Macroprudential Policy under Incomplete Information

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Two main Comments

1. Why are interest rates falling following a positive demand shock?

$$b_t \leq \frac{1}{z_t}\frac{q_t k_{t+1}}{R_t}$$

... at the binding equilibrium a higher z_t must imply of lower R_t.

... but even with $z_t = 0$, a demand shock still reduces R_t.

From FOC of the borrower (entrepreneur), R_t in this model is determined as,

$$R_t \approx \frac{1}{z_t + E_t\left[\frac{\gamma c_t}{c_{t+1}}\left(1 - z_t(1-\delta)\frac{q_{t+1}}{q_t} - z_t\frac{\mu}{q_t}\frac{y_{t+1}}{k_{t+1}}\right)\right]}$$

So even with $z_t = 0$, a demand shock reduces R_t ...because it is determined by the Euler equation....

$\Longrightarrow$ any shock that raises c_t will imply a lower R_t at equilibrium, Does it matter?

(a) it is hard to justify empirically that demand shocks reduces R_t.

(b) it is counterintuitive for R_t to fall at times of tighter bank regulation.

2. In a RBC/flex-price model are demand shock the right choice to examine macrpru policy?

3. Should bank capital regulation be examined independently of monetary policy?

Overall: I still expect the main message of the paper to be robust!

With incomplete information / noisy data:

(i) macropru responses in the short-run (*active policy*) $\Longrightarrow$ imply higher volatility and welfare loss

(ii) long-run macropru policy (*passive*) $\Longrightarrow$ reduced volatility vs. lower long-run GDP and income inequality.

...intuitive results that are also supported by the monetary policy literature.

Some other things to check

1. Typo, Eq (3) $b_t = \frac{1}{z}\frac{q_t k_t}{R_t}$ should be $b_t = \frac{1}{z}\frac{q_t \mathbf{k}_{t+1}}{R_t}$
2. In eq. 3 and 6 z should be z_t
3. Typo, Eq.(6) $\frac{1}{c_t} q_t = E_t \frac{\gamma}{c_{t+1}} \left(\mu \frac{y_{t+1}}{k_t} + .. \right)$ should be $\frac{1}{c_t} q_t = E_t \frac{\gamma}{c_{t+1}} \left(\mu \frac{y_{t+1}}{\mathbf{k}_{t+1}} + .. \right)$
   If 1 and 2 above are not true FOCs (4-6) do not hold
4. Berg et al 2010, I cannot find in references.
5. Definition of 'incomplete information' may be confusing to other literatures. The concepts of '*Noisy indicators*', '*sticky information*', '*lagged information*' and '*incomplete information*' appear to be used synonymously in the paper.
6. The paper treats monetary policy almost synonymously with macropru...