

Comments on

Identifying Excessive Credit Growth and Leverage: Historical Experience and Policy Challenges

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Assessing Credit Booms

Development vs Stability

- Especially pertinent in emerging markets
 - Focus on “too hot or too cold” vs efficiency and serving needs of economy

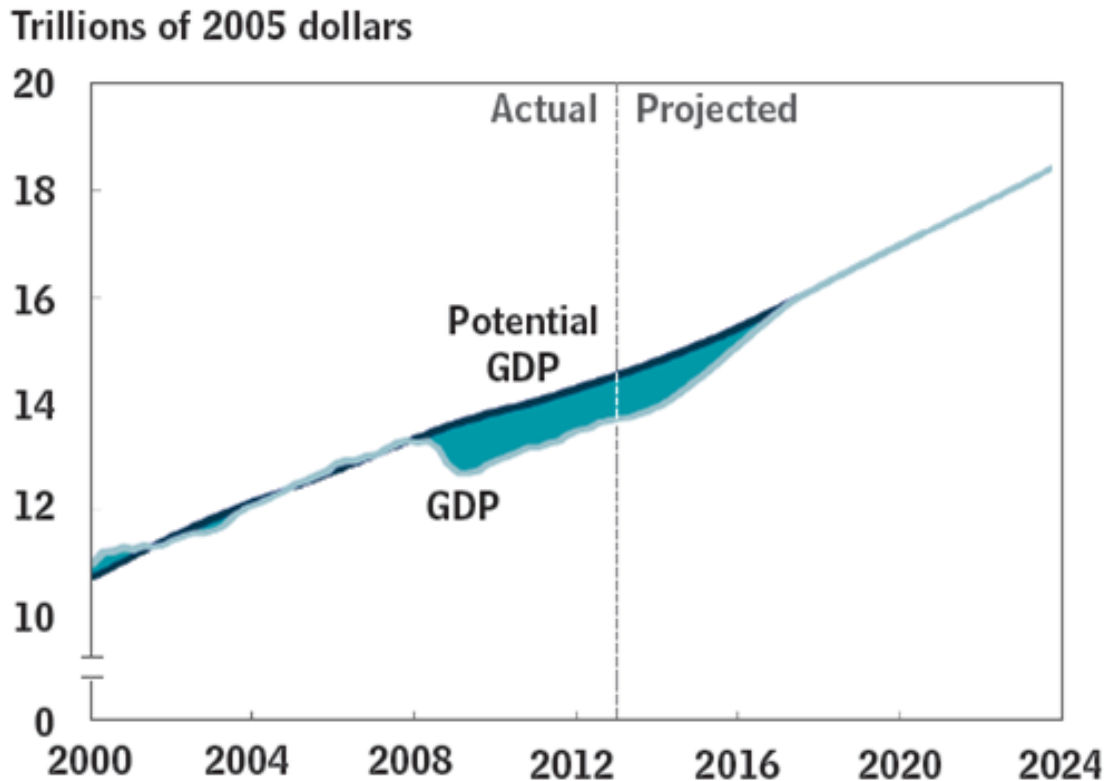
Limitations of aggregate analysis

- Need for micro data
 - Distribution matters
- Identify nature of risk
 - Maturity, currency, valuation
 - Amplification mechanisms

Role of Monetary Policy

Conventional views crisis as temporary shocks...

CBO Projections of US GDP

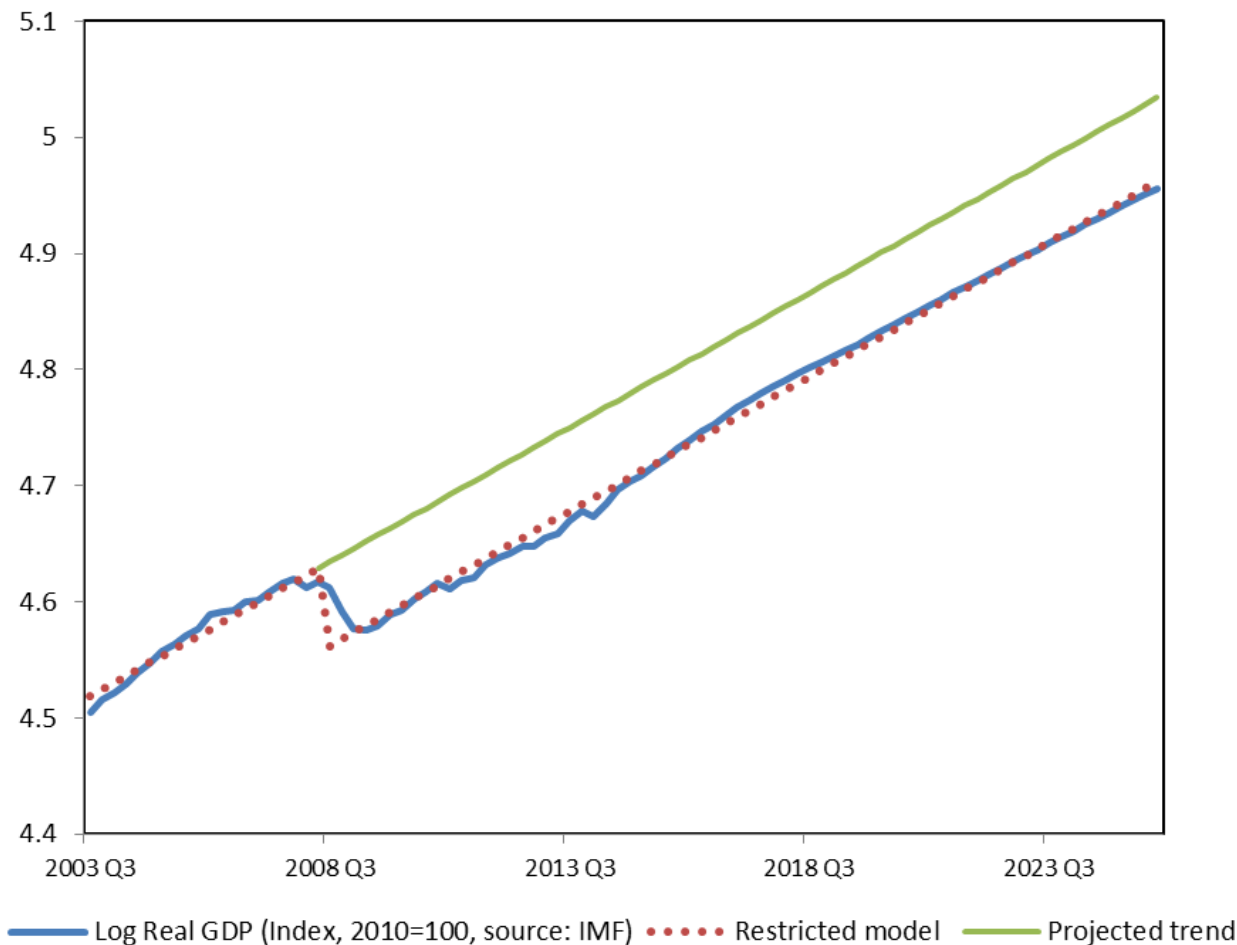


GDP and Potential GDP

Source: <http://cbo.gov/sites/default/files/cbofiles/attachments/43907-BudgetOutlook.pdf>

Role of Monetary Policy

...but what if they have long-lasting impact?...

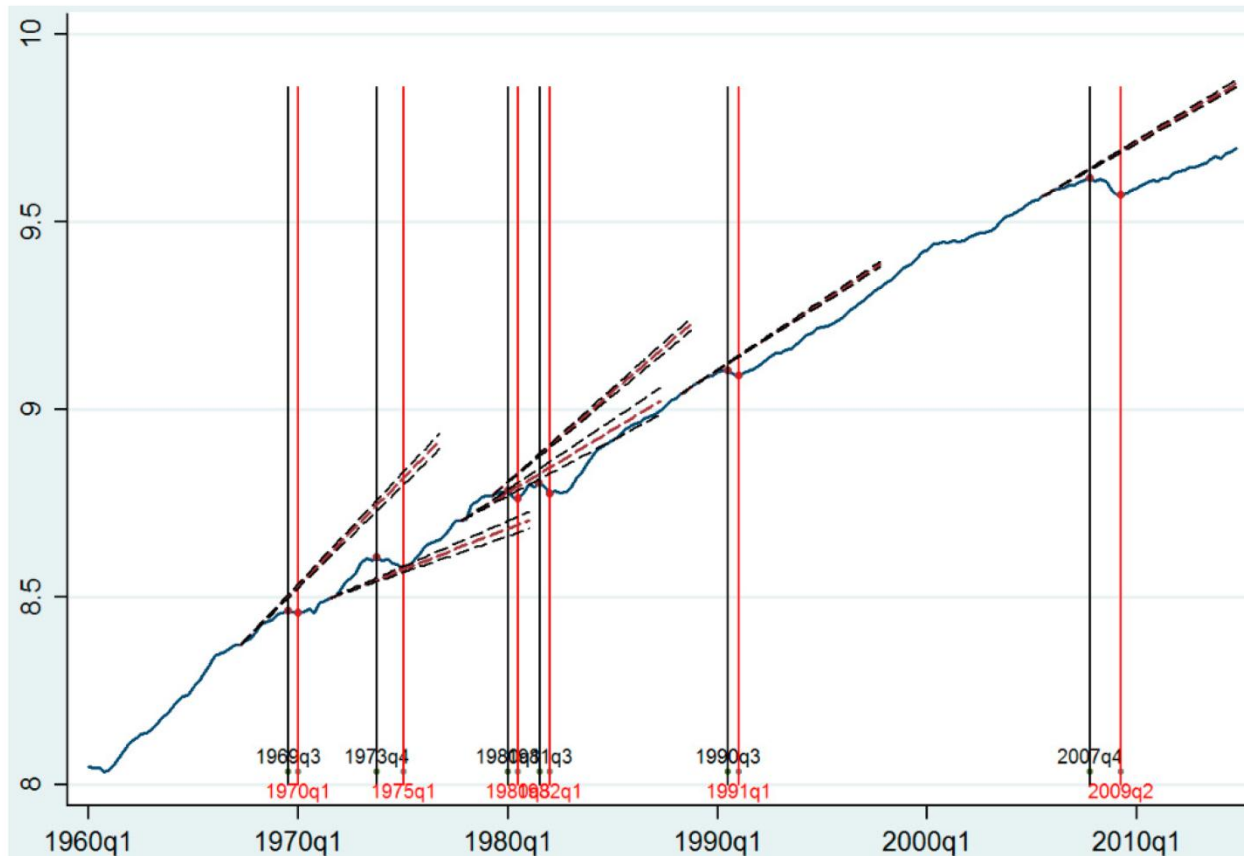


Source: <http://econbrowser.com/archives/2015/02/guest-contribution-long-term-effects-of-the-great-recession>

Role of Monetary Policy

...which seems to be the case

Figure 3: United States – Evolution of log real GDP and Extrapolated Trends



Source: Blanchard O, E Cerutti and L Summers (2015): “Inflation and Activity – Two Explorations and their Monetary Policy Implications,” IMF Working Paper, No. 15/230.

Role of Monetary Policy

1. Cost of financial imbalance understated

- Ignore level effects
- Output costs even without crisis

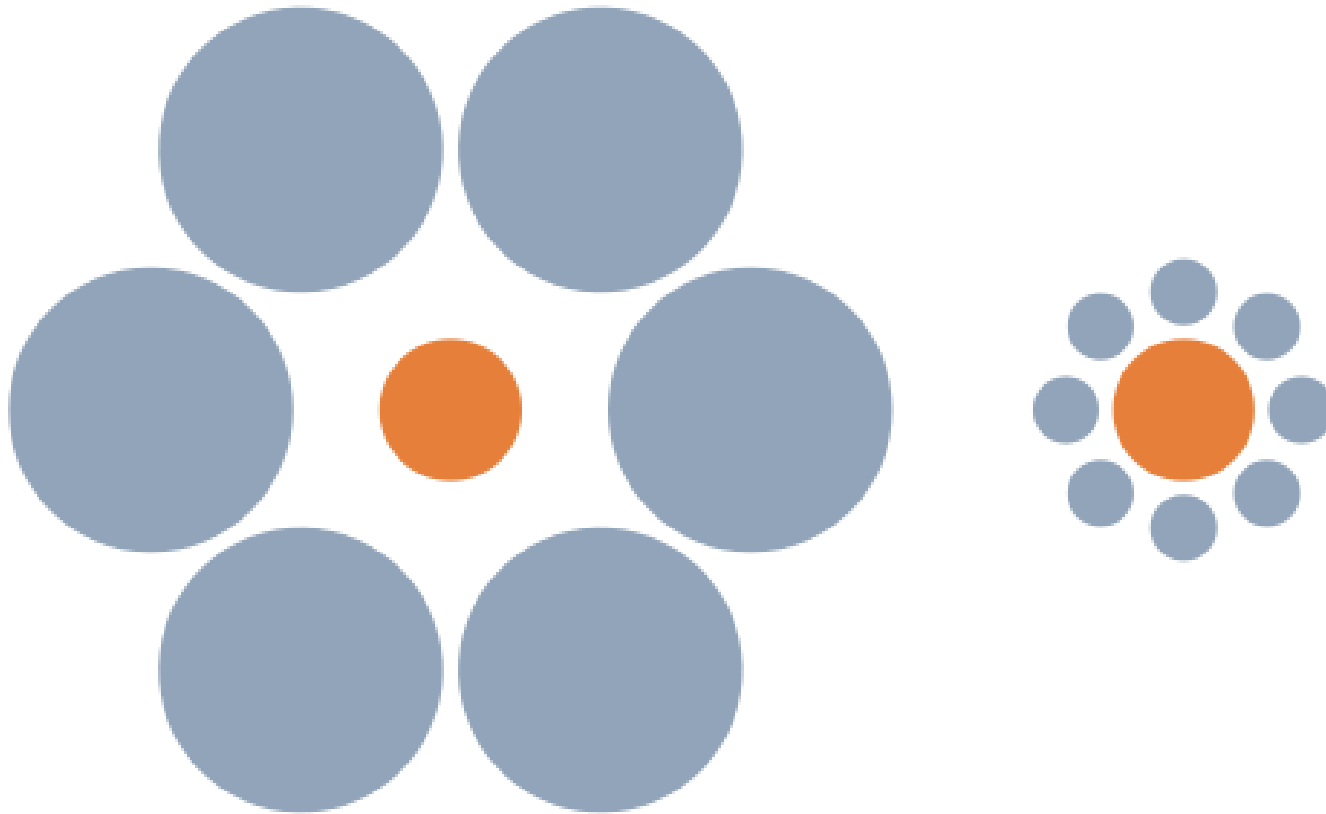
...Monetary policy can have long-run effects through financial cycle...

2. Contribution of monetary policy understated

- Path dependency implies crisis probability affected not only by current policy but also *past* ones
 - Treating crisis as shocks understates cumulative role of policy

3. Misleading way to frame the issue

- Aim to avoid crisis by EWS and prompt action?
- ...or systematically keep finance on an even keel?



Ebbinghaus Illusion