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

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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

1 Introduction

2 Crash Narratives
   Overview
   Reflections

3 Bank Runs, Fragility, and Credit Easing
   Overview
   Reflections

4 Conclusion
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
• 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.
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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
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?
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
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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!