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Citation: Beck, T. (2015). Macroprudential Policies and Housing Prices: A New Database and Empirical Evidence for Central, Eastern, and Southeastern Europe Discussion of Vandebussche, Vogel, and Detragiache. *Journal of Money, Credit and Banking*, 47(S1), pp. 379-381. doi: 10.1111/jmcb.12207

This is the accepted version of the paper.

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Link to published version: <https://doi.org/10.1111/jmcb.12207>

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Comments on Vandenbusche, Vogel and Detragiache: Macroprudential Policies and Housing Prices-A New Database and Empirical Evidence for Central, Eastern, and South-Eastern Europe

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Macro-prudential regulation has gained in importance over the past years, in the wake of the Global Financial Crisis and the realization that it is impossible to use one instrument (monetary policy) to target two objectives (price stability and financial stability) at the same time. In addition and related to this, consumer price and asset price inflation might not commove, so that targeting consumer price and asset price stability might require different policy tools. In the wake of the crisis, many countries have therefore expanded their regulatory toolkit with macroprudential instruments. Basel 3 also contains provisions for countercyclical capital buffers. On the other hand, the evidence on the effectiveness of these tools is still scarce. This paper breaks new ground in this respect, while at the same time opening the door for more research.

This paper assesses whether changes in macroprudential policies across 16 countries in Central, Eastern, and Southeastern Europe over the period 1997-2011 were associated with changes in housing prices. The authors find that some macroprudential policies, notably higher regulatory capital ratios and changes in the maximum ratio of household loans to capital as well as two types of non-standard liquidity measures had a significant correlation with house prices, while others (such as provisioning rules and reserve requirements) had no significant relationship. The authors also show that two of these four policies affect household credit growth, while the two others that are related to housing price growth are not related to credit growth.

The contribution of the paper, as I see it, is two-fold. First, it offers, for the first time, a data collection on macroprudential policy changes for a large group of countries. Second, it offers an analysis of the effectiveness of these policy changes. The sample countries offer a nice sample to explore these questions, as most of them experienced rapid financial deepening, which was often interpreted as convergence process. However, these countries' experience

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has also shown that there can be too much of a good thing – credit-fuelled housing price bubbles ending in systemic fragility. Another advantage of this sample is that there is significant variation in the degree to which macroprudential policies were applied.

The results are quite intriguing, especially the fact that rather crude measures such as changes in capital requirements work relatively well, while more targeted ones do not seem to work well. This is in line with other recent research that has shown that crude capital requirements, such as leverage ratios, might be more effective than more sophisticated capital adequacy requirements (e.g. Demirguc-Kunt, Detragiache and Merrouche, 2015). The authors, however, also recognize that there are definitional challenges in macroprudential regulation. First, the effect of macroprudential regulation on banks' credit decisions should be a function of the changes and the extent to which restrictions are actually binding, where the latter is harder to quantitatively capture than the former; this is a point to which I return below. Second, some policy changes might not be related to macroprudential objectives; are we still interpreting them in the context of macroprudential policy? Finally, and as pointed out by the authors, moral suasion might be an important policy tool, which is hard to capture quantitatively.

While the authors gauge the relationship between macroprudential policy changes and housing prices and household credit growth, one can consider a much broader set of outcome variables to be related to macroprudential policy changes. Banks' risk-taking and bank fragility are other important outcome variables. Ultimately, we are interested in knowing what macroprudential tools can be used and to which extent are they effective in reducing the risk of systemic bank fragility and, in the case of systemic banking crises, in reducing bank (and ultimately taxpayer) losses.

Given that this is one of the first papers in this literature, it falls somewhat short on several fronts, partly related to the aggregation level but also to the cross-country nature of the exercise. First, there is the issue of endogeneity, as recognized by the authors themselves. The authors argue that this might actually bias results against them and should make significant results more convincing. For policy advice, however, we need more reliable and robust estimates. Going forward, it will be therefore important to isolate exogenous variation in different macroprudential tools and policies to assess their importance for credit growth. Second, it is important to explore the mechanisms through which macroprudential policies

can influence asset price inflation and financial stability. The authors have taken a first step by considering credit growth. Credit growth, however, is a very aggregate indicator and might mask important shifts on a more disaggregated level.

Third, the impact of macro-prudential regulation might very well be a function of the structure and health of banks. While the authors control for these factors, they do not explore whether the effects of macro-prudential policies are conditional on the structure and health of the banking system. Banks might react differently to tightening macroprudential regulations if they are well capitalized than if they are in a fragile state and thus willing to gamble for resurrection. Similarly, the importance of herding effects has been established in the literature, which in turn can be a function of the competitive environment. Banks might react to macroprudential policies differently depending on how much competition they face, as they react differently in their risk-taking across different competitive environments depending on the regulatory framework they face (Beck, De Jonghe and Schepens, 2013). There are also important differences in the effectiveness of these policies according to the degree to which banks can escape them, being foreign branches or, being foreign subsidiaries, having arbitrage options through parent banks (Aiyar, Calomiris and Wieladek, 2014). These questions are important not just for academic interests, but also for purposes of external validity. If we find that certain policies work in country (group) A, how can we know they also work in country (group) B? Knowing the circumstances under which certain macroprudential policies do or do not work, will thus increase the external validity of the finding.

The shortcomings outlined above point to the use of micro data as the next step in the research agenda. The recent literature on monetary policy transmission has successfully used credit registry data to address both endogeneity biases and explore the transmission channels through which changes in monetary policy affects banks' risk taking decisions (e.g. Jimenez et al., 2014)). Such loan-level data could also help gauge the effectiveness of macroprudential policies. While the downside of going to country-level studies is obvious – reduction in external validity – they allow a much more clearly identified exploration of mechanisms through which macroprudential regulation can influence asset prices and credit growth. Gauging the effect of macroprudential policy changes on screening standards, pricing and other contract terms would give a better picture on how exactly banks adjust. It would allow differentiating between effects on the borrower population (extensive margin),

lending volume (intensive margin) and pricing and would thus also enable to better gauge the effect on mortgage holders and allow looking beyond aggregate household indebtedness. It would also allow exploring whether banks with different characteristics (including their capital and liquidity strength) react differently to such policy changes.

In summary, this is an important paper that is one of the first pieces of empirical evidence on the effectiveness of different macroprudential policies. It provides important impetus into further research. As most early papers in the literature, it provides first answers, but also puts additional questions on the table.

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