Discussion of Gospodarchuk and Shashkina: *Consolidation of price and financial stability goals in the monetary policy of central banks*

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This Paper

Motivation

- The global financial crisis has highlighted the interconnectedness of financial stability and macroeconomic/price stability

Research question

- Develop a unified framework for central banks to address price and financial stability

$\Rightarrow$ But how to quantify financial stability in the first place?

Contributions

- Recommend a (weighted average) real rate of debt instruments as indicator for financial stability
- Use a broad indicator for price stability (consumer prices, real estate prices, and stock market prices)
- Qualitative framework to assess the degree of price and financial stability simultaneously

This Paper (cont'd)

Indicator for financial stability

- Real weighted average cost of external financing
  - $=$ nominal average borrowing costs (loans and bonds; weighted by market volume)
  - $-$ inflation measure (consumer prices, real estate prices, and stock market; weighted by market volume)

Monetary policy reaction function

- Policy rate $=$ IFS $+$ Expected inflation (target) $-$ Risk premium

Application

- For the period 2018-2020, the Russian monetary policy rate should be between 6% and 8%

Main Comments: Macroprudential Policy

1. **Tinbergen's principle**
   - IFS and inflation negatively correlated $\Rightarrow$ one instrument (MP key rate) for two (opposed) goals
   - Monetary policy aimed at price stability and **macroprudential policies** aimed at financial stability
   - Problem: **coordination** between central bank and macroprudential authority (Angelini et al., 2011; Galati and Moessner, 2013; Smets, 2014)

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2. **Leaning against the wind**
   - Monetary policy stance affects risk taking of financial intermediaries and stability of financial intermediaries is related to the transmission mechanism of monetary policy (Borio and Lowe, 2002; White, 2006)
   - Woodford (2011, 2012): Monetary policy targeting rule also involves financial stability indicator $\Rightarrow$ financial stability concerns affect adjustment path, but in medium term price stability objective dominates
   - Trade-off between two objectives $\Rightarrow$ credibility of price stability target (Smets, 2014)

Main Comments: Macroprudential Policy (cont'd)

3. **Time inconsistency issues** when both objectives are equally ranked (Ueda and Valancia, 2012; Smets, 2014; Adrian and Liang, 2018)
    - Central banks as **lender of last resorts** $\Rightarrow$ reduce debt overhang after financial crisis by providing liquidity
    - However, this does not address fundamental problems that had led to the debt overhang $\Rightarrow$ But may jeopardize price stability goal in the long run

Main Comments: Policy Rule

4. No model-based justification for the **indicator of financial stability**

- High interest rates on bonds and loans may indicate different issues depending on circumstances (supply/demand driven)
- Build-up of imbalances/vulnerability of financial system $\Rightarrow$ quantity aggregates
- Instruments discussed in literature: ratios of capital-to-assets, loan-to-value, loan-to-deposits, (Hanson et al., 2011; BoE, 2011; Nier et al., 2013)
- Optimal monetary and (macro-)prudential policies $\Rightarrow$ Collard et al. (2017)
- Binder et al. (2017): Robust macroprudential policy rules

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5. **Monetary policy reaction function** exogenous to economic conditions?
   - Target values for financial and price stability or expected/forecast values?
   - Dynamic stability/multiple equilibria

Minor Comments

- Qualitative assessment of price stability
  - Table 4: deflation ($\pi \leq 0$) preferred?
- Unclear what the *negative* square root of R^2 should be (page 18)
- Risk premium reflects term premia as well as (various) default risks
  $\Rightarrow$ varying relevance for financial stability

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