Comments on “Overborrowing, Financial Crises and ‘Macro-prudential’ Policy” by Javier Bianchi and Enrique G. Mendoza

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The paper

\[ y_t = \varepsilon_t F(k_t, h_t) \]

Assets: \( k_t = \bar{K}; b \) international

Collateral constraint: \( -\frac{b_{t+1}}{R} + \theta w_t h_t \leq \kappa q_t k_{t+1} (\mu_t) \)

First order conditions

Labor : \( \varepsilon_t F_h(t) = w_t \left[ 1 + \theta \mu_t / u'(t) \right] \)

Bonds : \( u'(t) = \beta R E_t u'(t+1) + \mu_t \)

Capital : \( u'(t) - \mu_t \kappa = \beta E_t \left[ u'(t+1) \left( \frac{\varepsilon_{t+1} F_k(t+1) + q_{t+1}}{q_t} \right) \right] \)

Benevolent regulator

\[ \max_{\{B_t, c, h\}} \ldots s.t. \quad -\frac{B_{t+1}}{R} + \theta w(B_t, \varepsilon_t) h \leq \kappa q(B_t, \varepsilon_t) \bar{K}; \]

\[ u'(t) = \beta R E_t \left[ u'(t+1) + \mu_{t+1} \psi_{t+1} \right] + \mu_t \]

\[ \psi_{t+1} = \kappa \bar{K} \frac{\partial q_{t+1}}{\partial b_{t+1}} - \theta h_{t+1} \frac{\partial w_{t+1}}{\partial b_{t+1}} \]
The Issues

- What happened? Crisis? Recession? (Graph)
- Central ingredient? Collateral? Intermediaries? Run?
- Frictions. Why don’t people fix them? Why don’t we fix them?
- “Macro-prudential” (Hayek’s nightmare) Fix current policy first?
- Take papers seriously
The issues

Billions of dollars

Potential GDP

Real GDP

2007 2008 2009 2010 2011 2012 2013

12,400 12,800 13,200 13,600 14,000 14,400 14,800