A discussion of
The genesis and effects of asset booms
by Maria Socorro G. Bautista

Eli Remolona

2017 BSP-UP Professorial Chair Lectures
Manila, 17-18 October 2017

The views expressed are my own and do not necessarily reflect those of the BIS
What it’s all about

Chart 7: Net Private Flows and EME Credit Growth

Source: Clark, Converse, Coulibaly, Kamin (2016)
Five things

- Why Corina’s paper matters
- Corina versus BdiGKOU
- VIX as measure of risk appetite
- A little work to be done
- Leakages and LAW
Why Corina’s paper matters

- Asset and credit booms
  - Gochoco-Bautista (2008): Asset price booms, especially in housing, raise probability of recession
  - Schularick and Taylor (2012): Financial crises are credit booms gone bust

- The global financial cycle
  - Rey (2015): “There is a global financial cycle in capital flows, asset prices and credit growth. This cycle co-moves with the VIX ...[and] transforms the trilemma into a ‘dilemma’.”
  - Basakaya, di Giovanni, Kalemli-Ozcan, Ulu (2017) confirm role of cycle with transaction-level loan data for Turkey

- Policy issues
  - What macro-prudential measures do you apply?
  - Do you resort to LAW?
## Corina versus BdiGKOU

<table>
<thead>
<tr>
<th></th>
<th>BdiGKOU</th>
<th>Corina</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Data</strong></td>
<td>Loan-level data covering universe of corporate loans in 2003-2012, matched to banks and firms</td>
<td>Annual bank-level and firm-level financial statement data with 3 loan categories in 1998-2015</td>
</tr>
<tr>
<td><strong>Econometrics</strong></td>
<td>OLS with VIX as instrument for capital inflows</td>
<td>Dynamic panel GMM, restrictions on error terms, Arellano-Bond tests</td>
</tr>
<tr>
<td><strong>Results</strong></td>
<td>Lower VIX leads to lower borrowing costs and greater credit growth</td>
<td>Cross-border bank loans lead to lending to real estate and housing; VIX is either insignificant or has the wrong sign</td>
</tr>
</tbody>
</table>
VIX as a measure of risk appetite

- The VIX is the “fear gauge.”
- It is an index computed from prices of options on the S&P 500 -- a weighted average of the implied volatilities, with more weight on puts than on calls.
- That implied volatility has two components:
  - A 30-day forecast of realized volatility
  - A risk premium
- To estimate risk aversion, try
  \[
  VIX = \sigma + \lambda \sigma
  \]
  \[
  \lambda = \frac{VIX}{\sigma} - 1
  \]
Is VIX still a good measure of risk aversion?

VIX and realized volatility

Percentage points

VIX = 9.65
σ = 5.36
λ = 0.80

Brexit
Trump

Sources: Bloomberg; S&P Dow Jones Indices; BIS calculations.
A little work to be done

- Try BdiGKOU’s IV approach and 2003-2012 sample period, compare results
- Refine measure of risk appetite
- Consider event study of global crisis
- Explore roles of macro-prudential measures and LAW
Leakages and LAW
The IMF’s decision tree

- Excessive build-up of risk
  - Large leakages from macro-pru?
    - Yes: Consider LAW
    - No: Macro-pru only
  - Good tradeoffs in monetary policy?
    - Yes: Consider LAW
    - No: Macro-pru only

If the Greenspan put led to a crisis, would a Yellen call avert one?
References