Inflationary Shocks and the Financial Stability Trade-off

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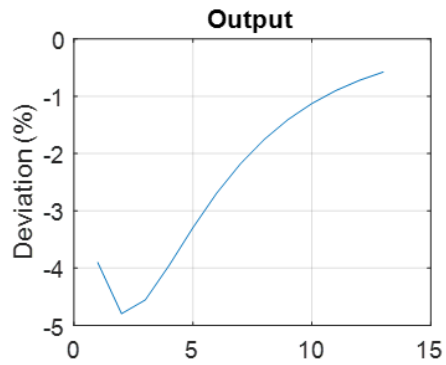
This presentation reflects the opinions of the authors and does not necessarily express the views of the Banque de France.

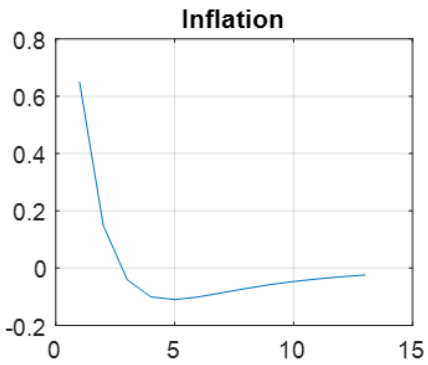
Great contribution to the literature

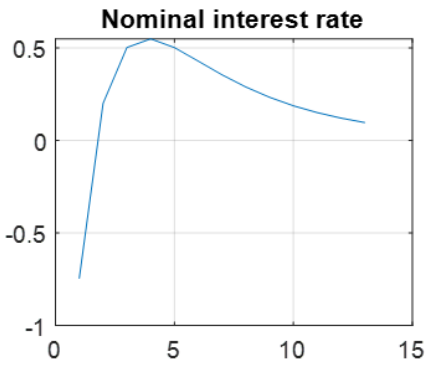
- **Great contribution in the current context:** we need more papers on the effects of cost-push shocks on financial stability (for ex. for MPAG-AWG and MPPG-IWG Agile Team on the topic).
- **Great framework** to assess the transmission mechanisms of these shocks and the **policy trade-off for monetary and macroprudential authorities**.
- **Main results:**
  1. Strict Inflation Targeting amplifies financial stability risks compared to the Taylor rule.
     - Borrowers are more affected by the shock.
     - Credit risk increases.
  2. No obvious benefits from releasing Capital Buffers.

Comments: Progressive cost-push shock and policy reaction

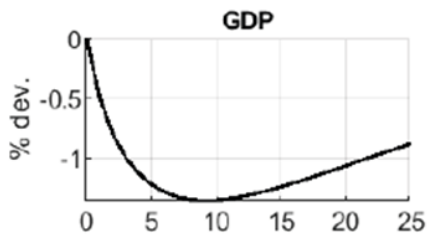
A standard cost-push shock (Gali, 2008)

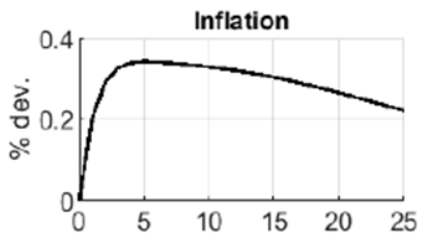


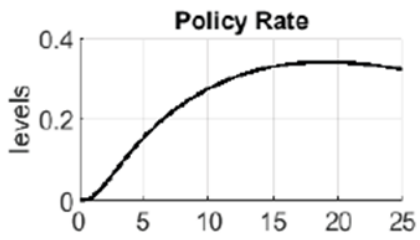




This paper







- It would be interesting to get more details on the cost-push scenario.
- Implications for financial stability?

Comments: Bank capital release effects depend on initial probability of default

Paper/Yearly Default Prob.	Banks	NFC	HH
Mendicino et al. (2018)	1.53 %	1.7 %	0.66 %
Mendicino et al. (2020)	0.65 %	2.5 %	.
This paper	3.3 %	2.5 %	1 %

- Why is **bank default higher than NFC and HH default** ? It is different than in previous papers
- The effects of mark-up shocks are robust to the different levels of risk for banks.
- But the effects of bank capital release are more dependent on initial banks' risk (and default probability).

Comments: CCyB vs No CCyB (1)

- Have you assessed the effects of **different countercyclical rules** in your simulation ?
  - Bekiros et al. (2018) assessed rules responding to credit to output ratio, to deviations of credit to its steady state and to credit growth.
  - They found that the one responding to deviations of credit to its steady state is better to enhance bank stability and welfare.

Comments: CCyB vs No CCyB (2)

- **CCyB release during the COVID-19 crisis**:
  - Jude and Levieuge (2023) found that on average, for one percentage point release of the CCyB, corporate bank lending rates decreased by around 11 basis points more in countries with a CCyB release.
- **What are the effect of a CCyB release on lending rates with markup shock** ?
  - As relaxing the CCyB reduces the lending rate, the question of the interaction between CCyB release and monetary policy is crucial.

Conclusion

Great paper !

Bibliography

Stelios Bekiros, Rachatar Nilavongse, and Gazi Salah Uddin. Bank capital shocks and countercyclical requirements: Implications for banking stability and welfare. *Journal of Economic Dynamics and Control*, 93:315–331, 2018.

Cristina Jude and Grégory Levieuge. The combined effect of ccyb release and monetary policy easing theory and evidence based on the covid-19 crisis. *Available at SSRN 4439353*, 2023.