Newsletter no. 38, October 2018

Research Newsletter

DeNederlandscheBank
EUROSYSTEEM

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Walk on the Wild Side: Temporarily Unstable Paths and Multiplicative Sunspots

Written by Guido Ascari, Paolo Bonomolo and Hedibert Lopes, forthcoming in the *American Economic Review*.

We study how time variation in the expectation formation process can generate unstable dynamics of macroeconomic variables.

The majority of macroeconomic models relies on the hypothesis of rational expectations to focus the analysis on a unique *stable* equilibrium, while *unstable* equilibria are excluded a priori. This practice limits the ability of the models to describe the unstable behavior that the data often display, such as period of high inflation, or boom and bust episodes in asset markets. Then, we propose a generalization of rational expectations to allow for *temporarily unstable* dynamics.

We apply our approach to study the Great Inflation period in the US. Under our framework, in some periods inflation expectations are anchored to the target, in other periods they are more based on past information. When the latter situation occurs, the self-fulfilling nature of

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Previous conferences

25-26 June 2018: *"Ten Years after the Global Financial Crisis: What Have We Learned about Ensuring Financial Stability?"*

Annual *International Journal of Central Banking* Research Conference Hosted by De Nederlandsche Bank (DNB) in Amsterdam, The Netherlands, June 25-26, 2018.

The *International Journal of Central Banking (IJCB)* research conferences bring together leading economists from central banks and academic institutions to consider issues of critical importance for policymaking focusing on topics related to financial stability and monetary policy. The conference at DNB had three sessions. The first one was on *macro-prudential tools*, with

two presentations: "Calibrating Macroprudential Policy to Forecasts of Financial Stability", written by Scott Brave and Jose Lopez (both from the Federal Reserve Bank of San Francisco) and "Can Macroprudential Measures Make Cross-Border Lending More Resilient? Lessons from the Taper Tantrum" written by Előd Takáts (Bank for International Settlements) and Judit Temesvary (Board of Governors of the Federal Reserve System). The second session focused on *bank capital*. Three papers were presented. The first one was "Impact of Higher Capital Buffers on Banks' Lending: Evidence from Euro Area Experiments", written by Zymantas Budrys (European University Institute), Giuseppe Cappelletti (ECB), Áurea Ponte Marques (ECB) and Paolo Varraso (New York University). The second paper was "Are Basel's Capital Surcharges for Global Systemically Important Banks Too Small?", written by Wayne Passmore and Alexander H. von Hafften (both from the Board of Governors of the Federal Reserve System). The final paper in this session was "The Rise of Shadow Banking: Evidence from Capital Regulation", written by Rustom Irani (University of Illinois at Urbana–Champaign), Rajkamal Iyer (Imperial College London), Ralf Meisenzahl (Board of Governors of the Federal Reserve System) and José-Luis Peydró (ICREA-Universitat Pompeu Fabra). The last session was about *monetary policy and financial stability policy interactions* and contained two papers: "A Quantitative Case for Leaning Against the Wind" by Andrew Filardo and Phurichai

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expectations leads to explosive dynamics. Moreover, this time variation in the expectation formation process yields drifting parameters and stochastic volatility. The empirical evidence suggests that the Great Inflation in the US can be explained by unstable dynamics. In our interpretation, the stagflation period in the Seventies is mainly caused by de-anchored drifting expectations.

Asymmetric Consumption Effects of Transitory Income Shocks

Written by Dimitris Christelis, Dimitris Georgarakos, Tullio Jappelli, Luigi Pistaferri and Maarten van Rooij, forthcoming in *The Economic Journal*

Using a representative survey of the Dutch population, this paper studies the empirical distribution of the marginal propensity to consume (MPC) in response to unexpected transitory income changes (positive and negative; small and large). The average MPC corresponding to non-durable consumption is between 15 and 25 percent (and between 35 and 50 percent when including durable expenditures). The MPC increases with the respondent's age and is larger at low levels of cash-on-hand. Most importantly, we find significant asymmetries between the MPC responses to positive and negative income changes. In particular, the MPC in response to a negative income shock is larger than the MPC in response to a positive shock. Furthermore, the size of the shock also matters, especially at low levels of cash-in-hand. For large positive unexpected changes in »

Rungcharoenkitkul (both from the Bank for International Settlements) and "Coordinating Monetary and Financial Regulatory Policies" written by Alejandro Van der Ghote (ECB).

DNB governor Klaas Knot provided some opening remarks. He paid ample attention to the interactions between monetary and financial stability policies. He argued that although they are distinct policies, with distinct objectives and instruments, the relationship between these policies merits further research given our limited understanding of how they may interact, especially in the context of very accommodative monetary policies over a prolonged period. He discussed how monetary policy can have important effects on financial stability through its impact on risk-taking of the financial system as a whole. He also called attention to how changes in prudential policy may affect banks' risk-taking, their financing conditions, balance sheet composition and size, and hence, monetary transmission. Knot emphasized that monetary and prudential policies and their effectiveness should not be assessed in isolation, acknowledging that both can benefit from taking a systemic view in which the interactions are considered.

5-6 July 2018: *"Sixth International Research Conference on Corporate Governance in Emerging Market"*

De Nederlandsche Bank hosted the Sixth International Conference on Corporate Governance in Emerging Market on July 5 and 6, 2018. The conference was co-organized by the Institute of Governance and Organizational Responsibility (*i*GOR) at Groningen University and the Emerging Markets Corporate Governance Network (EMCGN) with support from European Investment Bank and NN Investment Partners. The aim of the EMCGN is to promote the corporate governance policy agenda in emerging markets and transition economies. The Global Corporate Governance Forum (GCGF) at the International Finance Corporation (IFC) endorses and supports the Network.

The sixth conference focused on themes that were important to academics and practitioners interested in the role and effect of corporate governance in emerging markets and created a platform for research related discussions from both theoretical and policy perspectives. Academic researchers and policy makers from nineteen countries around the world gathered during this event. Twenty-three research papers were presented in seven thematically different sessions explore recurring issues in corporate governance research; such as governance in family-controlled firms, governance of financial institutions and related party transactions in controlled firms, as well as less studied topics such as the effect of board gender quotas on firm performance in an emerging market context. The conference was concluded with a panel discussion on a contested subject by governance practitioners; implementing Environmental, Social and Governance in emerging markets. The panel underlined the fact that more work on the role of corporate governance for environmental performance, and other social concerns, including poverty and inequality, would be very valuable.

The keynote speech of the conference was delivered by Simeon Djankov (Executive Director, Financial Markets Group Research Center, LSE; former Minister of Finance, Bulgaria). Djankov, in his speech on "The Future of Work in Emerging Markets: Governance and Finance Challenges", focused on how the nature of work is changing as a result of advances in technology. The main key points in Djankov's speech were as follows: A first priority should be significant investments in human capital throughout a person's lifecycle in this rapidly »

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income, consumers are more likely to overcome liquidity constraints and therefore the corresponding MPC is smaller than for small positive income shocks. The empirical estimates confirm results from a simple simulation analysis and are broadly in line with models of intertemporal choice with precautionary saving, borrowing constraints and finite horizons.

An important advantage of our survey design is that we are able to compare the responses to the hypothetical positive and negative income changes for the same household. Using the within-household MPC differences, we can classify households according to the predictions of economic models of consumption behavior. About four in ten respondents provide symmetric MPCs in response to shocks of different size and direction (as predicted by the permanent income hypothesis). Likewise, a four in ten respondents report asymmetric responses as predicted by models with liquidity constraints. And about a fifth of respondents display asymmetric MPCs that are inconsistent with these standard models and could be related to behavioral biases in decision-making or low financial sophistication.

Our research findings contain important lessons for predicting consumption responses to policy interventions that affect household incomes, such as changes in policy interest rates, tax reforms, money transfers and other redistributive policies. Our results suggest that the effects of a temporary policy intervention depend on the distribution of household resources, and that negative changes in income have more impact on consumption than positive shocks.

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changing environment. In addition to investments in human capital, the changing nature of work demands updates to social protection systems. Traditional provisions of social protection based on steady wage employment, clear definitions of employers and employees, as well as a fixed point of retirement become increasingly obsolete. Improved private sector policies to encourage startup activity and competition can also help countries to compete in the digital age. Djankov also stressed that governments will need additional revenues to fund the investments demanded by the changing nature of work.

The conference was a success to reach to the aim of the network as building global links, encouraging research collaboration and facilitating outreach. For the future of the conference series, Stijn Cleassens (the chair of the EMCGN) believes that there is still a need, however, to assure that research continues to improve and that research on individual countries is better disseminated to share methodologies and, to the extent possible, generalize lessons. In addition, while substantial reforms have taken place in many (developing) countries, the outcome of these reforms has not been yet fully captured by academic research.

Future conference

21st Annual Research Conference De Nederlandsche Bank Amsterdam, 12-13 November 2018 UNCLOGGING THE CREDIT CHANNEL

MONDAY, 12 November 2018

8:45-9:30 Registration with coffee/ tea
9:30-9:45 Opening address: **Jan Marc Berk** (Division Director Economic Policy and Research, DNB)

SESSION I: (Un)conventional monetary policy and credit channel
Chair: **Christiaan Pattipeilohy** (DNB)

9:45-10:45 The signaling channel of negative interest rates
Presenter: **Oliver de Groot** (DIW)
Discussant: **Paolo Bonomolo** (DNB)
10:45-11:15 Coffee break
11:15-12:15 Credit supply and demand in unconventional times *Presenter*: **Sarah Holton** (European Central Bank) *Discussant*: **Ibolya Schindele** (Central Bank of Hungary)
12:15-13:30 Lunch in Foyer
13:30-14:30 Keynote Address: **Simon Gilchrist** (Boston University)

SESSION II, Part 1: Credit market frictions and debt-overhang
Chair: **Andrea Colciago** (DNB)

14:30-15:30 The aggregate effects of credit market frictions: evidence from firm-level default assessments
Presenter: **Isabelle Roland** (University of Oxford, LSE)
Discussant: **Vivien Lewis** (Deutsche Bundesbank)
15:30-16:00 Coffee break
16:00-17:30 Policy Panel: **Simon Gilchrist** (Boston University)**, Atif Mian** (Princeton University)**, Leonardo Gambacorta** (BIS)
Moderator: **Jakob De Haan** (DNB, University of Groningen)
18:30-21:30 Conference Dinner (*by invitation*)

TUESDAY, 13 November 2018

08:45-09:15 Registration with coffee/tea

SESSION II, Part 2: Credit market frictions and debt-overhang
Chair: **Andrea Colciago** *(DNB)*

09.15-10:15 Bank bailouts, debt-overhang and macroeconomic fluctuations
Presenter: **Mark Mink** (DNB)
Discussant: **Andrea Gerali** (Bank of Italy)

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SESSION III: Expectations and credit cycles
Chair: **Gabriele Galati** (DNB)

10:15-11:15 Default cycles
Presenter: **Wei Cui** (University College London)
Discussant: **Francesco Zanetti** (University of Oxford)
11:15-11:30 Coffee break
11:30-12:30 Funding shocks and credit quality
Presenter: **Magdalena Rola-Janicka** (University of Amsterdam)
Discussant: **Kalin Nikolov** (European Central Bank)
12:30-13:30 Lunch in Foyer
13.30-14:30 **Keynote speech**: **Atif Mian** (Princeton University)
14:30-15:00 Coffee break

SESSION IV: Macroprudential policies: bank and non-bank credit
Chair: **Aerdt Houben** (DNB)

15:00-16:00 The forced safety effect: how higher capital requirements can increase bank lending
Presenter: **Saleem Bahaj** (Bank of England)
Discussant: **Caterina Mendicino** (European Central Bank)
16.00-16.15 Coffee break
16:15-17:15 Implications of shadow bank regulation for monetary policy at the zero lower bound
Presenter: **Falk Mazelis** (European Central Bank)
Discussant: **Margarita Rubio** (The University of Nottingham)

DNB workingpapers

Since June 2018 the following Working Papers have been published, please use the following Link:

- **596** - Liquidity regulation, the central bank and the money market, Julia Körding and Beatrice Scheubel - 1 June 2018
- **597** - Walk on the wild side: Multiplicative sunspots and temporarily unstable paths, Guido Ascari, Paolo Bonomolo and Hedibert Lopes - 1 June 2018
- **598** - Macroprudential policy and income inequality, Jon Frost and René van Stralen - 1 June 2018
- **599** - Counterparty credit risk and the effectiveness of banking regulation, Sînziana Kroon and Iman van Lelyveld - 26 June 2018
- **600** - European banks after the global financial crisis: Peak accumulated losses, twin crises and business models, Leo de Haan and Jan Kakes - 3 July 2018
- **601** - The relation between supply constraints and house price dynamics in the Netherlands, Bahar Öztürk, Dorinth van Dijk, Frank van Hoenselaar and Sander Burgers - 18 July 2018
- **602** - Herding behavior of Dutch pension funds in asset class investments, Ian Koetsier and Jacob Bikker - 24 July 2018
- **603** - Benchmark selection and performance, Dirk Broeders and Leo de Haan - 2 August 2018
- **604** - How internal and external supervision impact the dynamics between boards and Top Management Teams and TMT reflexivity, Melanie de Waal, Floor Rink, Janka Stoker and Dennis Veltrop - 15 August 2018
- **605** - Drivers of market liquidity - Regulation, monetary policy or new players? Clemens Bonner, Eward Brouwer and Iman van Lelyveld - 17 September 2018
- **606** - Pension fund equity performance: Patience, activity or both? Tanja Artiga Gonzalez, Iman van Lelyveld and Katarina Lucivjanska - 21 September 2018

DNB occasional studies

Since June 2018 the following occasional studies have been published, please use the following Link:

- **Nr 3 (2018):** The natural rate of interest from a monetary and financial perspective by Dennis Bonam, Peter van Els, Jan Willem van den End, Leo de Haan and Irma Hindrayanto (June 2018)
- **Nr 4 (2018):** Revisiting the central bank's lender of last resort function by Joost Bats, Jan Willem van den End, John Thoolen (July 2018
- **Nr 5 (2018)**: DELFI 2.0, DNB's Macroeconomic Policy Model of the Netherlands by Robert-Paul Berben, Ide Kearney and Robert Vermeulen (September 2018)

Published Articles in Journals

A descriptive model of banking and aggregate demand, Jochen Mierau and Mark Mink, *De Economist*, 2018, 166, 207-237

For published articles in journals please use the following Link:

Forthcoming Articles in Journals

- **Pension profile preferences: the influence of trust and expected expenses,** Carin van der Cruijsen and Nicole Jonker, *Applied Economics*
- **Learning Dynamics in the Formation of European Inflation Expectation** Christina Bräuning and Carin van der Cruijsen, *Journal of Forecasting*
- **Applying complexity theory to interest rates: Evidence of critical transitions in the euro area,** Jan-Willem van den End, *Credit and Capital Markets*
- **Financial institutions' business models and the global transmission of monetary** ››

policy, Isabel Argimon, Clemens Bonner, Ricardo Correa, Patty Duijm, Jon Frost, Jakob de Haan, Leo de Haan and Viktors Stebunovs, *Journal of International Money and Finance*

- **Asymmetric consumption effects of transitory income shocks,** Dimitris Christelis, Dimitris Georgarakos, Tullio Jappelli, Luigi Pistaferri and Maarten van Rooij, *The Economic Journal*

- **Does the media help the general public in understanding inflation**? David-Jan Jansen and Matthias Neuenkirch, *Oxford Bulletin of Economics and Statistics*

- **Walk on the wild side: Multiplicative sunspots and temporarily unstable paths,** Guido Ascari, Paolo Bonomolo and Hedibert Lopes, *American Economic Review*

For forthcoming articles in journals please use the following link: Link

Forthcoming Articles in Books

- **ECB communication: effects on expectations**
  Jakob de Haan
  In: Jaques Ziller (ed.), *The European Central Bank's Communication: An Instrument of Monetary Policy and a Vector of Accountability*, Giappichelli

- **The banknote designer and the banknote design manager: Who does what?**
  Hans de Heij
  International Banknote Designers Association, Lausanne

- **Detection and explanation of anomalies in real-time gross settlement systems**
  Ron Triepels, Hennie Daniels and Ronald Heijmans
  Springer Lecture Notes in Business Information Processing

- **Competition in EU banking**
  Olivier de Jonghe, Maaike Diepstraten and Glenn Schepens
  In: T. Beck and B. Casu (Eds.), *The Palgrave Handbook of European Banking*, Palgrave Macmillan

For forthcoming articles in books please use the following Link

Published Articles in Books

- **Zahlungsverhalten in den Niederlanden – eine Fallstudie**, Sascha Füllbrunn and Carin van der Cruijsen, Chapter 14 in: Lempp J., Pitz T., und Sickmann J. (eds), *Die Zukunft des Bargelds*. Wiesbaden: Springer Gabler, 2018, 205-217

- **The struggle of German central banks to maintain price stability**, Jakob de Haan in: Rodney Edvinsson, Tor Jacobson, and Daniel Waldenström (eds.), *Sveriges Riksbank and the History of Central Banking*, 2018, Oxford University Press

- **Structural Reforms: An Introduction**, Jakob de Haan and Jante Parlevliet, in: Jakob de Haan and Jante Parlevliet (eds.), *Structural Reforms - Moving the Economy Forward*, 2018, Springer

- **Structural Reforms - Moving the Economy Forward**, Jakob de Haan and Jante Parlevliet (eds.), Springer, 2018

- **Competition and prices by bank service line**, Wilko Bolt and David Humphrey in: J. Bikker and L. Spierdijk (eds.), *Handbook on Competition in Banking and Finance*, 2018, Edward Elgar

- **The politics of central bank independence**, Jakob de Haan and Sylvester Eijffinger in: R. Congleton, B. Grofman and S. Voigt (eds.), *Oxford Handbook of Public Choice*, 2018, Oxford: Oxford University Press

- **Central bank communication: How to manage expectations?**
  Jakob de Haan and Jan-Egbert Sturm in: D. Mayes, P. Siklos and J-E. Sturm (eds.), *Handbook on the Economics of Central Banking*, 2018, Oxford: Oxford University Press

- **The case for more fiscal risk sharing and coordination of fiscal and monetary policy**, Jakob de Haan and Patrick Kosterink
  in: Nauro Campos and Jan-Egbert Sturm (eds.), *Bretton Woods, Brussels and Beyond: Redesigning the Institutions of Europe*, 2018, CEPR ebook

- **Central bank policies after the crisis**, Alan Blinder, Michael Ehrmann, Jakob de Haan and David-Jan Jansen
  in: S.C.W. Eijffinger and D. Masciandaro (eds.), *Hawks and Doves, Deeds and Words*, 2018, CEPR ebook, 97-103

- **Utility-equivalence of pension security mechanisms**, Dirk Broeders, An Chen and Birgit Koos in: J.A. Bikker (ed.), *Pension Fund Economics and Finance*, 2018, Routledge, London, 233-250

- **Pension fund economics and finance: efficiency, investments and risk-taking**, Jacob Bikker (ed.), Routledge, 2018

For published articles in books please use the following Link:

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