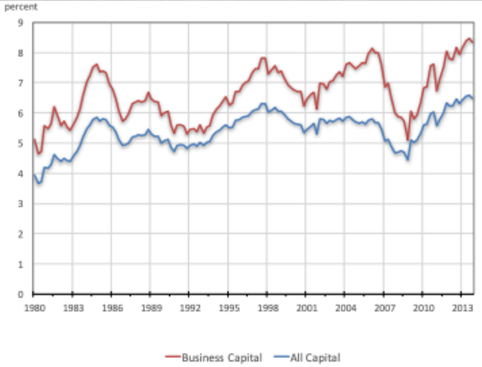
MY DISCUSSION

- Empirical evidence
- Policy Analysis

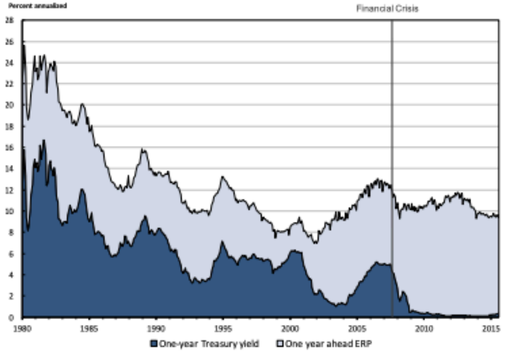
EMPIRICAL EVIDENCE

Return on capital and policy rate differ considerably

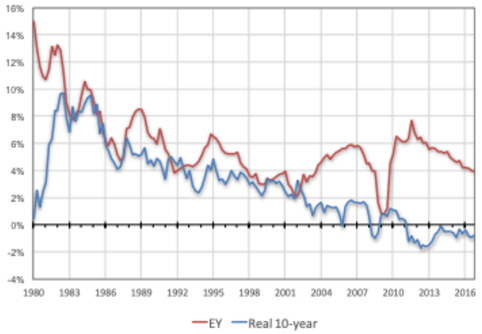
(a) Real Return U.S. Treasuries



(b) Real Return to U.S. Capital



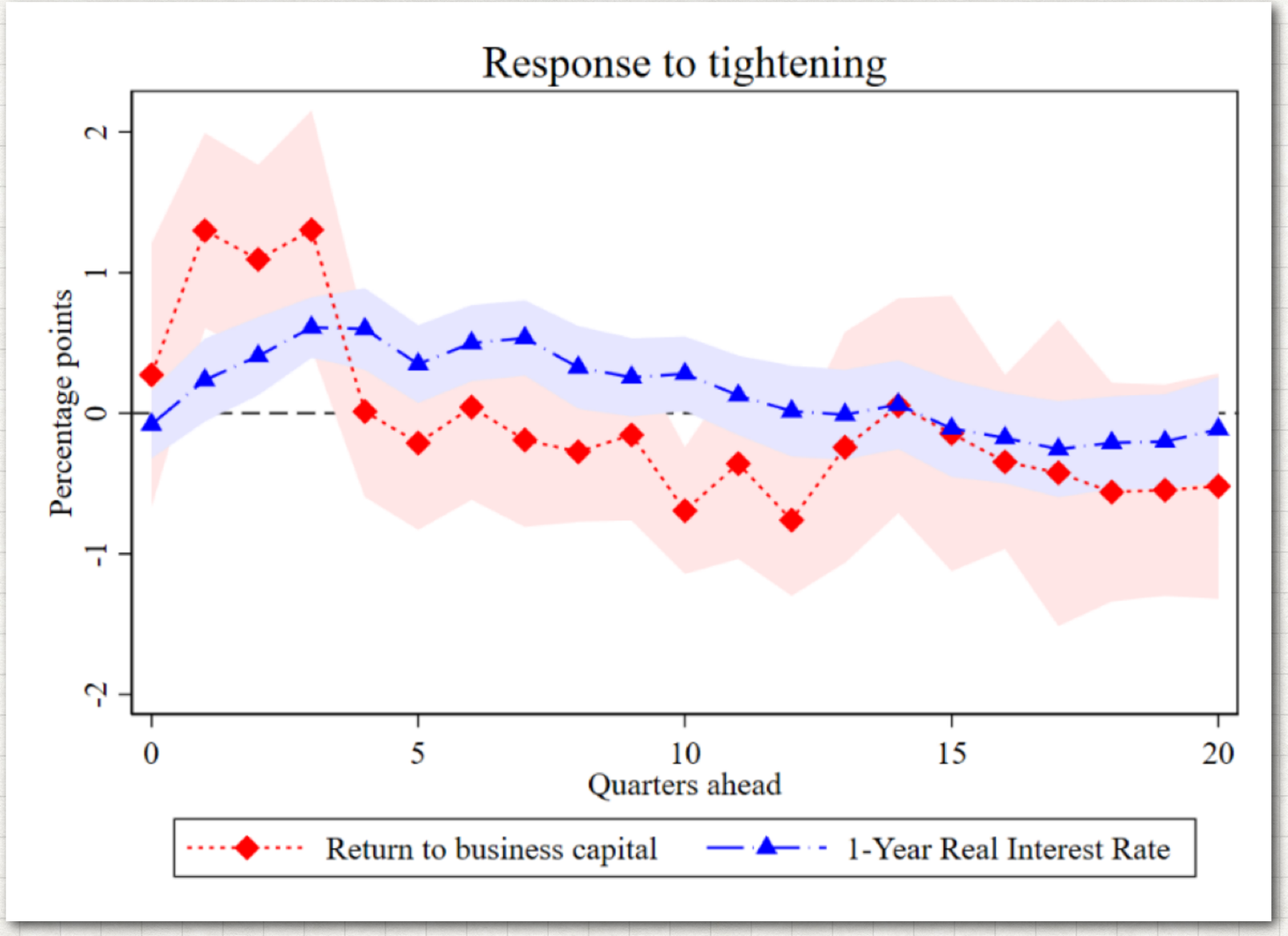
(d) U.S. Equity Risk Premium



(e) Earnings Yield S&P 500 and 10-year U.S. Treasury Yield

Caballero, Farhi and Gourinchas 2017.

EMPIRICAL EVIDENCE IN THE SHORT AND MEDIUM RUN



POLICY ANALYSIS

The paper compares different policies:

- Inflation target
- Standard Taylor rule
- Standard Taylor rule augmented with the yield gap
- Regime-contingent rule

Don’t you notice something missing?

MACROPRUDENTIAL POLICIES

Definition of financial stability

Financial stability can be defined as a condition in which the financial system – which comprises financial intermediaries, markets and market infrastructures – is capable of withstanding shocks and the unravelling of financial imbalances.

This mitigates the prospect of disruptions in the financial intermediation process that are severe enough to adversely impact real economic activity.

Explainer: Spotlight on financial stability

Macroprudential policies aim to:

- prevent the excessive build-up of risk, resulting from external factors and market failures, to smoothen the financial cycle (time dimension)
- make the financial sector more resilient and limit contagion effects (cross-section dimension)
- encourage a system-wide perspective in financial regulation to create the right set of incentives for market participants (structural dimension)

MACROPRUDENTIAL ANALYS

- In good times, central banks subsidize savings
- Capital will increase even more in good times, depressing the return on capital
- Increase the probability of a crisis occurence
- In this context, central banks should not play macroprudential policies
- Interesting to analyze how to implement this unconventional policies.

CONCLUSIONS

- Very interesting paper
- Novel mechanism and novel results
- Medium-term effect of monetary policy
- I would use it to analyze unconventional monetary policy and financial policies