

Discussion of Darracq Pariès, Sørensen and Rodriguez Palenzuela & Discussion of Antipa, Mengus and Mojon

Matteo Iacoviello
Federal Reserve Board

RTF TF, December 1, 2010

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- Then, I learned I had to discuss two papers I did not know
- Yesterday, I realized I had to discuss **one paper I did not know...**
- ... and **one book I did not know**
(the paper by Matthieu, Christopher and Diego is 94 pages long)

Overall Considerations

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- Antipa, Mengus and Mojon (AMM) deal primarily with 1
Darracq Pariès, Sørensen and Rodriguez Palenzuela (DSR) deal primarily with 2.

So no future research is needed any longer, and we can write about something else.

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- Bank chooses θ_t balancing two considerations; consider raising θ_t
 $MB = p_t s_t$, p is probability of repay, s_t lending-deposit spread
 $MC = \kappa (\theta_t - \bar{\theta})$, where $\bar{\theta}$ is fraction of collateral that can be recovered
in equilibrium, p_t is a negative function of θ_t , given by $p_t = \bar{\theta} / \theta_t$
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- Idea: excess leverage occurs and default occur when individual lenders do not internalize that by lending more they reduce aggregate probability of repayment
- This idea is embedded in an estimated DSGE model where spread is assumed (?) to rise when policy rate falls, and where default is a choice variable for household.

AMM: Comments

- Not entirely clear to me how default works on borrowers' side; what is cost of defaulting on entire stock of debt? It would be important to clarify how one can get an internal solution for θ_t from borrower's perspective. From equation (7), it looks like gains are on average zero.

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 - In terms of dynamics, what are key elements relative to my previous work? To me, two new elements
 - (1) LTVs fall, defaults rise (how much?) when house prices fall (ok);
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- For estimation, measures of defaults and spreads could be useful.

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- Using the estimated model, DSR study the appropriateness of alternative monetary policy and macro prudential rules.

DSR: Comments

- DSR conclude that “... capital requirements have no tangible impact on the real allocation over the long term.” Is it because we are embracing a new standard too quickly? In GNSS, capital requirements do not impact long-run capital; yet policy debate on long-run costs of high capital requirements centers around this issue.

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- It would be also nice to do some counterfactual exercises. How would have variables evolved under the optimal rules being studied?
- Model is estimated using 15 variables and 15 shocks. Yet no variable informing about bank capital or defaults is used in estimation (bank capital cost parameter χ is unidentified according to authors).

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- Main suggestion for AMM: clarify how the default decision of the borrower works, and whether model generates realistic default rates over the business cycles. Likewise, for the loan supply function (and the LTV) of the bank.
- Main suggestion for DSR: for the next paper, first present a toy model that conveys the main intuition and can feature a shock that can make sense of the great recession (housing demand, bank capital shock, or something else....). Such a model has great potential to inform policy analysis.