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Normale Superiore

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Thiemann
Taming the Cycles of Finance?

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Central Banks and the Macro-prudential Shift in Financial Regulation

Matthias Thiemann



CAMBRIDGE
UNIVERSITY PRESS

ISBN 978-1-009-23313-2



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Outline of the talk

- Research Question and Object of Study
- Method and Data
- The early history of the macroprudential thought collective
- The building of macroprudential policy devices
- The use of macroprudential policy devices
- Conclusion: The unhappy consciousness of central bankers

What, if anything, changed after the financial crisis?

- 2007-2008: historical moment
- The role of models in blinding technocratic institutions
- Financialization: the end of the road?
- Investigate in “quasi-real time” --> unfinished process?

What, if anything, changed after the financial crisis? II

- Widespread assessment that there was no significant change in regulation of finance post-crisis (Helleiner 2014)
- one argument for why little to nothing has changed in terms of regulation is that there was simply no economic idea set that could challenge neoliberal views on finance (Muegge 2013)
- The only real challenger to pre-crisis thinking was seen to be macroprudential idea set (Baker 2013, Underhill 2015), which emphasizes the need for a systemic view on the financial system, including the need to increase the resilience of the financial system and the need to tame financial cycles

Views on macroprudential regulation

- Some analysts speak of a mere rhetorical device (Helleiner 2014), an act of symbolic politics by the G20 in 2009 (Lombardi and Moschella 2017)
- Underhill argues that it was emasculated by the power of finance in a process of adverse ideational selection
- Baker (2013a, b, c, 2015) speaks of an ideational paradigm shift, a Gestaltflip of the thinking about financial regulation, which however still lacks the policy tools and setting: thinkers at BIS (Borio) and some economists at several institutions (many of which linked to Goodhart at LSE) push for this idea

Different Visions of finance and associated policy devices

Vision of finance	Efficient Market Hypothesis	Macroprudential Vision
Nature of finance	Finance follows a random walk	Finance is cyclical
Capital allocation	Optimal capital allocation	Misallocation due to manias
Epistemic Authority	Markets	Regulators/state officials
Policy Devices for seeing and knowing risks	Bottom up, Private risk management systems integrated into public risk management	Public Systemic risk measurements; top down assessment by regulators
Policy Devices for interventions to alleviate risks	Rules based; interventions only in case of individual failures, interventions regarding individual risk management systems, “benchmarking”	Discretionary, ex ante intervention by regulators in markets and institutions based on public systemic risk measurements

Financial Crisis of 2008: The macroprudential paradigm shift?

- Common answer: No (Helleiner 2014)
- Dismissive approach based on a binary logic and on a too narrow field of study (policy only, and even there: financial stability mandate)
- Fragmented change: «where different dimensions of an overall policy paradigm shift at several different speeds, at different points in time, and led by a variety of different institutional activities. » (Kaya and Reay 2019)

Baker's fallacy

- Overestimates the epistemic authority of BIS and these scholars (although they were taken notice of before)
- Underestimates the requirements of “regulatory science” (Jasanoff 2011, 2012), that is the need for established objectified knowledge that could be used in regulation
- a too flat understanding of ideational change: a blueprint which needs to be translated into action (Austinian performativity vs ANT performativity).
- Instead, need to pay attention to academic economists and “economists in the wild” (Callon 1998) seeking to develop economic models and policy devices that justify and guide policy intervention

My suggestion to study this fragmented change

- This book studies the (unintended) effects of the macroprudential policy turn in three fields, the field of economics, the bureaucratic field and the political field (based on Hall 1989), inquiring into the viability of these new economic ideas in these respective fields
- Combines this framework with an STS approach to the construction of « risk objects » which are construed as requiring intervention and which lead to the creation of **policy devices**
- follows these policy devices from birth to implementation to activation, asking in how far they are used and how they interact with competing thought collectives/ Actor-Networks/)

Process	Creation of policy devices	Stabilization of policy devices	Use of policy devices
Field of occurrence	Transnational Field of Economics	Administrative Field: Interaction National and Transnational (IMF, BIS)	Field of Politics National Interaction of Technocrats/Politicians
Dimension	Economic Viability	Administrative Viability	Political Viability
Unit of analysis/Analytical Focus	Regulatory Science: Interaction of Applied and Academic Economists creating devices	Creation of Policy Frameworks, Organizational Transformation Central Banks	Policy Actions taken to mitigate systemic risk, interaction political actors and technocrats

Linking Political Economy and Sociology of Economics

- Central Banks as the central political-economic actors of our time (central bank led capitalism, Bouwman et al 2012)
- driving the continuation of financialization even after the GFC with the help of QE (Piketty 2014)
- Central Banks as central nodes in the use and production of scientific knowledge on the economy
- place where the practice of economics and its theoretical abstractions meet

Conceptualizing Central Banks as Actors sitting in a space between fields

- Central Banks are situated in a space between fields (administration, the market, politics, economics; Eyal 2015)
- Boundary Organizations (Coombs and Thiemann 2022), which shift the state-economy boundary and in a liberal system have to defend that very same boundary at the same time
- operating in a space between fields they are not necessarily bound by field logics, they can ally with different actors to reshape the way the different fields operate

CB economists as Boundary Walkers between two fields

- central bank economists as economists which share this hybridity with central banks (interacting with the market, operating in an administrative unit, interacting with the field of academic economics)
- they innovate to satisfy both the demands of economics as a science and economics as practice, producing policy devices that make the financial cycle visible and in theory at least justify interventions
- yet, technocratic governance has its limits and both financial actors and politicians strongly oppose anti-cyclical interventions (but case of Janet Yellen, Nellie Liang)

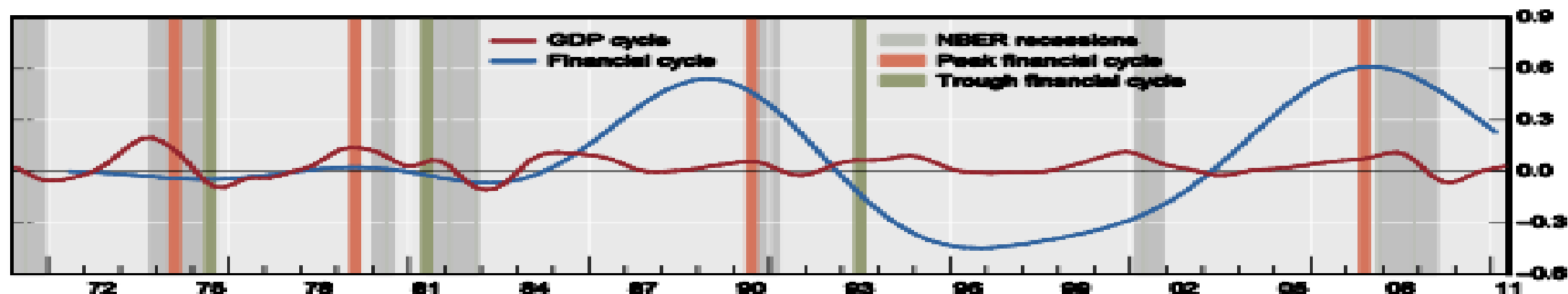
The materialization of ideas

- Focus on the production of new „policy devices“ (Hirschman and Popp Berman 2014) that allow regulators to see, know and regulate systemic risks
- Operationalizing this new approach entailed the challenge for regulators to identify, measure and regulate sources of systemic risk in an appropriate manner,
 - >generating data,
 - >identifying metrics (indicators) and
 - >trigger points for regulatory action

Policy device: the first version of the financial cycle

Graph 1

The financial and business cycles in the United States



Orange and green bars indicate peaks and troughs of the financial cycle measured by the combined behaviour of the component series (credit, the credit to GDP ratio and house prices) using the turning-point method. The blue line traces the financial cycle measured as the average of the medium-term cycle in the component series using frequency-based filters. The red line traces the GDP cycle identified by the traditional shorter-term frequency filter used to measure the business cycle.

Source: Drehmann et al (2012).

Methods and data

- Process tracing regarding the establishment of models, facts and metrics (policy devices) post-crises and their impact on financial regulation
- Document analysis to trace the evolution of the coordinative discourse among central bankers; conference attendances, video analysis
- Topic modeling and statistical analysis of publications on systemic risk and macroprudential regulation as well as economic discourse
- 77 Interviews with applied economists and central bankers working on macroprudential regulation (working within and outside of central banks)

Historical (1970s-2022) and Comparative Approach 2009-2022

- History of the Macroprudential Thought Collective
- Comparative Approach to the Implementation: US (Federal Reserve); UK (Bank of England) and EU (ECB, ESRB and its interactions with national frameworks (Germany, France, Netherlands))
- Focus on policy devices (CCyB, anti-cyclical interventions in housing markets, attempts to intervene in the procyclical character of the shadow banking system)
- Findings: the most impact on banking and through banking regulation, some impact on housing, pervert impact on shadow banking)

The Historical Narrative

The history of the macroprudential thought-collective

- Constitution of the thought collective: 1970s at the transnational level (Euro-Currency Standing Group)
- Persistently grappling with the financial innovations unfolding since the break-down of Bretton Woods, starting with the Euro-Dollar market (Braun et al 2021)
- Internally divided, dominated by the Basel Committee for Banking Supervision, its macroprudential approach is consistently oppressed in the 1980s and 1990s

1990s onwards: Rising financial instability which strengthens the thought collective

- 1995, 1997, 2001: rising financial instability
- Thought collective, while still dominated by the BCBS, gains in institutional power (FSF, IMF FSAP, BIS)
- Formation of a collaboration between academics and central bankers from 1995 onwards (in the shadow of the hinge identified by Seabrooke and Tsingou 2020): a nascent epistemic community
- Evolution of different concepts and themes; financial cycle one idea among many, more prominent are short-term concepts such as contagion, herding
- Push for financial cycle thinking by BIS (preliminary work, Borio, Borio and Drehmann)

The Financial Crisis of 2007-2008

- Macroprudential thinking is central to the initial framing of the crisis as systemic (October 2007, FSF)
- Manages to insert itself in the discussions on Bank regulation (CCyB)
- Fails miserably in the discussion of the regulation of what comes to be called shadow banking
- Limited Success, with the remaining work delegated to central banks in their jurisdictions

Success in Banking Regulation: Basel III

- Banking Regulation is quickly agreed by regulators of US; UK and Switzerland
- Lip service to macroprudential regulation
- The Counter-cyclical capital buffer as the only tangible immediate new measure
- Enters at the last possible point, operationalization for a long time unclear;
- in the end it is installed in a discretionary way to be set by the regulator because the majority thinks there is a need to change

Domestic Implementation Banking regulation

- US: resilience (stress tests), very limited anti-cyclical dimension
- UK: resilience, with cyclical as secondary goal
- Eurozone: anti-cyclical as a primary element, yet anti-cyclical prudential tools at the national level
- How to implement? Need for policy devices

Hard work of applied technocratic economists

- Building the policy devices to signal the build-up of cyclical risks
- Large scale collaboration central bank economists, with and without academics
- Amassing and analyzing large scale data-sets to generate early warning systems, then to seek to condense the findings into a simple number (« actionable knowledge »)
- Growth at Risk framework as one example; these items often implemented in stress tests (UK), but made impossible in EU and in US

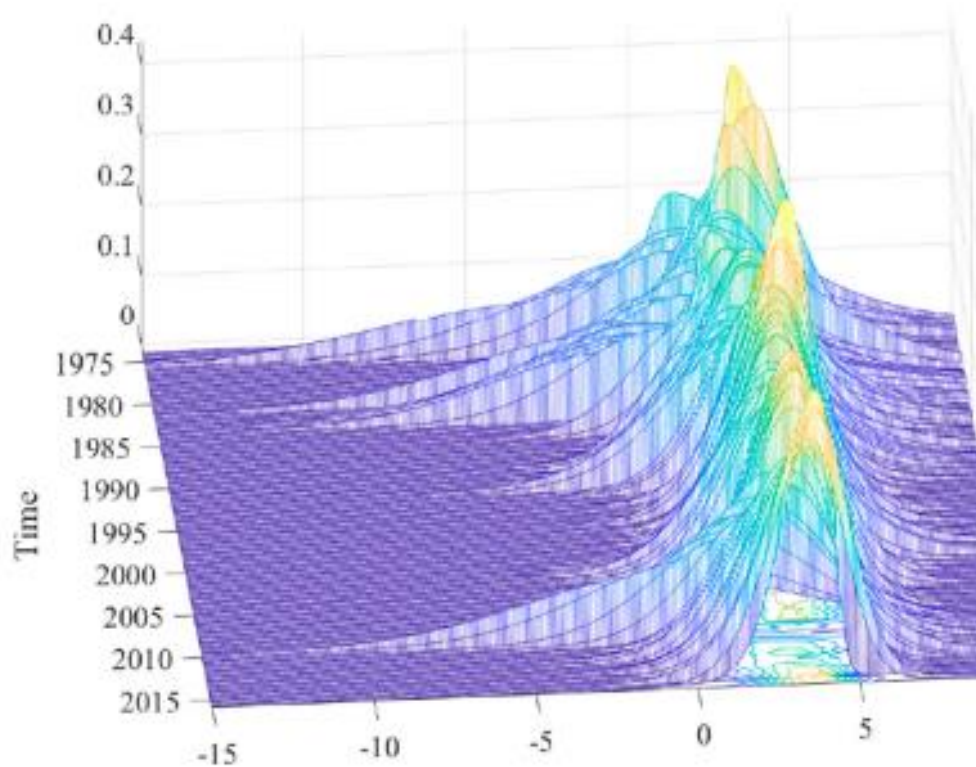


Figure 1 Distribution of GDP growth over time. One-year-ahead predictive bution of real GDP growth, based on quantile regression with current real growth and NFCI as conditioning variables
Source: Adrian et al. (2019, p. 1265).

Growth at Risk (Adrian et al 2016→ Adrian et al 2019)

Stylized facts about the relationship between an upswing in financial conditions and GDP growth in 3 years from now (asymmetrically negative)

Built as “actionable knowledge”

Not applied in US, but built into stress tests in the UK

Implementing these Devices in Banking Regulation

- US: hidden action (anti-cyclical action in structural terms) through stress tests and anticipatory action on broker-dealers
- UK: gentlemanly discussion on the need for anti-cyclical action
- Euro-zone: use of models by the ECB to coax national central banks and national policy makers into action
- Models are implemented by bureaucratic actor central bank according to the mandate and the administrative procedures they have to fit with (strategic reflexive actors)

Conquering the nowhere's land

- Shadow banking: the unobserved system of credit intermediation which led to the market breakdown in 2008
- Markets for refinancing with 1000s of billion of dollars (repo)
- Pre-crisis: no data collection
- Crisis narrative: run on « shadow banking » (Gorton and Metrick 2008), but despite that: no regulation (lack of data to prove what was going on)
- Instead of action: research
- Piecing together the data in order to convince skeptical market regulators and industry

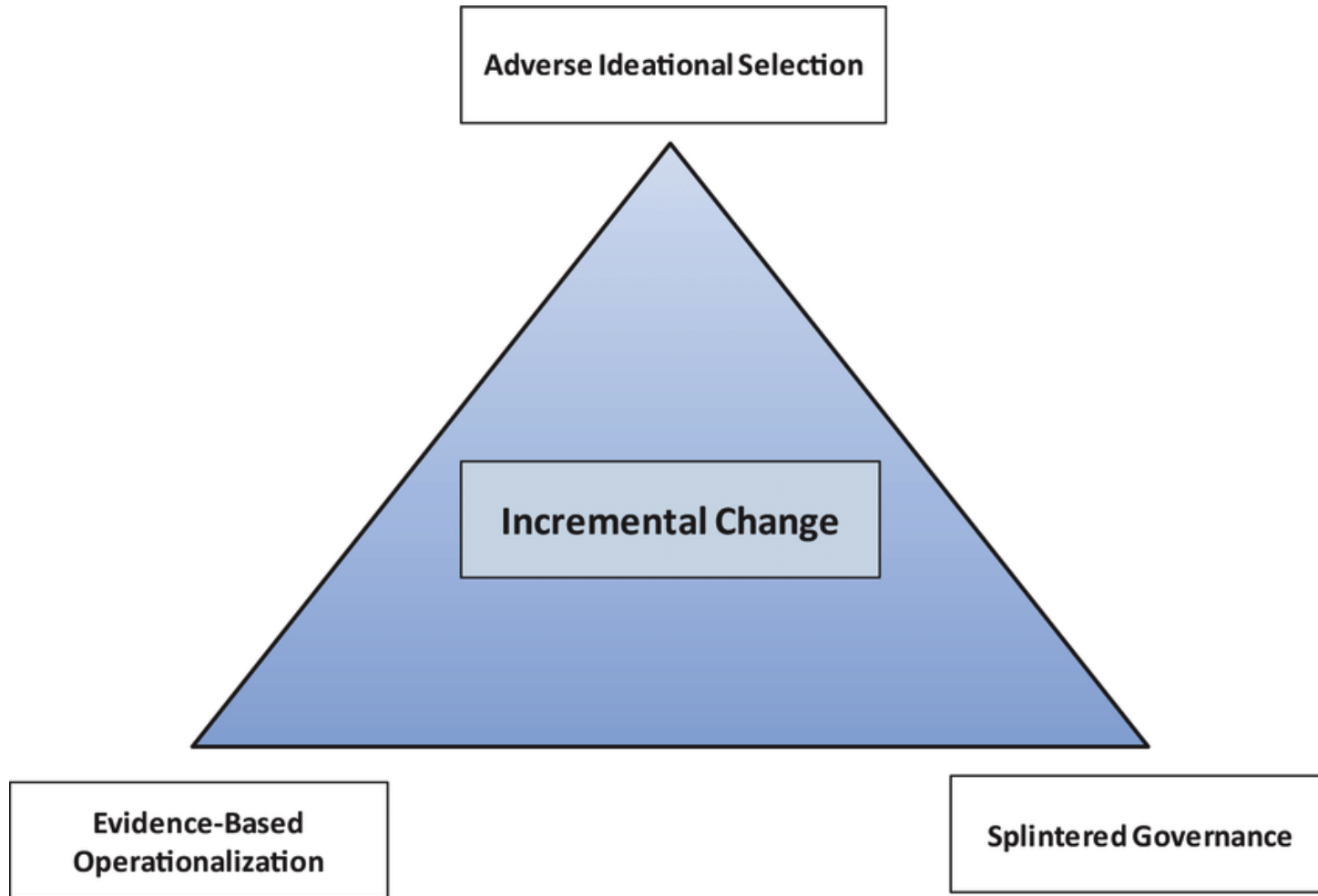
Failure with respect to shadow banking

- Macroprudential change agents point to the interplay of liquidity and leverage in capital markets as major cause of current turmoil
- Opposed by market regulators
- Opposed by accounting regulators
- Arguments in their infancy=> a research program
- surveillance

Regulating Shadow Banking System

- Repo-market action started in 2010: idea set of macroprudential change agents crucial (Brunnermeier and Pedersen 2009, Adrian and Shin 2008)
- But difficulty of agreement across jurisdictions and across regulators (no prudential culture at market regulators)
- Final results: anti-cyclical regulation for upswing ridiculously low
- But structural interventions by US regulators through FSB: the ruse of last minute adjustments to banking regulation (NSFR, LR): penalize broker-dealers

Reasons for Incremental Change of shadow banking regulation post-crisis



- Coordination with market regulators fails
- Coordination across transatlantic very difficult
- To impose regulation, regulators are asked to prove beyond a doubt the pro-cyclical aspects of shadow banking

The effects of regulating shadow banking

- Structural measures imposed and data collected (CCPs in EU), but not in US (lack of data)
- In US and globally: Regulatory constraints upon broker-dealers (NSFR, Leverage Ratio) leads to reduction in global market liquidity (well documented and observed: CGFS 2015, 2017)
- Repositioning of central banks as legitimate Market Makers of Last Resort (financial stability): from exception (2008) to increasingly established procedure (2020)
- Prevent the downswing and the pro-cyclical features of the shadow banking systems (QE)

What are its effects?

Using these policy devices from 2013 onwards

- Enacting these devices signalling danger: macroprudential regimes as an « excuse of a policy »?
- Some action on banks (counter-cyclical capital buffer)
- Little action on cyclical upswings housing (but variegated, more if central banks are in charge; Thiemann and Stellinga 2023, Lepers and Thiemann 2024)
- No action on shadow banking (through the cycle haircut, not anti-cyclical): global market, problems of coordination and problems of jurisdiction

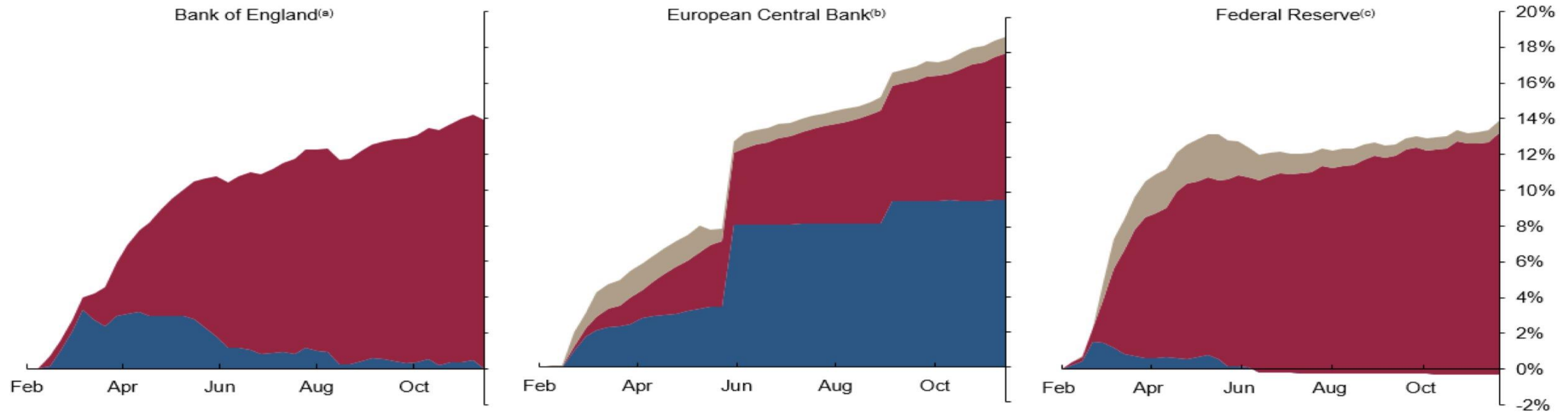
Repositioning of Central Banks post-2013

- Central banks worried about sudden drying-up of liquidity in repo-market, also caused by new structural regulation (CGFS 2013; 2015, 2017)
- Repositioning of central banks in repo-markets as a backstop: « Open for Business » (Carney 2013)
- Increasing use of emergency facilities to react to sudden spikes and transformation of these emergency facilities into more normal facilities (Fed 2021)
- These interventions are increasing, justified with financial stability concern (now including the use of QE during Covid)

Chart 4: Central bank balance sheet responses to the Covid-19 shock during 2020

Changes in components of central bank balance sheets since end-Feb 2020 (as % of 2019 nominal GDP)

- Lending operations
- Asset purchases
- Other



Sources: Bank of England, Bureau of Economic Analysis, European Central Bank, Eurostat, Federal Reserve Board, ONS and Bank calculations.

- (a) Bank of England lending operations shown here: Indexed long-term repo, Contingent term repo facility, US dollar repo operations, Liquidity Facility in Euros, Term Funding Scheme and Term Funding Scheme with additional incentives for SMEs. Bank of England asset purchases shown here: Asset Purchase Facility and Covid Corporate Financing Facility.
- (b) ECB lending operations: Lending to euro-area credit institutions related to monetary policy operations denominated in euro. ECB asset purchases: Securities held for monetary policy and other purposes.
- (c) Federal Reserve lending operations: Repurchase agreements, Loans and Net portfolio holdings of TALF II LLC. Federal Reserve asset purchases: Securities held outright. Section of chart lying below the zero line from mid-2020 reflects a decline in repo outstanding relative to end-February.

Conclusion: comparison 2008 and 2023

- Macroprudential thought collective has established the idea of the cycle both in academia and in central bank discourse
- Macroprudential ideas have been implemented in policy devices, which signal the build-up of risks, both for credit aggregates but also for repo-markets
- Preventive Action on these signals is generally weak and variegated; strongest for banking; weakest for shadow banking
- Financial stability concerns, established as a valid mandate of CBs now come to justify interventions in the downswing, but not the upswing: perversion of the idea...

The asymmetry of the evidence based approach and financial stability

- Stress tests have become the preferred locus of application of anti-cyclical thinking
- QE as a new tool for intervening in the downswing (MMLR)
- CB's financial stability mandate: caught between a rock and a hard place: unable to change the financial system, they have to back it up based on their knowledge
- The evidence based approach and central bank action: for action in upswing required, for downswing not required
- No capacity to get the data still; for a long time no coordination with market-based supervisors

Unhappy Consciousness

- Knowing, but not acting: Researching the definite proof in the face of skeptical market regulators and powerful industry (Blackrock)
- Evidence and the regulation of finance: uphill battle
- Evidence and the interventions to save finance: not necessary, still doing QE despite accumulation of evidence of negative effects; exception
- The asymmetry of central banking and the paradox of rescuing the financial system without stating its name (QE)
- The metaphor of a firefighter who knows the house is easily lightening up, but only has the foam to fight the fire, but no capacity to remove the causes of it catching fire easily

The effects: shifting the state-Economy Boundary

- Central banks, through their actions cement the status quo order, at the same time that they grow their central banks' balance sheets into unknown proportions (today more than 20% of all financial assets on central banks' balance sheets in Europe, US and UK)
- Increased inequality and Inflation (contribution to)
- No crashes, which means no public outrage, which means no further regulation of finance
- Untenable situation? (Minsky, Konings): central banks as the ultimate arbiters of the state of exception?

Positive Suggestions: What to do?

- Need to move beyond evidence based policies: precautionary principle
- Empower central banks to fix the issues of regulation of run risks in the shadow banking sector
- How? Either by generating a macroprudential supervisor for the financial system as a whole or by forcing shadow banks into the remit of central banks:
- How to do that?

Taming the cycles of finance?

Central Banks and the Macroprudential Shift in Post-Crisis Financial
Regulation

Views on macroprudential regulation

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Fallacies of paradigm change thinking

Constructivist institutionalism (Clift 2018):
Ideational change, but not paradigm change

My intervention

- Yet, while very insightful to understand the institutional context in which economic ideas can thrive, this research still largely **ignores the preconditions for new economic idea sets to become viable** in the **economic field** in the first place and their translation into policy devices to make them suitable for policy practice. As Mudge and Vauchez put it eloquently, this “nondifferentiation of ideas and inattention to their scholarly and professional origins” has caused “difficulty moving beyond the basic proposition that “ideas matter” to an understanding of the interconnected processes by which ideas are produced, imported into political and bureaucratic spaces, and translated into categories of perception and programs of action” (Mudge and Vauchez 2012, 454).
- The neglect of these questions is at full display in the recent scholarship on post-crisis regulatory change. **If this scholarship has focused on ideational change, it has only looked at discursive changes at the top of the political and technocratic levels, commitments to a new macro-prudential approach to the regulation of finance, but not on the substantiation of these promises through the practical work of economists.**

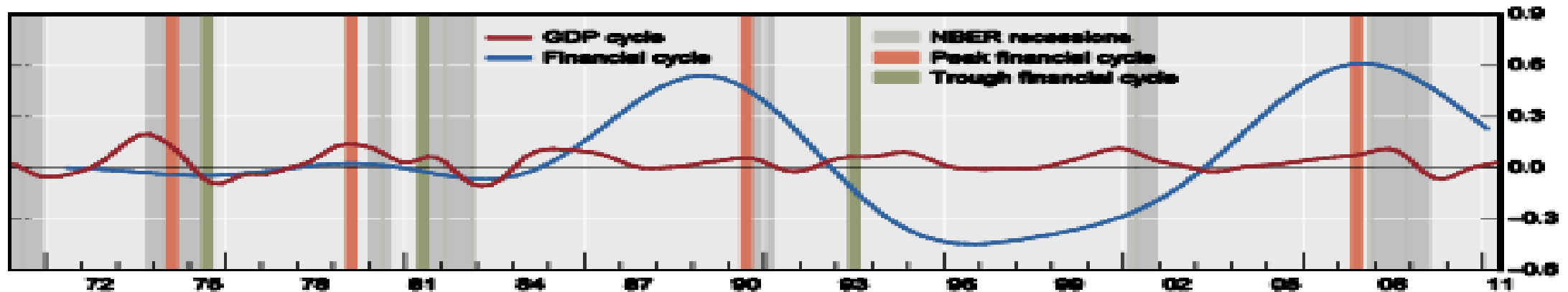
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Measuring ex ante: The financial cycle

Graph 1

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Source: Drehmann et al (2012).

Literature on the Power of Economic Ideas- (Hall (eds) 1989

- power of economic ideas depends on their political, economic and administrative viability
- For politics: is it in the interest of politicians to pursue the topic?
- Economic viability: is it accepted in the economic profession as a viable proposition?
- Administrative viability: is administration capable of implementing these economic ideas? Is it in the interest of administrative leadership to pursue these policies?

Hence my focus is on

- Economic viability (in the sense of economics): focus on the engagement of economics as a social science with these themes
- Administrative viability: focus on the capabilities and interests of administrative leaders given the task to implement the macroprudential reform agenda
- Political Viability: Focus on the political engagement with macroprudential ideas and macroprudential regulation

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Work Package	WP1	WP2	WP3

The trajectories of governability paradigms

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