Cyclical American Macroprudential Policy

Douglas J. Elliott, Greg Feldberg, Andreas Lehnert

May 8, 2014

Conference on Bank Structure and Competition

Federal Reserve Bank of Chicago

Macroprudential Policy

- Policies that strengthen the financial system and/or slow credit growth
  - Focus here on "Cyclical macroprudential policies to slow credit growth" which we'll just call "macroprudential policy"
- Evidence that excessive credit growth leads to financial crises (Borio, Schularick & Taylor)
  - So constraining excessive credit growth prevents crises?
- Don't know how effective MP tools will be at slowing credit growth
  - May get insight from Asia, Canada in coming months/years
- Macroprudential tools touted as novel but were commonly used in U.S. through 1980 or so

Our Contribution

1. Create comprehensive time series of U.S. macropru actions & make available to others

2. Document the political/policy debate around the use of tools

3. Estimate quantitative impact of tools on credit growth

Findings—1

- U.S. has long tradition of targeting credit growth

- Tools of choice shifted over the years
  - Reaction to financial innovation
  - Perceived urgency of need to control credit
  - Concerns about disparate impact

Findings—2

- Relative to monetary policy:
  - Administratively more complex
  - More intrusive

- Statistical results
  - Asymmetric effect: more effective at *tightening* credit than *easing* credit.
  - MP policy affects <u>consumer</u> credit growth but not <u>bank</u> credit growth

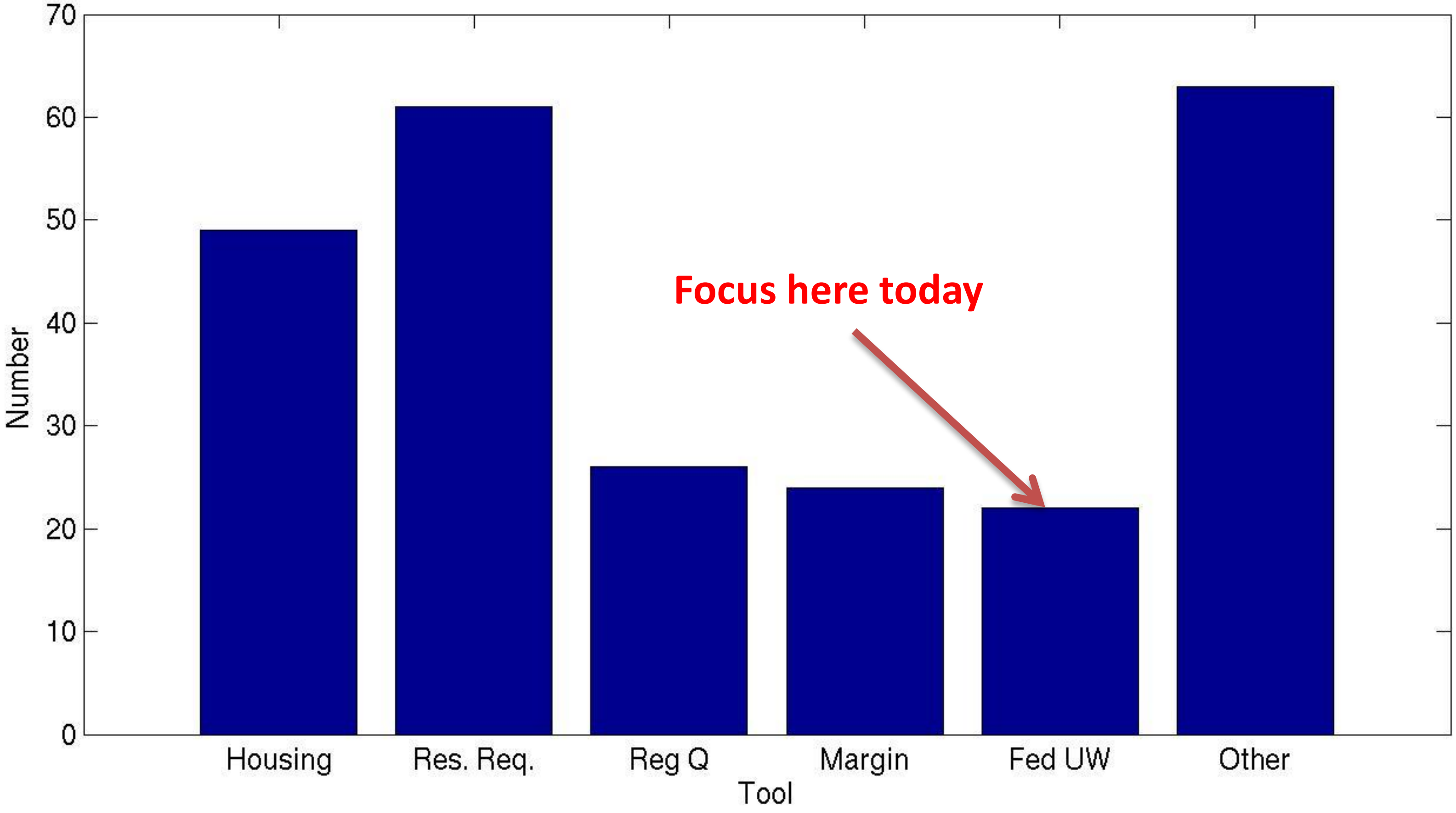
Full Dataset

- We identified 245 separate MP actions from 1913 to 1992
- Coded each one as “easing” or “tightening”
- Did not attempt to measure magnitude of actions

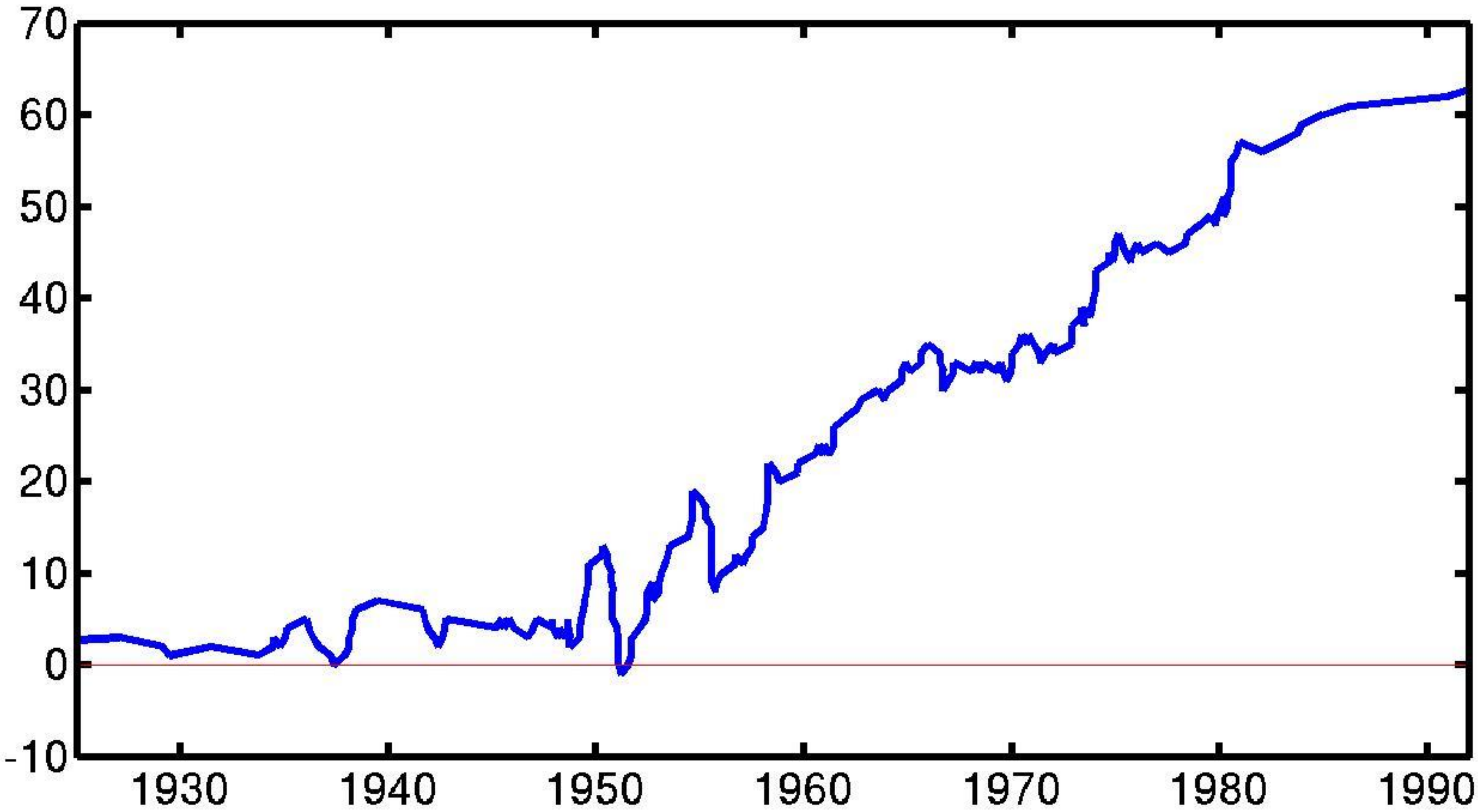
Types of MP Tools

1. Underwriting standards (LTV & maturity)
2. Margin requirements (Regs T & U)
3. Limits on portfolios (mainly at banks)
4. Reserve requirements
5. Bank liability rate ceilings (Reg Q)
6. Capital requirements
7. Supervisory pressure (e.g. SR letters)

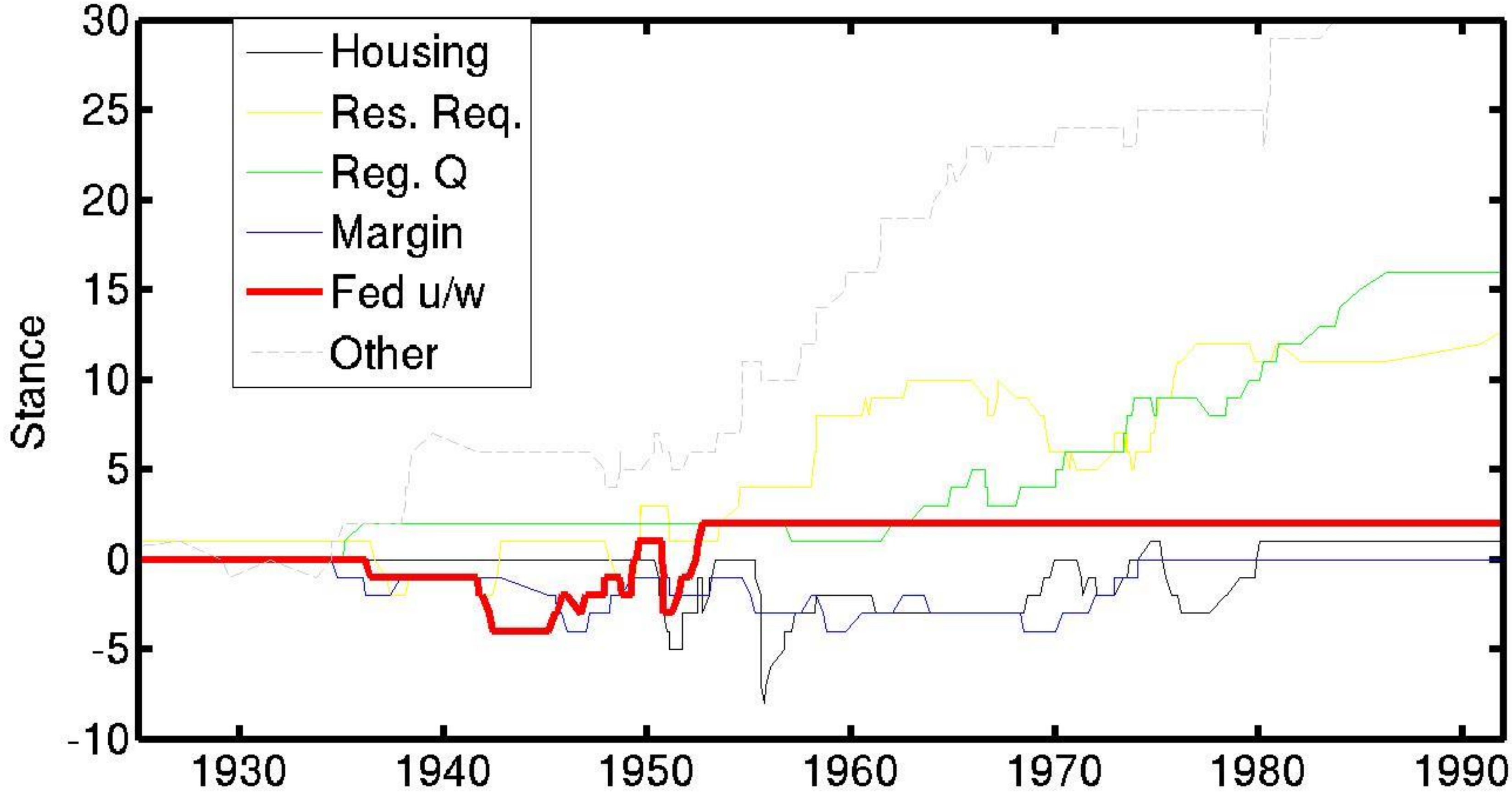
Macroprudential tool use: 1913—1992



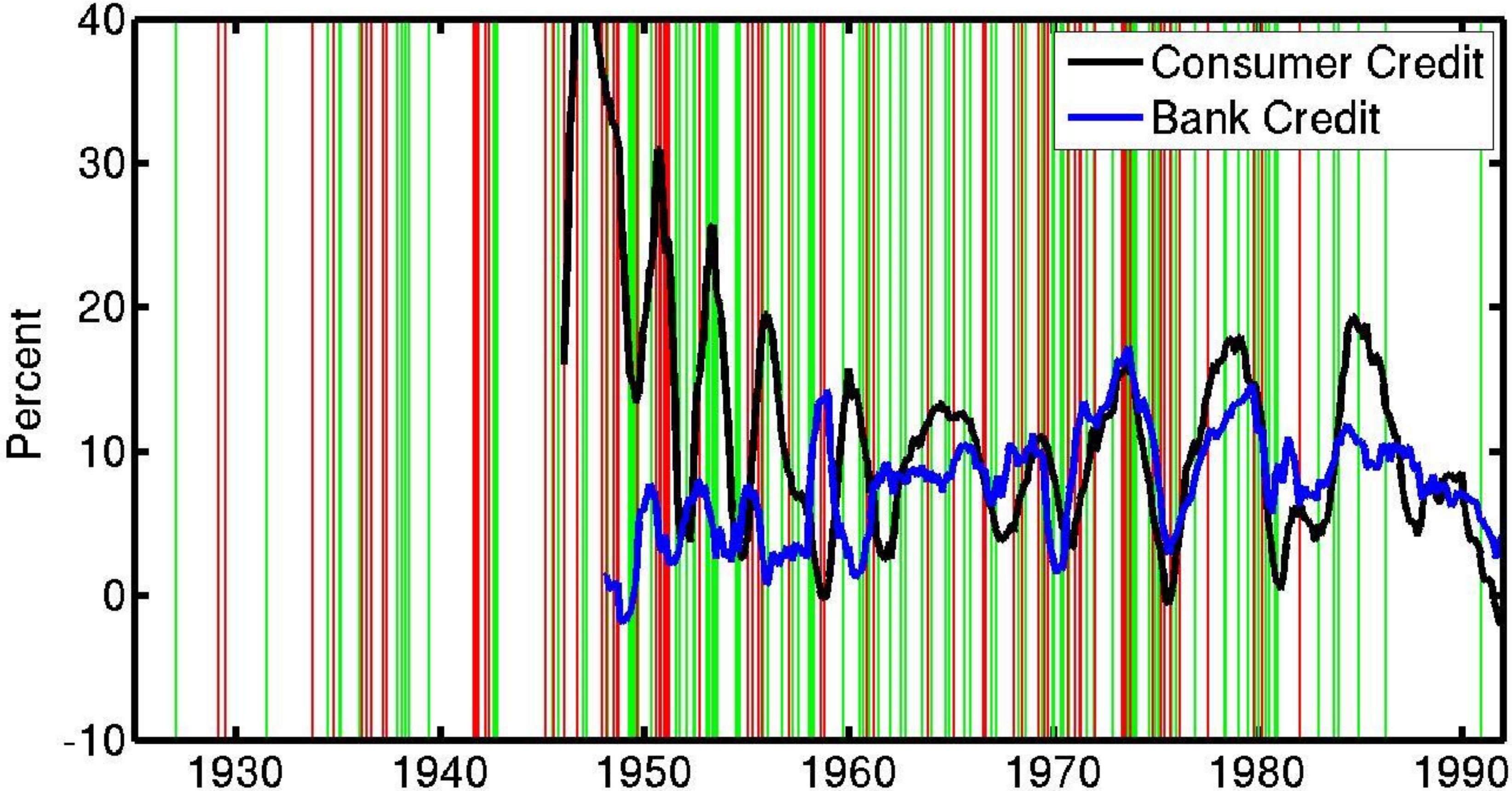
Macroprudential stance: Net number of MP easings (tightenings) 1913—1992



Macroprudential stance: Net number of MP easings (tightenings) 1913—1992 by tool



Macroprudential stance: MP easings (green) and tightenings (red) and year-on-year percent change in consumer credit and bank credit.



Underwriting Standards: Implementation History

- Focus from 1863 to 1941 was on mortgages
  - 1863 to Great Depression: safety & soundness, ability of banks to handle maturity mismatch
  - 1934 to 1941: FHA created to <u>ease</u> credit
- 1941 to 1952: Focus on <u>consumer credit</u>-- Selective credit controls (Regs W and X)
- 1950s: FHA underwriting to combat perceived housing boom
- 1969 and 1980: Credit Control Act (repealed 1982)—striking example (technically a reserve requirement on all lenders)

Underwriting Standards: Debate

Roosevelt 1941: "[l]iberal terms for such credit tend to stimulate demand for consumers' durable goods the production of which requires materials, skills, and equipment needed for national defense"

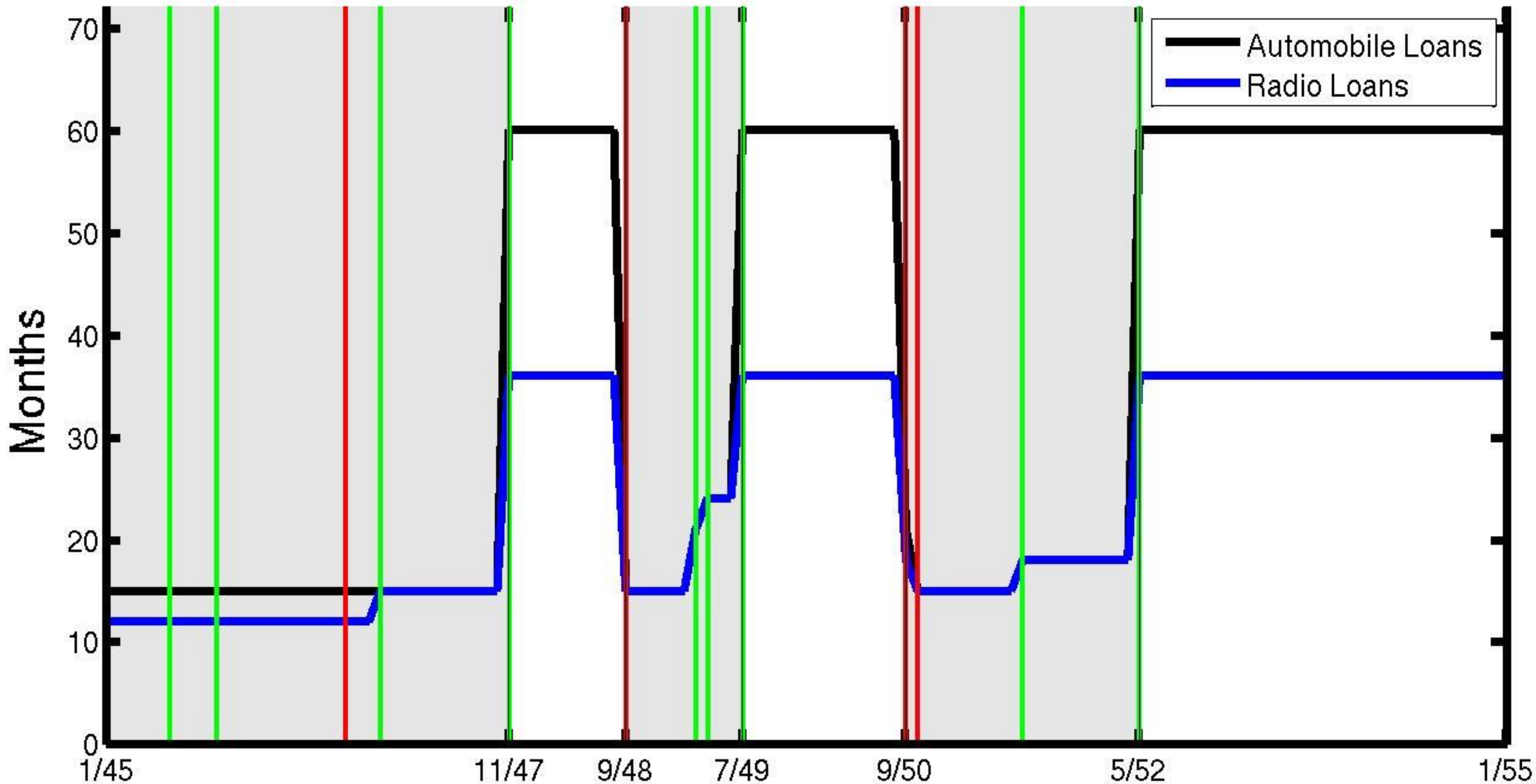
ne

upswings and downswings of the business cycle. **There is no way of preventing such excessive expansion and contraction except government regulation of the terms on which consumer credit shall be made available**, such as the down payment required on installment sales or financing and the length permissible for installment contracts

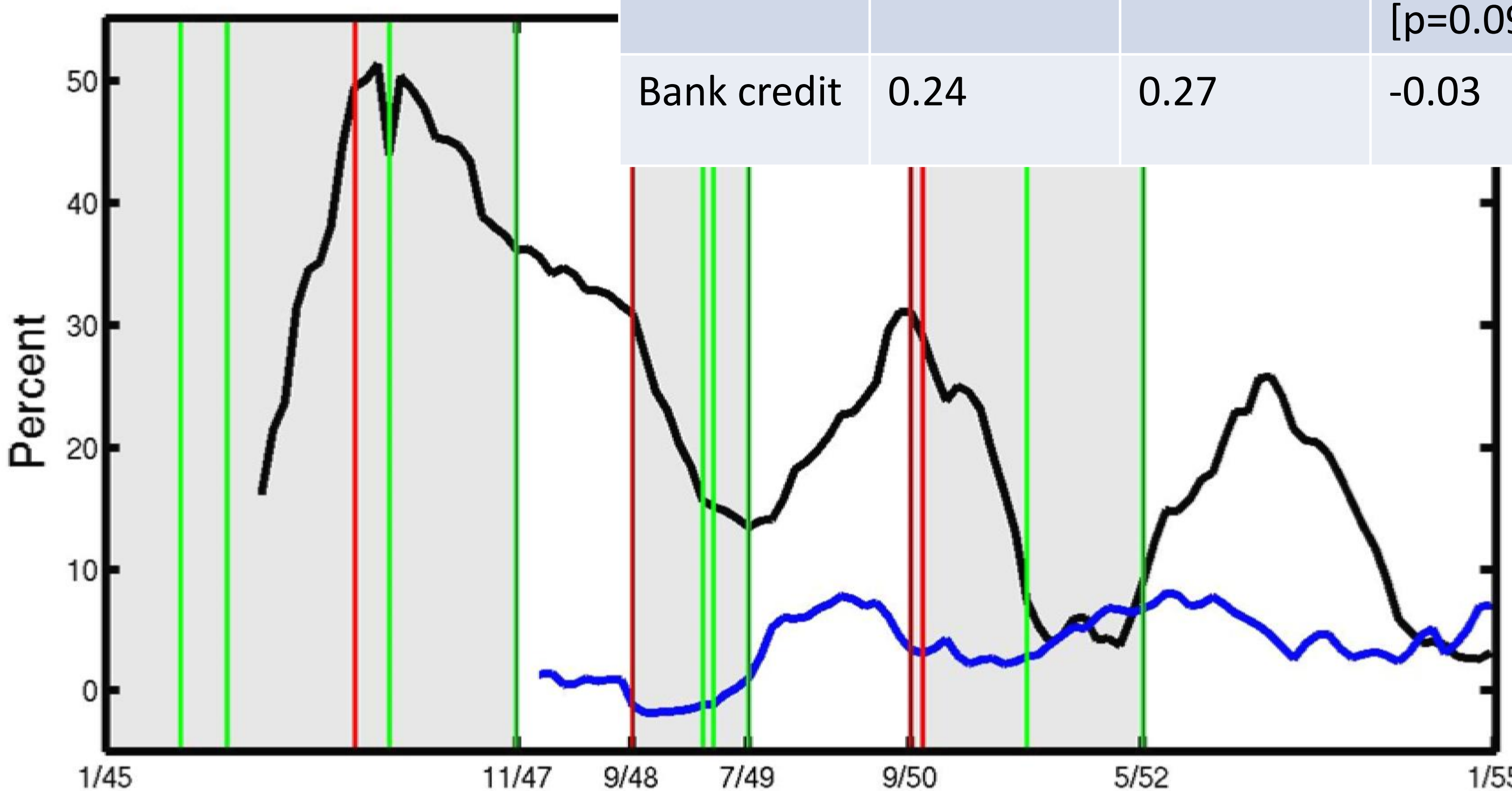
Did Reg W Affect Credit Growth?

- Reg W in force 1941—1952 but with gaps (allowed to expire three times)
  - Affected all kinds of lenders (nonbanks, banks)
  - Max LTV and maturity on loans secured by autos and radios
- While in force, terms were tightened and loosened
  - E.g. max maturity on loans secured by radios changed
- Examine how total consumer credit and bank credit were affected by Reg W

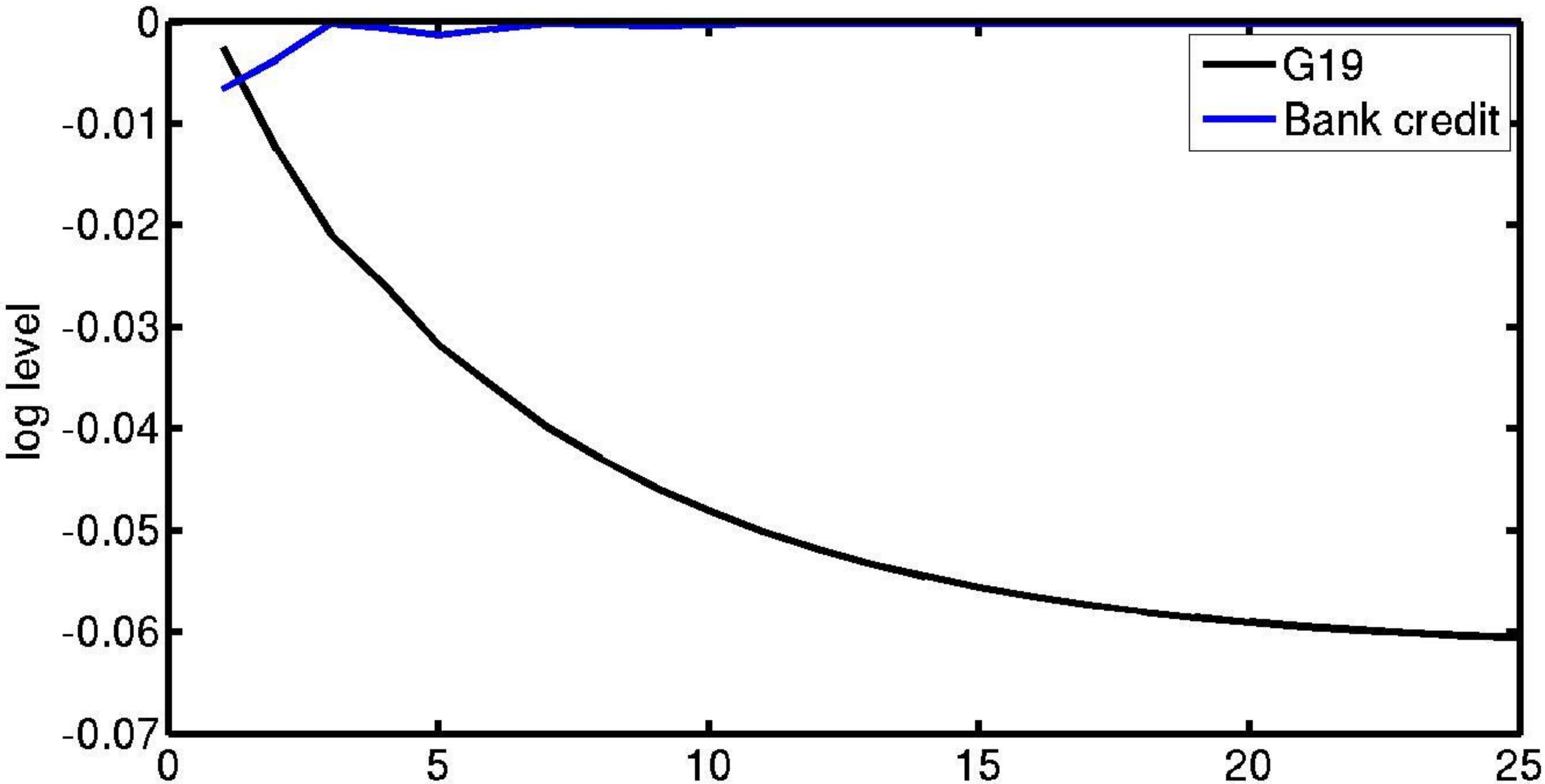
Reg W. limits on the maturity of select consumer loans



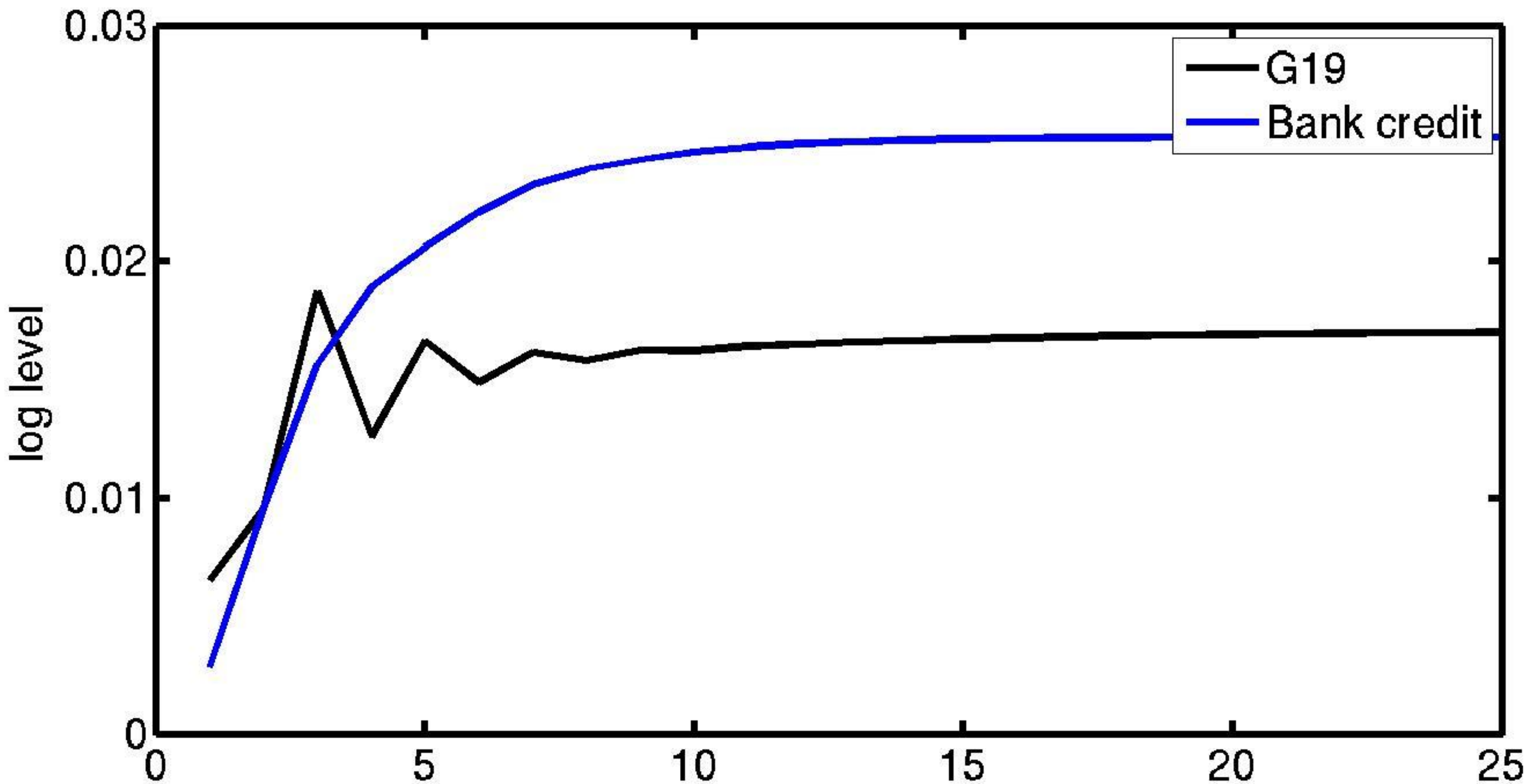
	Reg W off	Reg W on	Diff
G.19	2.12	1.61	0.51 [p=0.09]
Bank credit	0.24	0.27	-0.03



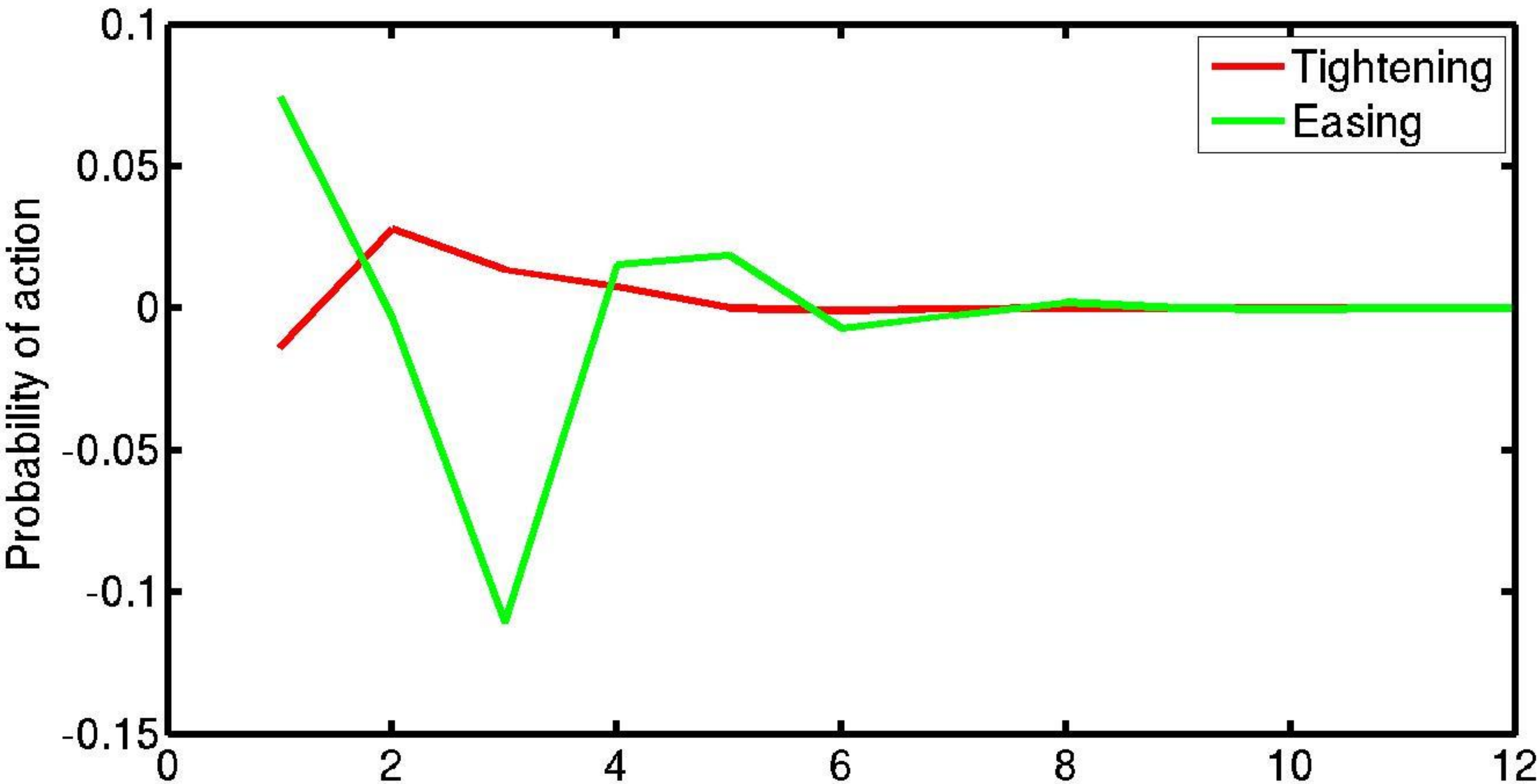
Effect of a tightening of Reg W standards on credit



Effect of an easing of Reg W standards on credit



Linear probability model responses to a 1 s.d. shock to G.19



Summary of statistical results

- MP policy has no effect on bank credit but does have an effect on consumer credit (G19)
  - Bank credit: All kinds of loans, just banks
  - Consumer credit (G19): Just consumer loans, all lenders
- MP tightening → bigger impact than easing