Discussion on "Implications of Shadow Bank Regulation for Monetary Policy at the Zero Lower Bound" by Falk Mazelis

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Introduction

- In the post GFC world, there are new challenges to the conduct of macro-financial stabilization policies
  - Institutions/Sectors that escape regulation
  - Low interest-rate environment

This paper

- Focuses on monetary policy
- Two research questions:
    - How does a monetary tightening affect shadow banks differently from traditional banks?
    - Are there any implications at the ZLB?

Q1: Shadow Banking

Former US Federal Reserve Chair Ben Bernanke, November 2013

"**Shadow banking**, *as usually defined, comprises a diverse set of institutions and markets that, collectively, carry out traditional banking functions — but do so outside, or in ways only loosely linked to, the traditional system of regulated depository institutions*".

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Shadow Banking and Policies

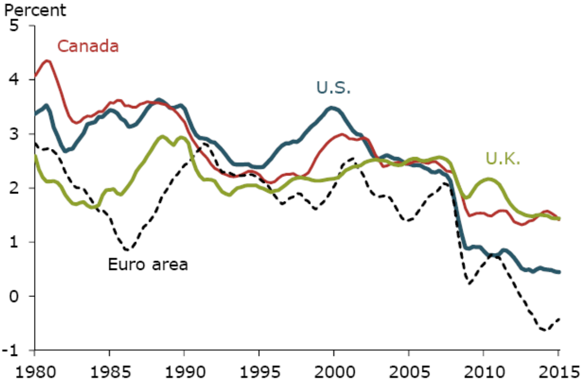
- Shadow banking is an issue of concern among policy makers
- It can be used to circumvent policies aimed at preventing excessive credit growth
    - Macroprudential policies
    - Monetary policy tightening => THE FOCUS OF THIS PAPER

Q2: The ZLB

- We live in a low interest-rate environment
  - Low interest rates make the economy more prone to hit the ZLB
  - Low neutral rates limit the scope of conventional monetary policy in stabilizing the economy, especially when it hits the ZLB
  - Low interest rates raise concerns about financial imbalances and risks to financial stability

Evidence

Figure 1
Estimated inflation-adjusted natural rates of interest



Source: Holston, Laubach, and Williams (2016); data are four-quarter moving averages.

Simulations

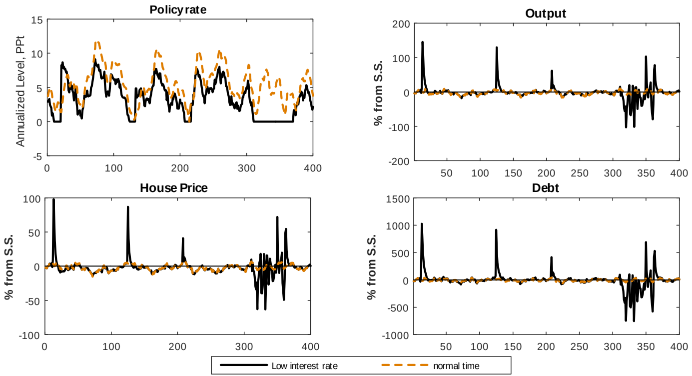


Figure: Simulated economy for productivity shocks. "Normal times" (4% SS interest rate) vs. "Low interest rate" (2% SS interest rate). Source: Rubio and Yao (2017)

Shadow banking+ZLB

- This paper touches upon two key issues for policy making
  - That makes the paper extremely relevant!

The model

- A standard monetary DSGE model
  - Financial sector with commercial banks, shadow banks and investment funds
- Bayesian estimation

Main Results

- The presence of shadow banks make financial markets more unstable
- A monetary policy tightening affects financial institutions in different ways: banks decrease lending, while shadow banks and investment funds increase lending => Leakages from monetary policy
- A recessionary demand shock that moves the economy to the ZLB has similar effects to a monetary tightening due to the inability to reduce the policy rate below zero

Costs and Benefits of Shadow Banking

- There is consensus that a large shadow banking sector endangers financial stability $=>$ THIS PAPER EXPLICITLY ACCOUNTS FOR THAT
- However, it may promote the flow of credit and therefore be beneficial for growth
  - Could we find an equilibrium between these opposing forces?

Example

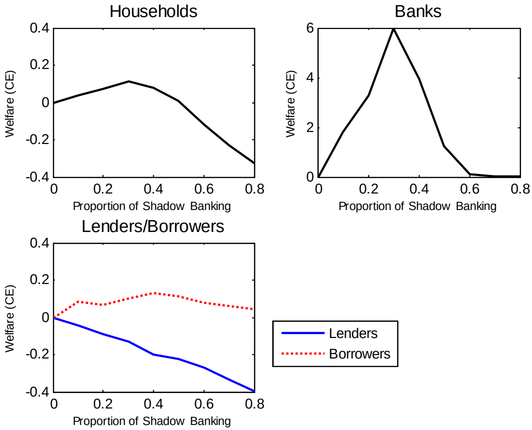


Figure: Welfare values (Consumption Equivalents) implied for different proportions of shadow banking. Source: Rubio (2018)

Welfare Analysis

- Results show that shadow banks promote financial instability => Is that necessarily welfare-decreasing?
- The paper would benefit from some welfare analysis to disentangle the welfare mechanisms and finding an optimal size of the shadow banking sector
  - It is a DSGE => Technology is there!

Macropru/Financial regulation

- Both shadow banks and the ZLB pose financial stability issues
- This calls for the use of macropru
- The paper does not touch upon this topic

Macropru and monetary policy interaction

- Stricter banking regulation (LTV, CRR) could complement the effects of monetary policy, especially at the ZLB
  - The paper would benefit from some macropru and monetary policy interaction

Conclusion

- The paper touches upon a very policy-relevant topic
- The analysis is rigorous and well executed
- I miss some welfare evaluation and some interaction between monetary and macropru policies