Comments to "Capital Requirements, Risk Taking and Welfare in a Growing Economy" (Agénor and Pereira) and "Bank Capital Buffers Around the World: Cyclical Patterns and the Effect of Market Power" (Carvallo and Ortiz)

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"Capital Requirements, Risk Taking and Welfare in a Growing Economy" (Agénor and Pereira)

Main contributions:

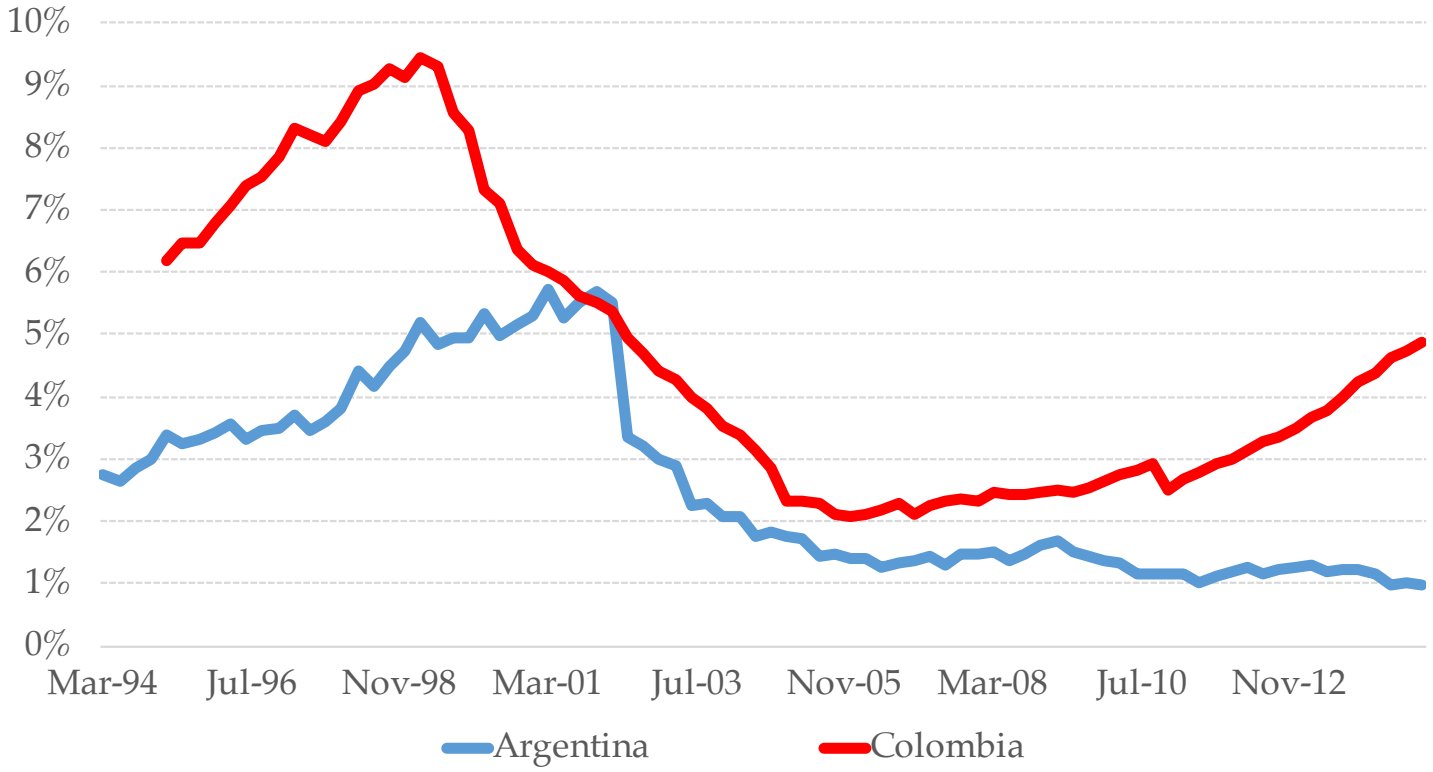
- Capital requirements are not neutral to welfare.
- Criteria to assess optimality of capital requirements: risk-taking (reduction of default) vs. long-run economic growth.
- High capital requirements may be detrimental to welfare even if they prevent risk-taking behavior in equilibrium.
- Yet another extremely useful framework from the authors that could inform model-building at central banks.

Comments: The Cost of Financial Crises

- Let's go quantitative...
- The paper underestimates the true benefits of preventing risk-taking behavior: the model assumes that every period "the dice are rolled again" - no financial crises or systemic risk.
- Financial crisis are extremely costly and have persistent effects.
- These costs may be so high that the benefit of low capital requirements may pay off only in the *very* long run.
- Optimal requirements may be higher than the authors would calculate!

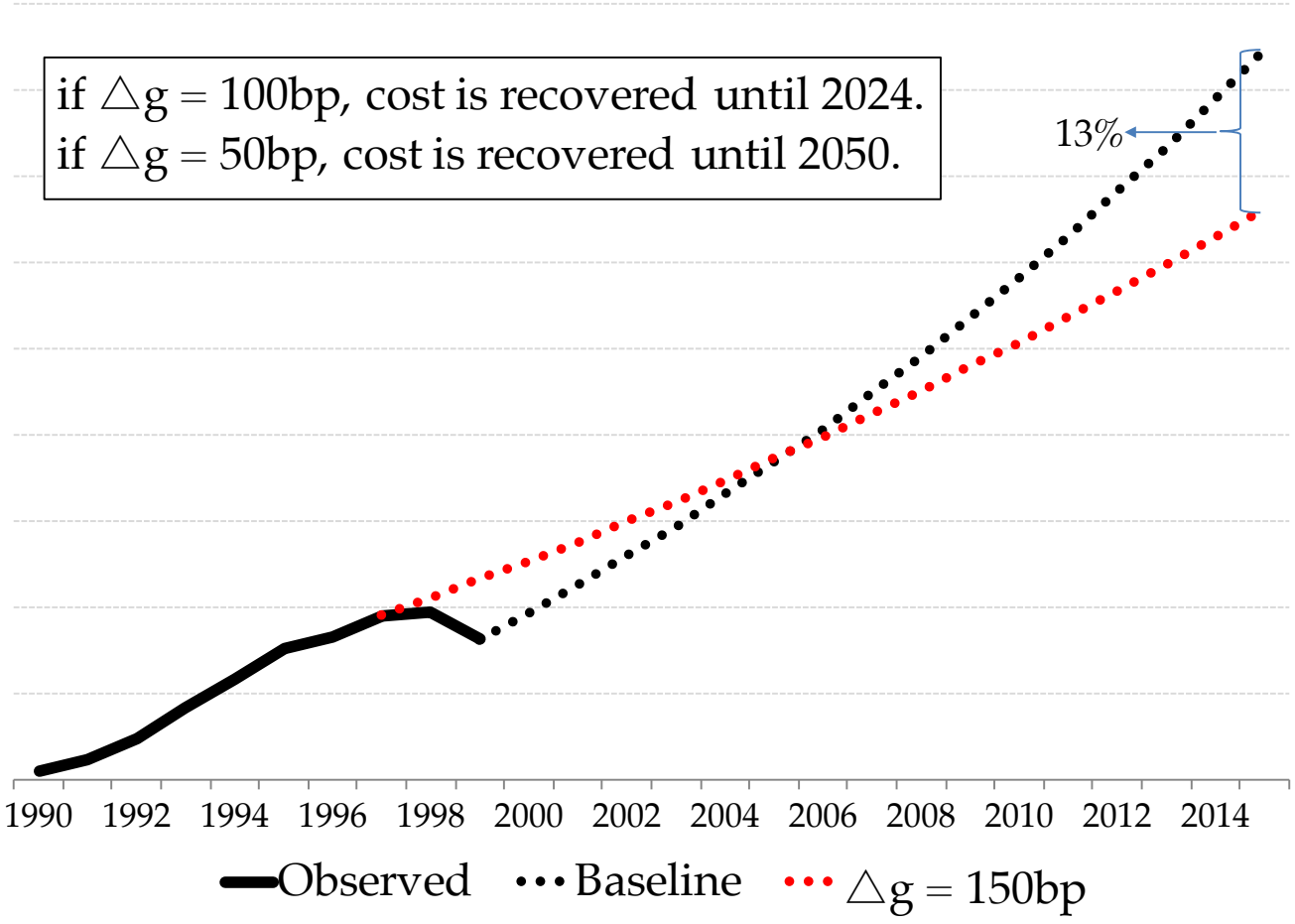
Comments: The Cost of Financial Crises

The persistent, destructive effects of financial crises on credit markets: Mortgage Credit-to-GDP ratio



Comment: The Cost of Financial Crises

Recovering the cost of a financial crisis (Colombia: roughly 13% of GDP):



Comments: CCB

- The model can incorporate the welfare analysis of countercyclical capital buffers (CCB).
- Is the average (along the business cycle) capital requirement what matters? or the speed with which it is activated (or deactivated)?
- Fresh consideration: tax smoothing...

"Bank Capital Buffers Around the World: Cyclical Patterns and the Effect of Market Power" (Carvallo and Ortiz)

Main contributions:

- Capital buffers (excess of capital with respect to regulatory minima) respond systematically to aggregate conditions and individual bank characteristics, mostly in accordance to theory.
- Comprehensive study including the largest set of banks/countries in the literature.
- Extremely useful to understand the effect of changes to regulatory capital requirements: when these do not bind, the response of capital buffers is everything!
- Remarkable heterogeneity in the relationship between capital buffers and the business cycle.

Comment: CCB

- In Colombia the regulator intends to complement the system of Dynamic Provisions (DP) with a CCB.
- A discussion emerged as to what extent DP complements/substitutes CCB.
- An argument in favor of having both is externalities/strategic complementarities: CCB (DP) is activated following aggregate (individual) results.
- The results of the paper seem to support this view, and therefore to support he whole agenda on countercyclical buffers proposed in Basel III.
- Question for future research: do capital buffers depend on the existence of other buffers (such as DP?)

Comment: Buffers as Macroprudential Instrument

- Sometimes the buffer is *the* instrument!
- Example: Colombia, 2008.
- Key: credibility of the regulator, coordination between banks and regulator.