

Targeting Asset Bubbles: Evolution of Policies

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Abstract

Before the Great Recession the policy was not to interfere with increases in asset values, and if any resulting asset bubble crashes led to financial instability, then policies would be enacted to help the recovery. The crash that led to the recent financial crisis changed the mind of many researchers as they more thoroughly investigated the present and the past crises concluding that more attention needs to be paid to financial stability. This involved microprudential policies, meaning policies that would stabilize financial firms, as well as experimentation with macroprudential policies whose purpose is to stabilize a specific sector. By stabilizing a sector, the hope is that no spill over would take place to destabilize the financial system.

JEL Classifications: E44, E65, M38

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1. Introduction

The financial crisis, which started in 2008, surprised most observers by its sudden, deep intensity and degree of damage done to the economy. In many ways it was a perfect storm, for the rapid growth in asset prices driven by leverage led in time to their collapse. The surprise of the intensity of this financial crisis was also due to the fact that for many decades the recessions were tamer and our policy tools seemed to be adequate to the task. However, the crisis and the lengthy recovery from this recession made us question if any change in policies are needed in order to avoid another intense recession. Are our policy tools adequate to address another danger to financial stability?

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The objective of this paper is to show that there are changes in policy approaches underway as much was learned from this Great Recession. Our thinking changed with respect to policies that could prevent large failures in the financial system and thus reduce the chances of certain bubble formations. The changes do not only involve fortifying the financial system, sometimes known as microprudential policies, but also involve a formation of a new policy front known as macroprudential policies. Macroprudential policies address an industry or sector in order to reduce rising risk to avoid the possibility of bubble formation. In addition, some changes occurred in the area of regulation enforcement, as that too is necessary to monitor expansion of risk in a financial system to improve stability.

The paper is organized in several sections:

- Policies in transition
- Financial stability: A higher level of concern
- Macroprudential view: A new type of policy
- Regulators and their changing mission
- Discussion and conclusion: What was learned after the Great Recession?

2. Policies in transition

2.1. Views before 2008

For almost a half century after the Great Depression there were no bank failures of any significant size, therefore it was easy to assume that the structure of the banking system was solid enough, and likely not to be a cause of disruptions or recessions. The Federal Reserve role as a ‘lender of last resort’ was accepted as an additional stabilizing effect; bringing a level of assurance to the banking system. The accepted doctrine was that the Federal Reserve would assist and support solvent institutions that are able to provide solid collateral. The various shocks to our financial system including the failure of Continental Illinois, the S&L crisis in the 1980’s, followed later by the Latin American crisis, the stock market crashes of 1987 and in 2000, and the failure of Long Term Capital, caused concerns but did not disrupt the stability of the financial system. In sum our financial system was stable enough, meaning that with present regulatory and monetary tools it was managed reasonable well.

Economic history has many examples by bubbles forming a bursting, and to assure financial stability one would have to have a policy that addresses this issue. Discussion of how to address a bubble formation presented us with two possibilities. The first one was not to interfere or do something to prevent a bubble from forming and then to clean up after the bubble bursts. This was viewed as the less costly to the economy. The second option was to prevent a bubble from forming, which may slow down the economy early in its cycle (leaning against the bubble) and thus be costly. Hahn, Mishkin, H. S. Shin and K. Shin (2012) and others have referred to this discussion as ‘clean’ vs. ‘lean’ debate.

Past research provided much evidence that monetary policy, which stabilizes inflation and output, is very likely to stabilize asset prices thus decreasing the chance of forming an asset-price bubble (Bernanke & Gertler, 2001). In addition, if a bubble formed one would wait for the bubble to burst and affect the macro economy - then the Federal Reserve would intervene. That was the view held steady until our recent crisis, even if it was visible that an asset bubble was developing (Cecchetti, Genberg, Lipsky & Wadhvani, 2000; Greenspan, 2002; Borio, English & Filardo, 2003; White, 2004; Kohn, 2006; Mishkin, 2008). Some arguments in favor of this policy were difficult to ignore:

- Bubbles are difficult to detect. Although rapid increases in the prices of assets - with respect to their intrinsic value - is nothing new. Since the “tulip mania” and the South Sea (Company) Bubble there were many others where asset prices increased rapidly only to fall and devastate investors and have a negative effect on the economy. However, many have claimed that bubbles are not easy to detect and that their formation is somewhat of a surprise. For these reasons and before the recent financial crisis, policy makers argued that monetary policy should not react directly to market bubbles. “Moreover, even if correctly identified, bubbles can be difficult to deflate without imposing significant costs on the economy. The implication is that, instead of leaning against a bubble while it was inflating, it would be better to clean up after it had burst” (Trehan, 2009).
- The standard monetary policy tools may not be satisfactory in leaning against the bubble as they are a blunt monetary policy tool that affects the whole economy, although the price asset bubble may show up only in one or few sectors. The authors cited above as well as Yellen (2011) have described the bluntness of monetary policy as a sledgehammer, for it is certainly not a tool that can address one sector or one region. Therefore, increasing the interest rates (to slow down the bubble formation) could do more damage to the economy.
- An increase in interest rates could be ineffective against a bubble as market participants expect high rates of return in the bubble driven assets. Bubbles are a departure from normal conditions and there is no guarantee that normal monetary policies will work in abnormal conditions.

2.2. Changing Policy Views

The idea that bursting of a bubble may be very costly was discussed early enough. Kindleberger (1978) examining historic evidence and concluded that bursting of bubbles was followed by sharp declines in economic activity. C. M. Reinhart and Rogoff (2009) found that after a financial crisis, the massive bailouts of financial institutions, fiscal stimulus packages, and a reduction in tax revenues due to a recession will tend to increase governmental indebtedness. If global in character, the financial crisis was likely to cause increases in debt for many countries. In addition, C. M. Reinhart and V. R. Reinhart (2010) pointed out that a strong recovery of a V-shape is not what follows after a financial crisis. A recovery will be slow, with smaller increases in GDP and higher levels of unemployment for years to follow. In other words the output losses from a financial crisis are rather larger than believed earlier. Since a financial crisis impacts all sectors of the economy, the uncertainty about the future is deeper and business investment is slow to grow and thus overall economic growth is likely to be below normal afterwards. All this implies that the cost of a bubble bursting (without intervention) is rather high. The current research has shaken the earlier belief that monetary policy, by stabilizing output and inflation, is likely to always bring stability to the financial system.

The US Government Accountability Office [GAO] (2013) reported that the decline in output in our financial crisis just in the period 2009-2011 was about \$13 trillion, almost a year’s GDP. While this is an estimate, it points to the damage caused by a deep recession and supports the hypothesis that damage caused by a bursting bubble is rather high. Another type of evidence has brought a clearer picture of the consequences when a large financial firm fails due to the firm’s complexity and interconnectedness. The failure of Lehman Brothers in 2009 shows the immediate and longer term effects as captured by Fleming and Sarkar (2014, pp 28-29,):

- The bankruptcy of Lehman Brothers was one of the largest and most complex in history, encompassing over \$1 trillion worth of creditor claims, four bodies of applicable U.S. laws, and insolvency proceedings that involved over eighty international legal jurisdictions. This was accompanied by the complexity of claims and litigations to follow.

- The predictability of Lehman's claims settlement procedures were hindered by the novelty of its business and financial structure in the context of bankruptcy cases. Chapter 11 proceedings are based on the application of case law relating to the Bankruptcy Court's prior interpretations of cases. While existing case law provided a useful starting point for Lehman's resolution, the court provided new interpretations of provisions in the Bankruptcy Code. In part, this reflected the prominence of complex financial securities that the bankruptcy court had to analyze, perhaps for the first time.
- The poor planning of the bankruptcy process, in particular, stands out as being especially costly. In contrast, creditor losses would have been more substantial without the ability of Lehman's U.S. brokerage subsidiary, and subsequently of Barclays, to finance positions through the Federal Reserve's newly provided liquidity facilities.
- Lehman's organizational complexity also resulted in delays. For example, in many instances, Lehman and its counterparties were uncertain of the identity of the specific Lehman subsidiary against which creditors had claims.
- Finally, Lehman's interconnectedness led to delays as creditors of the holding company, Lehman Brothers Holdings Inc. (LBHI), argued in court that they were entitled to a portion of recovery from subsidiary assets (since LBHI had guaranteed some of the subsidiaries' debt).

In sum, the bursting of the bubble in the last crisis was a heavy burden on the economy that was further complicated by the bankruptcy of a large financial institution. This therefore illustrates the micro view with specific costs of bankruptcy due to complexity of products and interconnectedness with other firms and how failure of one large banking institution affects directly other institutions through the interbank or derivative markets. The above example of Lehman Brothers is a current day micro-example of why a clean-up after the bubble bursts is rather messier than expected in the past.

The event of bubble formation and busts were of interest to many researchers (see Stiglitz, 2009; Keeley & Love, 2010). Two types of bubbles were specifically identified – one referred to as irrational exuberance bubble, and the other, a more dangerous one, was described by Mishkin (2010) and Yellen (2011) as a credit driven bubble.

The **irrational exuberance bubble** is driven by highly optimistic expectation as did the tech bubble in the 1990's. This bubble was not sustained by a feedback loop between bank lending and equity values and when it burst; no great damage was done to the balance sheets of banks. Thus the recession that followed was rather mild.

In a **credit driven bubble**, the demand for some assets increases leading in that sector which leads to increase in the same asset prices. The rise in value of these assets further increases lending against these assets, thus continuing to increase their value and prices creating the beginning of a feedback loop. If credit standards are eased, a bubble may begin forming as lenders become less concerned about the ability of borrowers to repay, anticipating appreciation of the assets as protection against losses. The bubble eventually bursts, reversing the direction of value and prices of the assets in question significantly as seen with subprime lending in the recent past. Lenders reduce credit availability for these types of assets which reduces further their value and prices. Loan losses increase and combined with the declining prices of assets cause the erosion of the balance sheets of financial institutions which reduces credit and investment for a broader range of assets. This reduction in lending in other sectors has been seen to depress business activity as well as household spending and possibly the financial system as a whole.

When bubbles burst, the speed of economic decline accelerates as the interconnectedness of banks and complex financial products cause an externality; a failure of a bank will directly affect

other financial institutions through the interbank market or the derivative market. Acemoglu, Malekian and Ozdaglar (2013) suggest another effect due to interconnectedness. High Interconnectedness of financial institutions mitigates the impacts of small shocks but amplify large shocks (as banks when dealing with other banks have been unconcerned with systemic risk).

In sum, the credit driven bubble is more dangerous as it could impact the whole economy. From our recent experience, it is rather costly when the credit driven bubble bursts. One silver lining could be that the credit driven bubble is easier to spot as it takes time for the feedback effects to work. If it is easier to spot we might identify policies that would address it before it before another crisis begins.

3. Financial Stability: A Higher Level of Concern

3.1. Microprudential Policies

Most reforms to date have been focused on bank regulation and for that reason they could be labeled microprudential policies, as they are designed to limit or reduce the risk-taking by banks to assure financial stability. Financial stability is defined as (European Central Bank [ECB], 2015): “A condition in which the financial system – intermediaries, markets and market infrastructure – can withstand shocks without major disruptions in financial intermediation and in the effective allocation of savings to productive investments.” In sum, all financial markets should operate as intended without panics and major distortions. A more specific definition is offered by the Office of Financial Research [OFR] (2015), one of the new agencies created in response to the Great Recession: “Financial stability occurs when the financial system can provide its six basic functions, even under stress: (1) credit allocation and leverage, (2) maturity transformation, (3) risk transfer, (4) price discovery, (5) liquidity provision, and (6) facilitation of payments. Financial stability is not about curbing market volatility, predicting financial shocks, or preventing them. Financial stability is about resilience. When shocks hit, a resilient financial system will continue to provide those basic functions to facilitate economic activity.”

As a result, banks and other financial institutions have been the target of this response given their role in the global economy. Accordingly, strengthening financial institutions is one way to bring stability to the financial system as banks could then more readily absorb sudden shocks without threatening the financial system. In the recent crisis, a problem in a small part of the financial system (subprime lending) led to a collapse of some financial firms that were too exposed to risk and endangered the stability of the financial system – one could say they acted as the straw that broke the camel’s back. In a healthier financial system a danger in one part of it could likely be absorbed without causing a recession.

As the financial crisis affected many countries, it was important to seek ways to make the global financial system more stable. One way to achieve that was to reduce the probability of failure among the largest financial firms. In the US, the reaction to the Great Recession led to the passage of Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010 (Dodd-Frank or the Act) and globally, the Basel Committee on Banking Supervision introduced Basel III. The goal of both pieces of rulemaking was to improve accountability and transparency in the financial system, to protect taxpayers from bail-outs of firms as well as to protect consumers from abusive financial services practices. To meet these goals, in the US, three new agencies were created: the Financial Stability Oversight Council, the OFR, and the Bureau of Consumer Financial Protection. In Europe the Basel Committee on Banking Supervision created the Financial Stability Board that is responsible for assuring financial stability.

While new regulations focus on stability issues including increasing bank capital requirements and introduce capital surcharges for systemically important banks; each country is left to decide

how to implement these stability policies. In the US, large financial firms that may threaten the financial system are known as Systemically Important Financial Institutions [SIFI] and have been subject to the most stringent rules and early phase-in periods starting in January 2015. A number of the new regulations and requirements include: holding extra capital to account for size, strategic focus, global reach and strategic importance plus holding larger amounts of good quality liquid assets. Institutions must also perform stress tests based on regulatory parameters (once a year) and based on internal measurements. Another major enhancement to financial stability is in the form of institutions acceptable resolution plans, known as “living wills” that address how an institution would be closed in the event of financial failure so that taxpayers are not burdened with a rescue of a large financial institution.

Overall, the requirements of these new regulations are anticipated to limit the possibility of an additional crisis. “This framework would provide incentives to these banking organizations to hold substantially increased levels of high-quality capital as a percentage of their risk-weighted assets,” Chair Janet L. Yellen said. “This, in turn, would encourage or require such firms to reduce their systemic footprint and lessen the threat that their failure could pose to overall financial stability” (Fisher, 2014) as it was intended by a proposal originating from by the Basel Committee on Banking Supervision. The increased levels of capital will be calculated based on considerations of size, interconnectedness, cross-jurisdictional activity, substitutability, and complexity. In addition, there are penalties for those who fail to maintain the new capital structure: including restrictions on capital distributions and discretionary bonus payments. These restrictions are encouragement to maintain managerial control, especially risk control, as individuals earning extremely large rewards may be tempted to take on more risk, and rely more on short term funding that also may contribute to greater instability.

It seems that the microprudential policies have stabilized the banking system, but one can still raise a question: Did central banks pay enough attention to financial stability in the past?

Historically, central bankers have from time to time discussed financial stability, but it was not generally the highlight of their meetings. This is not surprising as it seems that monetary policy in the last 40 years was a satisfactory force to manage the economy despite it being a blunt tool. Williams (2015) suggested that one reason for a smaller concern with financial stability was that it was viewed as a dangerous distraction; a distraction that may damage the credibility of a central bank in its price stability quest.

While we are content that the microprudential policies have brought a higher level of financial stability to the banking system, are we convinced that they can prevent another bubble? More assurance may come from a different type of policy one referred to as macroprudential.

4. Macroprudential View: A New Type of Policy

The Great Recession led many to raise several questions: Should more attention be paid to financial stability? Is monetary policy sufficient to deal with future recessions of the type we recently experienced? Hahn *et al.* (2012) asked: What if price and output stability do not insure financial stability? In consideration of that question, there is some news here as new policies are being applied that may further contribute to financial stability. These are targeted rules that can be applied to an affected sector where asset prices are rising rapidly. These types of policies are known as macroprudential and are a new addition to monetary policy. For example, in 2010, Basel III introduced a macroprudential policy known as the countercyclical buffer that allows regulators to limit credit growth in a sector where asset price increases could potentially affect financial stability. This would assure that the affected sector does not make conditions worse in times of existing shocks to financial system.

The application of macroprudential policies has been on the increase. In 2013 the Reserve Bank of New Zealand imposed higher loan-to-value ratio requirements on mortgage lenders as property prices were rising above their historic norms. This new policy resulted in prices of property leveling off and no harm occurred to the economy. The Bank of England had similar concerns over rising property prices; those were slowed down by restricting the size of mortgages relative to borrowers income. On January 27, 2015, the Central Bank of Ireland announced new mortgage policies that restricted borrowing by introducing loan-to value and loan to income limits. Do notice that these restrictions were all in the mortgage fields, an area where the credit driven bubble certainly formed the feedback loops that that we experienced in the recent financial crisis.

In addition to specific macroprudential policies in several countries, some countries have established macroprudential authorities. In the European Union the macroprudential authority is the European Systemic Risk Board [ESRB] set up in 2011; while it has limited authority, it can influence national policies (Jeanne & Korinek, 2014).

Macroprudential policies are a new development and potentially a helpful addition to the regulatory toolbox in the goal toward greater financial stability. Nonetheless, they are still early in their adoption and it is too early to suggest that no bubbles will ever form. Comments of participants at the Federal Reserve conference in Boston in October, 2015 (The New York Times, October 3-4, 2015) reflected the hope that macroprudential policies have much potential, but also the suspicion that the newness of this type of tool – untried widely and untested – may not be something to depend on yet (Appelbaum, 2015). The Federal Reserve policy that aligns with the Basel III countercyclical buffer policy is examining and discussing issues related to implementation and effectiveness of macroprudential proposals. The Federal Advisory Council and the Board of Governors (2015) have already focused on the following issues of interest:

- How to measure excess credit or systemic risk?
- When do we initiate a countercyclical buffer? What is the speed of implementation?
- Is there assurance that it will not impact healthy sectors?
- Are there unintended consequences?

Nonetheless, the idea of having a macroprudential policy tool is very promising. Although it may have limitations, having a new tool that could to some extent contribute to financial stability is a significant addition to stabilization policies.

5. Regulators and Their Changing Mission

5.1. Regulatory Enforcement before the Crisis

One cannot discuss policies without referring to those who enforce them. The boom and bust of the financial crisis certainly raised questions with respect to the enforcement bodies – the regulators who serve to prevent crises and ensure a level playing field: What was the role of regulators during the last crisis? While the charge often heard was that regulators were slow to react to the impending crisis, it is always a good thing to remember what contributed to the seemingly lax attitude among the regulating bodies.

Bank supervising bodies followed an approach that depended heavily on banks' own evaluation of internal risk. The main thrust of the examiners was to improve banks evaluation of the internal risk accompanied by the belief that markets always self-correct (Financial Crisis Inquiry Commission, 2011). Notice how this differs from what was learned in the S&L crisis: Act immediately when something is amiss, do not practice forbearance by hoping that over time things

will improve. Note: in the crisis of the 1980s, many S&L that were gently treated by regulators did fail despite regulatory leniency (Jain & Tomic, 1995).

As banks were in charge of their risk management, this also extended to compliance with capital standards. Banks did not favor the Basel 1988 accords as it did not give them flexibility to base their capital on the perceived riskiness of specific assets. Base II (2004) allowed banks to lower their capital charges if they had in place sophisticated internal models for estimating the riskiness of their assets, and with it, the required capital. With this, examiners again depended heavily on excessive faith in banks' internal risk models, and thus tolerated a reduction in levels of capital in return for (hopefully) better risk-management practices.

In late 2004 and early 2005, Secretary of the Treasury, John Snow met with regulators to discuss the concern over increases in poor lending practices. He was surprised to notice that no one had a 360-degree view of the financial markets. While some admitted that there may be a problem but was not "in my field of view," meaning that all things are fine in their specific areas (Financial Crisis Inquiry Commission, 2011).

Additionally, the financial services industry continued to strongly resist further controls by regulators. For example, in late 2005, guidance provided by federal agencies asking banks to consider a borrower's ability to make a loan payment in their loan underwriting was resisted although low documentation loans kept on reaching a wider number of clients. Some resistance from the regulated entities stated that "almost any form of documentation can be appropriate" or there was no need for "further consumer protection standards" or that such restrictions would be "stifle innovation." In anticipation of stricter lending standards, some institutions chose to change regulators in the hope for more lenient treatment (Financial Crisis Inquiry Commission, 2011).

In sum, across regulating agencies, the dominant belief was that a lighter hand at regulation was the appropriate role for regulator. Note how this is in contrast to the finding after the S&L crisis, where forbearance by regulators made things worse for many small banks (Jain & Tomic, 1995). The lesson learned again was that to act when a problem is spotted leads to fewer bank failures.

5.2. After the Great Recession

A lack of good quality data was also determined to be a problem for effective regulation. Intentionally or not, poor data collection and a lack of transparency may have served to hide market segments from regulators, making it difficult to act and address market excesses. Fortunately, two outcomes of Dodd-Frank are addressing this issue and thus improving financial stability:

The Financial Stability Oversight Council (FSOC) is responsible for designating nonbank financial companies for enhanced prudential standards and supervision by the Federal Reserve.

- To address the lack of data and visibility of events taking place in 'dark' corners of financial markets, regulators need information that is available immediately. The OFR was created by Dodd-Frank to promote financial stability by measuring risk across the financial system and collecting financial data. It serves as a provider of information that can point to urgent financial issues in the economy as they arise. Its Financial Stability Monitor is a color coded heat map that acts as an early warning system was created by OFR and is prepared biannually for public consumption.

In a report, the GAO (June 2015) emphasized the lessons learned by regulatory bodies which in sum included three areas where changes needed to be made:

- Just as in the S&L crisis, regulators often found that some firms had weak management practices that often led to higher-risk activities. The regulators should have acted in a more

effective manner before bank capital began to decline due to higher risk and losses. In sum, the early and more forceful action is more beneficial.

- Examiners are now focused on forward-looking information when assigning supervisory ratings; only current data was the decisive factor in the past. This is important to avoid practices that cause losses in the long run but are not obvious in the short term creating a situation where regulators potentially move from one crisis to another.
- Regulators must look at the broader financial system when assessing risk. One of the lessons learned was that examining information of an individual bank does not provide enough information for proper evaluation of risk and system financial stability.

6. Discussion and Conclusion

Following the Financial Crisis and the Great Recession, much has been said and written about the cause and the resulting global regulation. This paper focuses on particular policy developments that may serve to reduce the potential for future asset bubble-based crises. The reason for the evolution of policies that address bubbles and thus financial stability resulted from much that was learned from our Great Recession as well as similar issues abroad.

Predictions of bubble formations are not easy, but attention should be paid to those where the rise in value of an asset class further increases lending against these assets. These types of activities form feedback loops which are noticeable by vigilant regulators representing an environment where a bubble could form but that could be prevented by early regulatory action. **Lesson:** The cost of cleaning up after a bubble bursts is higher than anticipated earlier. Macroprudential policies could help in reducing the growth of a credit bubble.

The Great Recession led to another question: What if price and output stability may not always lead to financial stability? Williams (2015) suggests that the reason for a lesser concern with financial stability in the past was that it was viewed as a dangerous distraction that could damage the credibility of a central bank in its price stability quest. The question also suggests that normal monetary tools, blunt as they are, are not designed to address asset bubbles that threaten financial stability. Here too, macroprudential policies can play an important role as increases in the price of assets assisted by feedback loops can be stabilized. **Lesson:** Paying attention to financial stability may prevent larger shocks to the economy.

Much has been written about the diminished effectiveness of monetary policy due to the growth of the “shadow banking.” Before the recent financial crisis no policy existed to bring the shadow market under regulatory scrutiny in order to strengthen the tools of monetary policy. While the recent regulation, structure and tools will increase the ‘regulatory view’ of financial markets, new regulations bring an externality: some firms move to the ‘shadow’ market to avoid regulations. In their 2015 Annual Report, the Office of Financial Research reports that one of their three ‘Threats to Stability’ is: “While new regulations have been successfully implemented, other factors have spurred the migration of some financial activities and their related risks to areas that may be less transparent and less resilient’. Gaps in analysis, data, and policy also persist, despite progress in narrowing them. **Lesson:** While regulation may improve the stability of the system, policies that allow and encourage firms to leave regulated areas and move into the “shadows” need exploration.

Enforcement of regulation was made more difficult as regulating agencies have historically not cooperated well. While regulators should be fair and show their gentle side, from the S&L crisis we have learned that enforcement postponement may lead to firm failures - not a good outcome. In addition, resistance from industry could make regulators hesitate for this cry will be heard again: “the economy is growing so well, why disturb it?” **Lesson:** Just as in the S&L crisis, regulators

should not practice forbearance: enforce the rules immediately. When evaluating the risk of individual firms the focus of regulatory authorities should be:

- 1) based on forward-looking information
- 2) examination of individual institutions without considering the current economic climate does not necessarily provide enough information for proper evaluation of risk

While macroprudential policies hold much potential based on their function as another vehicle that can stabilize the financial system, it is still early in the game to evaluate their full potential. However, we are far from a celebration that we have discovered a policy tool that will be of assistance where monetary policy cannot be applied. Yet it is an exciting prospect that may bring additional stability to the financial system.

One other caution remains: Macroprudential policies are intended to provide financial stability and should be focused on items that threaten it. They are not designed to encourage an authority to begin regulating every single industry.

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