Essays on Economic Policy (ESPE in Spanish) - A Proposal on Macro-Prudential Regulation

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Abstract

This paper assesses the choice of different regulatory policy instruments for crisis management and prevention. To this end a two-period, rational expectations, monetary general equilibrium model with commercial banks, collateral, securitization and default is contructed in order to explain the 2007-2009 U.S. financial crisis. The equilibrium outcome is characterized by a contagion phenomenon that commences with increased default in the mortgage sector, and then spreads to the rest of the nominal sector of the economy. The resuslts show that in times of financial distress accommodative monetary policy mitigates housing crises, but it achieves only a partial improvement on financial stability. Regulatory measures are the primary tools to achieve financial stability; capital requirements reduce leverage in the banking sector, and induce banks to internalize (default) losses without taking a toll on the taxpayer; margin requirements prevent excess leverage in the housing and derivatives markets, thus containing the adverse effects of the housing crisis; and, liquidity requirements reduce banks´ exposure to risky assets, thereby promoting lending in times of financial distress and stemming house price deflation.

Fuente: https://www.banrep.gov.co/en/publications-research/espe/proposal-on-macro-prudential-regulation