

Assessing the Impact of FX-related Macroprudential Measures in Korea

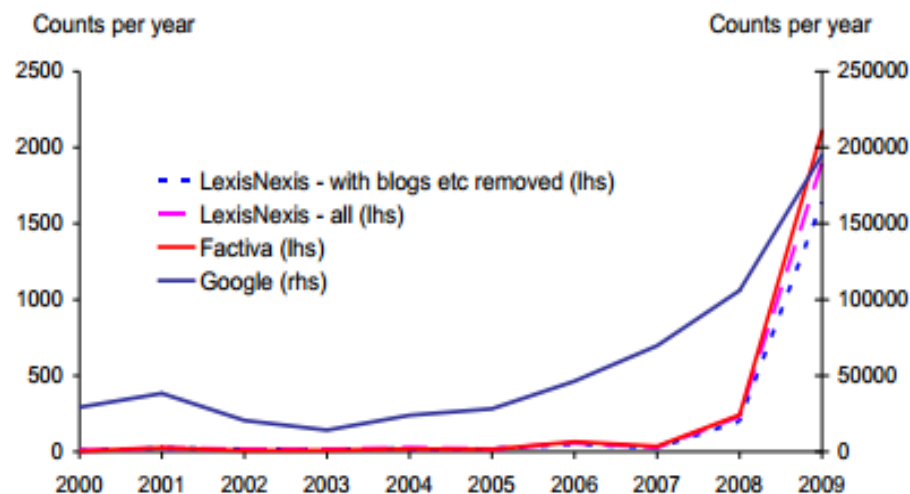
Discussion by Timo Bettendorf

Common challenges in Asia and Europe, 01.05.2014

Macprudential policies

- Macroprudential policies have become increasingly popular (see Galati and Moessner (2011))
- Empirical literature on macroprudential measures is scarce:
 - Difficult to investigate
 - Gained popularity following the 2008 financial crisis
 - Hence, data is limited

Usage of the term “macroprudential”



Source: Galati and Moessner (2011)

The story behind the paper

- Korea applied different macroprudential measures
 - Housing market (LTV and DTI regulations)
 - FX market (stability levy on non-core FX liabilities; leverage caps on FX derivatives positions)
- FX-related measures tend to limit the open FX positions or set constraints on certain types of FX-related assets (see Galati and Moessner (2011))
- The Korean measures affect the costs of bank liabilities directly.
- FX based measures are uncommon in Asia.
- Bruno and Shin (2013) exploit cross-section and time dimension of Korean data with respect to foreign countries.
- Research focuses generally more on the cross-section.

Characteristics of the paper

- Quantifies the impact of FX-related measures:
 - Leverage cap on FX derivatives position
 - Stability levy on non-core FX liabilities
 - Distinguishes between foreign bank branches and domestic banks
- Time series approach (BVAR)
 - Investigates the evolution of risk over time (in contrast to papers examining the cross-sectional dimension).
- Sign restrictions derived from a theoretical model (Bruno and Shin (2013) / Cetorelli and Goldberg (2011)).

The empirical model

- Bayesian VAR models
 - 4 variables / 3 variables
 - Minnesota prior
 - Samples for the counterfactual forecasts start in 2003Q1/2003M1 and end before the introduction of the corresponding measure.
- Identification of shocks using an agnostic sign restrictions approach
 - Disentangle supply, demand, risk perception and FX derivatives ratio shocks
- Counterfactual forecast subject to assumptions about the behavior of certain variables.

Comments

- Counterfactual forecast relies on the (reasonable) assumptions that
 - Leverage cap has led to a decrease in the FX derivatives ratio
 - Macroprudential levy has led to an increase in the borrowing spread/CIP deviation
- Hence, it is not data based.
- One could exploit the information provided by the identification scheme even more and discuss the contribution of the shocks more specifically.
- A historical decomposition might shed light on the importance of specific shocks (“global push” vs. “domestic pull”), as well as the effects of the successive reduction of the leverage cap.
- This might support the assumptions made and relate the paper closer to the underlying theoretical model (Bruno and Shin (2013)).

Conclusion

- Interesting and timely paper.
- It benefits from the very specific research question and the exploitation of the time dimension.
- Should be viewed and discussed from a broader perspective to highlight the strengths of this paper.

Literature

Bruno and Shin (2013), “Capital Flows, Cross-Border Banking and Global Liquidity”, NBER WP, No. 19038.

Bruno and Shin (2014), “Assessing Macroprudential Policies: Case of South Korea”, Scandinavian Journal of Economics, Volume 116, Issue 1, pp. 128–157.

Galati and Moessner (2011), “Macroprudential policy – a literature review”, BIS Working Papers, No. 336.