



Discussion of  
"Leaning against  
the Credit Cycle"  
by  
Gelain, Lansing  
and Natvik

Norges Bank Research Paper 4, 2015

Björn Lagerwall  
Sveriges Riksbank

# About the paper

- Very interesting paper on a very topical issue, at the centre of monetary policy debate (particularly in Sweden, Norway and Canada)
  - Analysis of prospects for leaning against the wind with monetary policy
    - Also important implications for macroprudential policy
  - Basis in Iacoviello (2005) model, with the addition of long-term mortgage contracts
  - Most important conclusions
    - Little scope for MP to lean against  $D/Y$  due to sticky  $D$ ; responses in  $Y$  similar to standard short-contract model
    - Better to lean against  $\Delta D$  (which is determined by new loans), but this has costs in terms of higher inflation volatility
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# Important mechanism in the model

## Debt stock dynamics (simplified):

- $D_t = (1 - \alpha) * D_{t-1} + L_t,$

where  $\alpha$  = amortisation rate

$L_t = LTV * IH_t$ , i.e. subject to changes in collateral value (housing investment) and LTV constraint

- In standard Iacoviello (2005) model,  $\alpha=1$ :

$$D_t = L_t = LTV * H_t,$$

where  $H_t$  is value of house

- Changes in housing prices (and LTV) have large effects on the stock of debt

- If, realistically,  $\alpha$  is set to be less than 1, e.g. 10 per cent per year:

$$D_t = 0.90 * D_{t-1} + L_t$$

Intuitive interpretation: Debt stock is

- to 90 per cent dependent on previous periods' debt and
- to 10 per cent dependent on new loans, subject to changes in collateral value and LTV constraint"\*

\* $L_t \leq 0$  has implications for the effects, further explored in NB WP 16, 2014

# Questions and comments

## General comments

- Very interesting paper on a highly topical issue
  - Clearly written and focus on a particular policy question
  - Important contribution to the rapidly growing research on monetary policy, MaP and financial stability by experts in the field (a series of papers in recent years)
  - I also have some specific comments/questions...
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# Questions and comments, cont.

## 1. Common view: "MaP first line of defence"

**But if debt contracts are long-term, can macroprudential policy have meaningful effects on the credit cycle?**

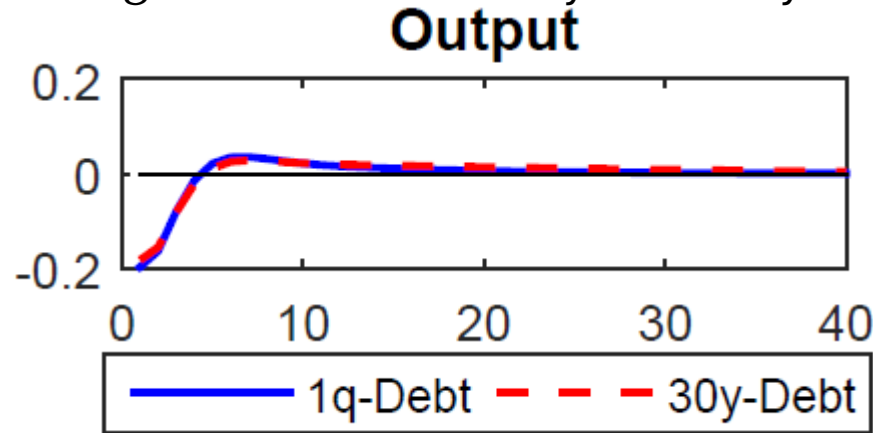
- Example: If mortgage contracts are long term, a change in LTV for new loans has very little effect on debt stock in the short-to-medium term
    - Though better "trade-off" with effects on GDP since more targeted tool than monetary policy
  - Similar for other MaP tools (e.g. LTI) affecting only new loans
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# Questions and comments, cont.

## 2. What is the intuition for the small difference in effects on GDP with short vs long-term debt contracts?

- My intuition is that the impatient households' Euler equation would be much affected => more sticky consumption with long-term debt

Figure 4: Contractionary Monetary Policy Shock



*Impulse responses to a 25 basis point increase in the quarterly interest rate*

# Questions and comments, cont.

## 3. How exogenous is the amortisation rate?

- Within this framework, the difference between tools affecting only new borrowers vs all borrowers not so important
- Apart from MaP on new loans, interest rate changes have *the potential* to affect also the stock of debt
  - This is ruled out with exogenous rate of amortisation
- But if the interest rate increases and collateral value decreases, there may be incentives to lower debt stock
- Banks may not be able to force households to increase amortisation, but households may voluntarily restore balance sheets through increased amortisation (savings)\*