Removing the Punch Bowl: Moderating Vulnerabilities from Global Economic Booms by Forbes and Klein

Discussion by Sebnem Kalemli-Ozcan
University of Maryland, CEPR and NBER

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Research Question and Key Finding

- Which policies are effective in moderating booms—removing the punch bowl?

- Increasing interest rates!
  - Moderates bank credit boom, equity boom, banking crises
  - Might cause an increase in NPLs

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Scope of the Study: 50 countries

7 policies during 2002–2007: (dummies/more than 10th percentile change)

- Increasing interest rates
- Tightening fiscal policy
- Allowing exchange rate to appreciate
- Accumulating reserves
- Capital controls on inflows
- Macroprudential

4 outcomes over 1-2 years:

- Bank credit boom
- Equity boom
- Banking crises
- NPL

Other Results

- Appreciation: reduce risk of banking crises and NPL but increase risk of credit and equity booms

- Macropru: 1 year lag reducing effect on credit booms and NPLs but increase risk of equity boom

- Capital controls: not significant

- Fiscal tightening/reserves: some effect on NPL and banking crises

Key Contribution

- Propensity score matching to deal with selection bias: endogeneity—reasons to implement policies are correlated with the outcomes

- Nicely executed with all the checks and balances, little room for nitpicking

One caveat of PSM: Matching on Observables

- PSM method matches on observable country characteristics.

- There might also be unobservable country heterogeneity yielding similar selection issues

- An instrument can solve this issue but we do PSM since we do not have an instrument at the first place

- Alternative solution: A differences-in-differences matching estimator

- Rather than evaluating the effect on the outcome variable, we can evaluate the effect on the change in the outcome variable, before and after the intervention.

- Akin to DID estimators in standard policy evaluation

- Then we can control for the notion that there may be substantial unobserved differences (non time varying) between treated and untreated units

Maybe some nitpicking...

- Can you display the frequency distributions of estimated propensity scores for treated and untreated to see if they are similar in distribution not only in means?
- Scores seem to be bigger than 1: maybe you are reporting log of odds of propensity scores but this means you have oversample of treated units?
- How is this possible with limited variation in the policies?

Variation in policies

- Low time variation (yearly data)
- Most variation is in decreasing appreciations and increase use of macro prudential
- Low cross sectional variation (0-1 dummies)
- Are insignificant results insignificant because of such degrees of freedom issues or real insignificance?
    - The authors also struggle with this issue

Conclusion

- Great, thought provoking paper!
- Pleasure to read, well executed work, very informative exercise!
- Looking forward to more from the team