Discussion of
“Bank Runs, Fragility, and Credit Easing” and “Crash Narratives”

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The views expressed in the presentation are those of the speaker and do not necessarily reflect the views of the Office of Financial Research or the U.S. Department of the Treasury.

Introduction

Macroprudential (MaP) and Monetary Policy (MP)

Two (related) big-idea questions regarding MaP and MP:

- Should we use MP for financial stability purposes?
  ➔ i.e., use MP *as* MaP?
- How does MaP affect the use of MP?
  ➔ i.e., are MaP and MP substitutes or complements?

The questions can really be reframed as:

- How do MP and MaP work differently and/or together in a given environment?
- What policy environment is or should be available? i.e., the regulatory, legal, supervisory institutional environment?

Introduction

Macroprudential (MaP) and Monetary Policy (MP)

These two papers raise different questions

- ➔ **“Bank Runs”**
  - ➔ how does the institutional setting affect bankruptcy/default/run decisions?
  - ➔ What are the policy implications?
- ➔ **“Crash Narratives”**
  - ➔ what shocks (and amplification or propagation mechanisms) might policymakers want to address?
  - ➔ How might “narrativity regime” affect policy?

Outline

Crash Narratives
Overview

- Journalists employ "crash narratives"
  - to **convey the specter of a crash**
  - irrespective of the specific causes
- Crash narratives have strong positive association with **volatility**
- Crash narratives affect **individual** investor beliefs
- Not just **'87 Narrative**—overall "narrativity" correlates and also predicts volatility (i.e., reads like a folk/fairy tale)

Crash Narratives

Reflections 1/3: Interpretation?

- We clearly can afford to set better policy and should welcome creative and innovative approaches
- I'm not an econometrician, but I kept wondering:
  - What's exogenous?
  - What is this *really* capturing?
  - **Folk narrativity** is strongly correlated!
- They've clearly hit on an interesting aspect of human behavior
- The paper sets the agenda and it behooves us to keep pushing

Crash Narratives

Reflections 2/3: Policy Implication?

- Policy implication?
  - Plug *WSJ Narrativity* into our forecasts?
  - Into a Taylor rule?
  - or RWA? (I'm kidding)
- Asking "policy?" maybe not the right response to these findings

Crash Narratives

Reflections 3/3: Policy Narrativity?

- Maybe MP itself already employs Narrativity
  - c.f. current references to 1970s Great Inflation
  - Do “regime shifts” into/out of narrativity tell us something?
- This is the start of a research agenda, but not the final word.

Outline

Bank Runs

Overview

- Suppose we think of bank default like sovereign default
  - Banks default because they *choose* not to meet obligations, not because they *cannot*
  - Future profits vs outside option compared to current assets vs liabilities
- Effect of asset prices on default depends on whether default driven by fundamentals or runs
  - Usually we think "higher asset prices improve solvency"
  - With strategic default, higher asset prices make default value higher (low asset prices make staying in business more attractive)
  - With expectations-driven default, need higher asset prices so bank can defend itself (i.e., selling capital makes bank run proof)
- Whether we want to support asset prices depends on source of default

Bank Runs

Reflections 1/3: Default?

- Default works like sovereign default model (autarky)
  - Is that the way to think about bankruptcy resolution?
  - Who are the parties "consuming" the autarkic value of the firm?
  - Does giving the bank log utility over dividends still make sense in that setting? (i.e., instead of using the HH SDF)
- Maybe "default" is not bankruptcy but some decision that happens "earlier" (e.g., giving up or shirking)
  - Is that interpretation possible?
  - If so, what legal or regulatory environment do we want to have?
- Can consider MaP more broadly, not simply asset prices

Bank Runs

Reflections 2/3: New Model?

- ➔ We want to understand the interaction between asset prices and bank failure
- Do we need an alternative model of bank default?
  - Existing models distinguish between solvency and illiquidity
  - "Franchise value" is an old idea, too
  - Do we need a different model of default, or a richer GE setting with the standard models?

Bank Runs

Reflections 3/3: Runs?

- ➔ Are these bank runs?
  - Banks default even though no withdrawals have occurred.
  - How are these liabilities are bank-like and not just debt.
  - Maybe crises are about short-term debt, not “money” (Diamond)
- Paper raises some important questions for policy to consider

Outline

Conclusion

Macroprudential (MaP) and Monetary Policy (MP)

- We want to understand how MaP and MP should be used together to respond to different shocks and prevent crises
- Both these papers push our understanding of how we need to think creatively about propagation and mechanisms
- Policy can be subtle and nonobvious
- Very interesting papers

Thank you!