Discussion of “Financial Regulation and Shadow Banking: A Small-Scale DSGE Perspective” by Fève and Pierrard (2017)

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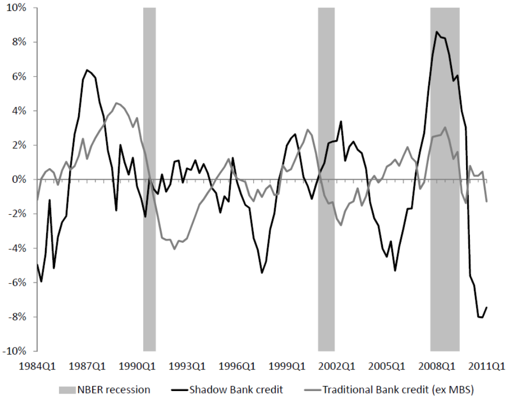
The Big Picture

- "Shadow banking" as relatively new subject (McCulley, 2007).
- Credit boom emerging in shadow bank sector as driver of global financial crisis (Adrian and Shin, 2009, 2010, Gorton and Metrick, 2010; Klein et al., 2009; Pozsar et al., 2013)
  - More shadow financing of credit to ultimate borrowers.
  - No deposit insurance and access to central bank liquidity makes shadow banking more vulnerable.
  - Largely unregulated.

The Big Picture

- Shadow bank credit cycles more volatile:

Figure 1: Credit cycles in traditional and shadow banking



Source: Meeks et al. (2014)

The Big Picture

- The emergence of a macroprudential approach to regulation (Hanson et al., 2011, Bernanke, 2013, and many others)

  Buch (2015): "[T]he level of knowledge and experience in [macroprudential policy] is roughly on a par with that in the field of monetary policy some years ago. The specific policy goals are difficult to quantify, transmission channels are often unknown, and the data sets and analytical methods need to be developed."

- Model uncertainty in DSGE models with financial frictions
  - Large variety of very heterogenous models with financial frictions (Binder et al., 2016, 2017).
  - Most DSGE models with explicit modelling of banks only feature traditional banking.

Summary

- RBC model with traditional and shadow banking.

Traditional Bank	
Assets	Liabilities
ABS	Bank Capital
Loans	Deposits

Shadow Bank	
Assets	Liabilities
Loans	ABS

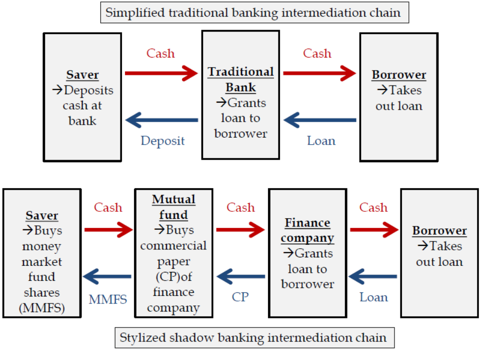
- ABS not (or less) regulated: Shadow banks increase intermediation efficiency.
- Macro-prudential policy is less effective in the presence of shadow banks.
- Macro-prudential regulation should be concerned with the whole financial sector including shadow banks.

Comments

- Very nice paper, well and concisely written, straightforward parsimonious model.
- Shadow banks emerge intuitively in the model due to regulatory arbitrage instead of asymmetric financial frictions.
- Careful Bayesian estimation with many robustness checks.
- Macro-prudential regulation explicitly tied to Basel I & III.
- Counterfactual regulation of all banks vs. only traditional banks.

Comments

- What kind of shadow banks are you modelling?
- Mehrling: "Shadow banking is money market funding of capital market lending"



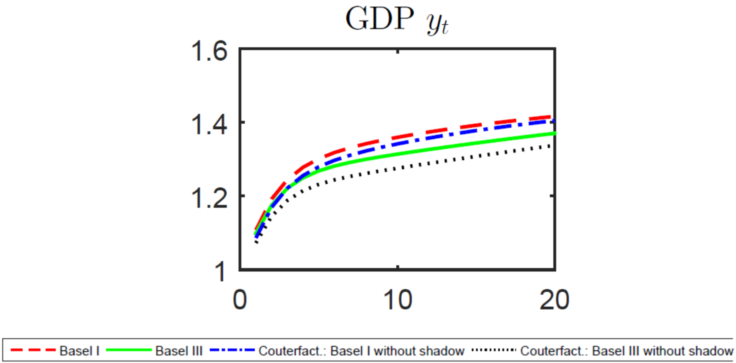
Source: Unger (2016)

Comments

- Shadow banks in the model don't have direct contact with savers (difference to Verona et al., 2013).
- They completely escape regulation (in baseline).
- They increase the efficiency of intermediation through lower regulatory costs (financial accelerator à la Bernanke et al., 1999).
- But don't seem to be significantly more vulnerable (as in Moreira and Savov, 2016) and cause substantially deeper recessions.

Comments

- Technology Shock



→ Some acceleration of shocks through existence of shadow banking.

Suggestions

- Be a bit more clear about what (part of the) shadow bank (chain) you are modelling.
- Disentangle upside and downside risks of shadow banking.
    - Monetary policy, QE, deposit insurance...
    - Capital requirements as occasionally binding constraint inducing non-linearities (instead of capital gap penalty).
- Welfare analysis of existence of shadow banks and associated macroprudential regulation.