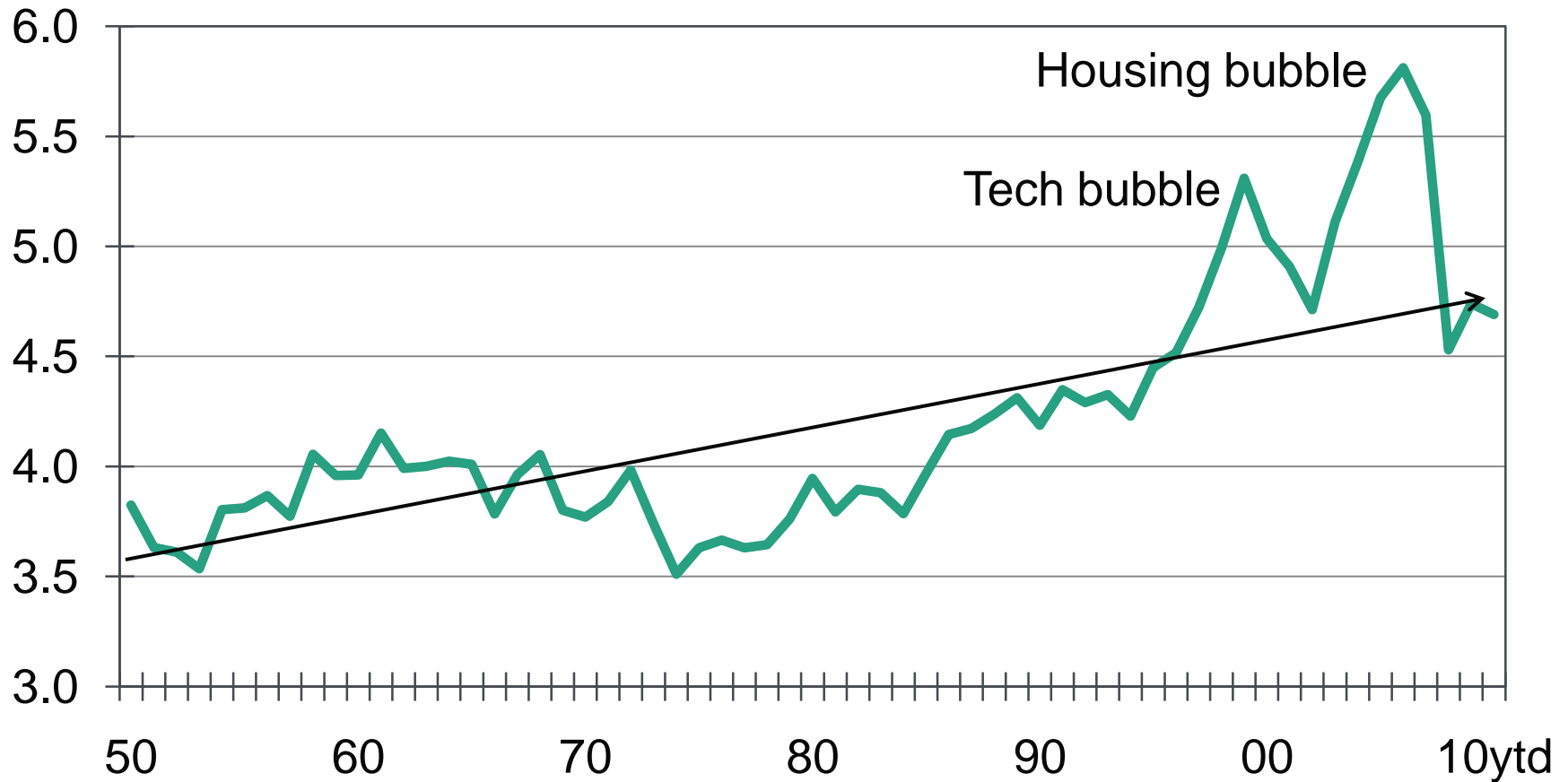


Preventing Asset Bubbles

MARK ZANDI, CHIEF ECONOMIST

Asset Bubbles Can Be Identified...

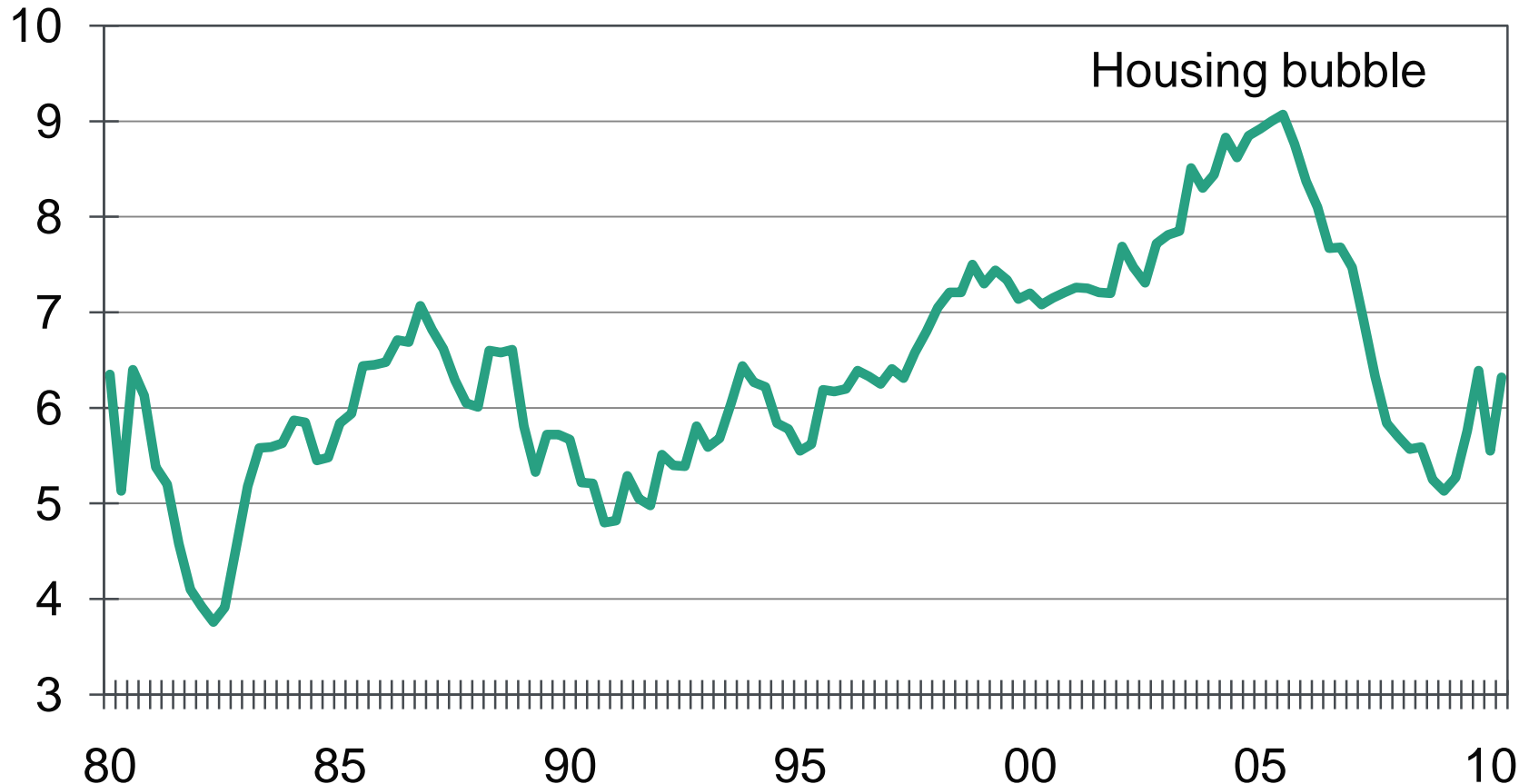
Ratio of Household Assets to GDP



Sources: Federal Reserve Board, BEA, Moody's Analytics

...When There is Flipping...

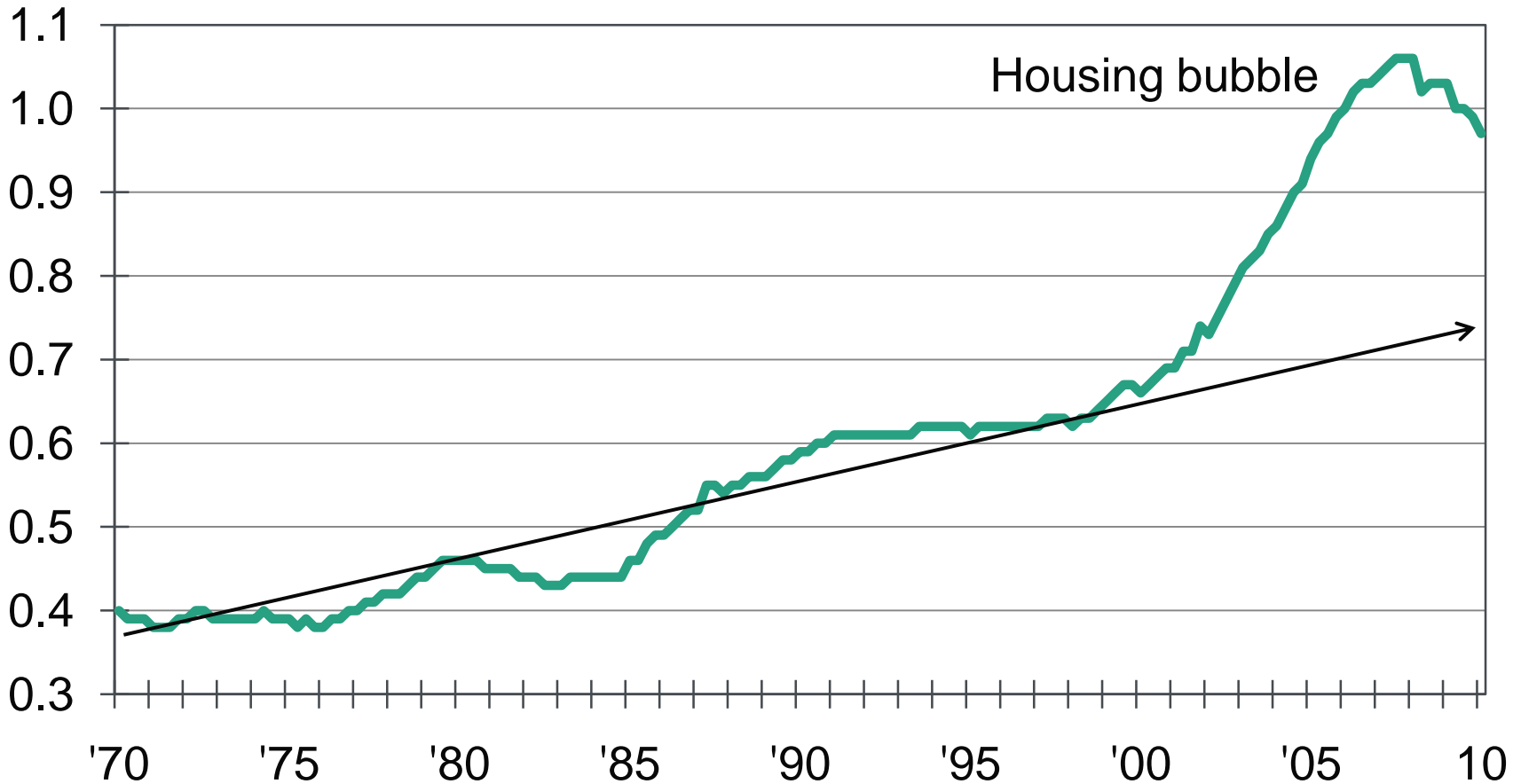
Housing turnover rate, home sales as a % of housing stock



Sources: Census, Moody's Analytics

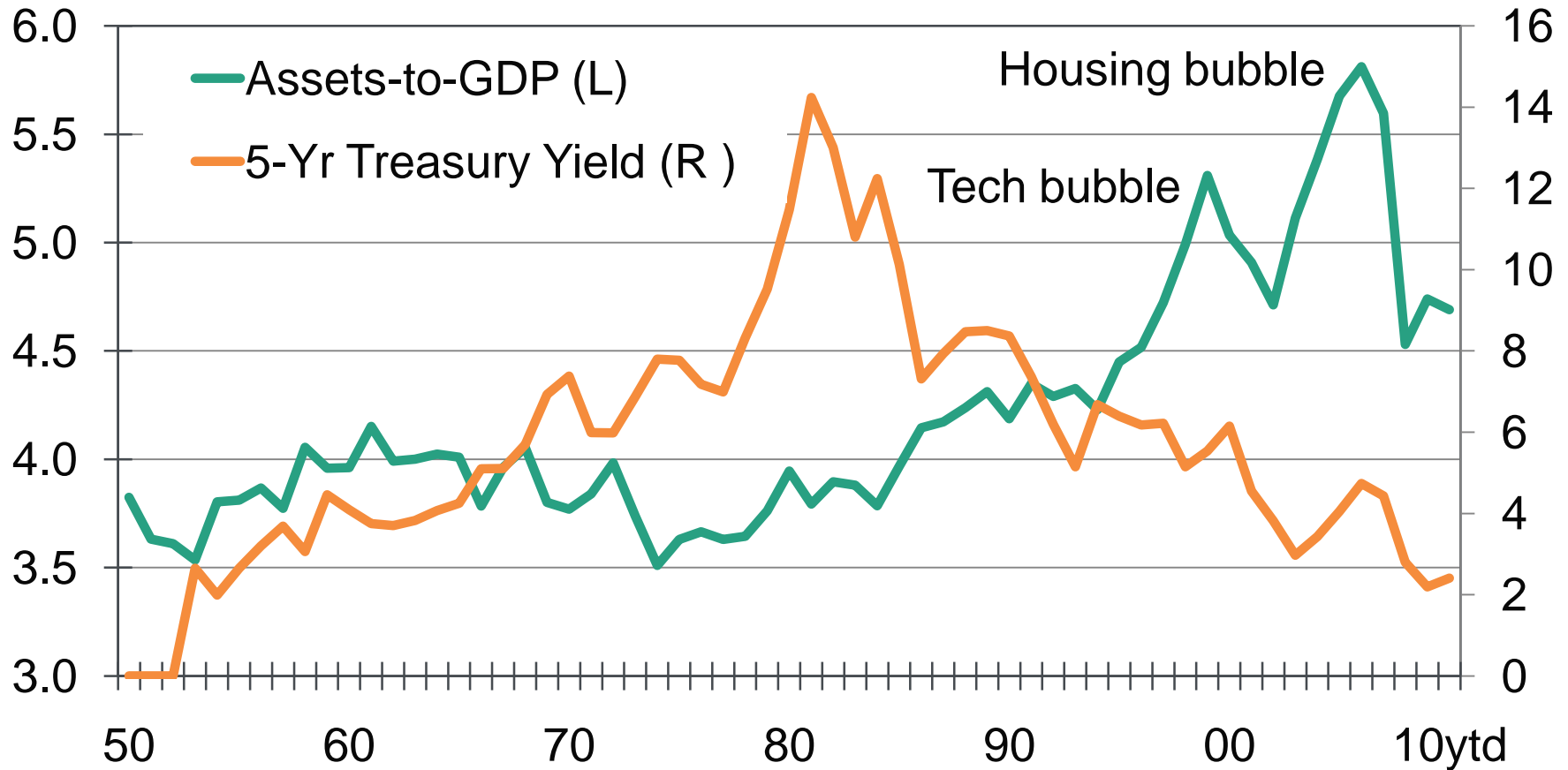
...and Lots of Leverage...

Ratio to Residential Mortgage Debt to Disposable Income



Sources: Federal Reserve Board, BEA, Moody's Analytics

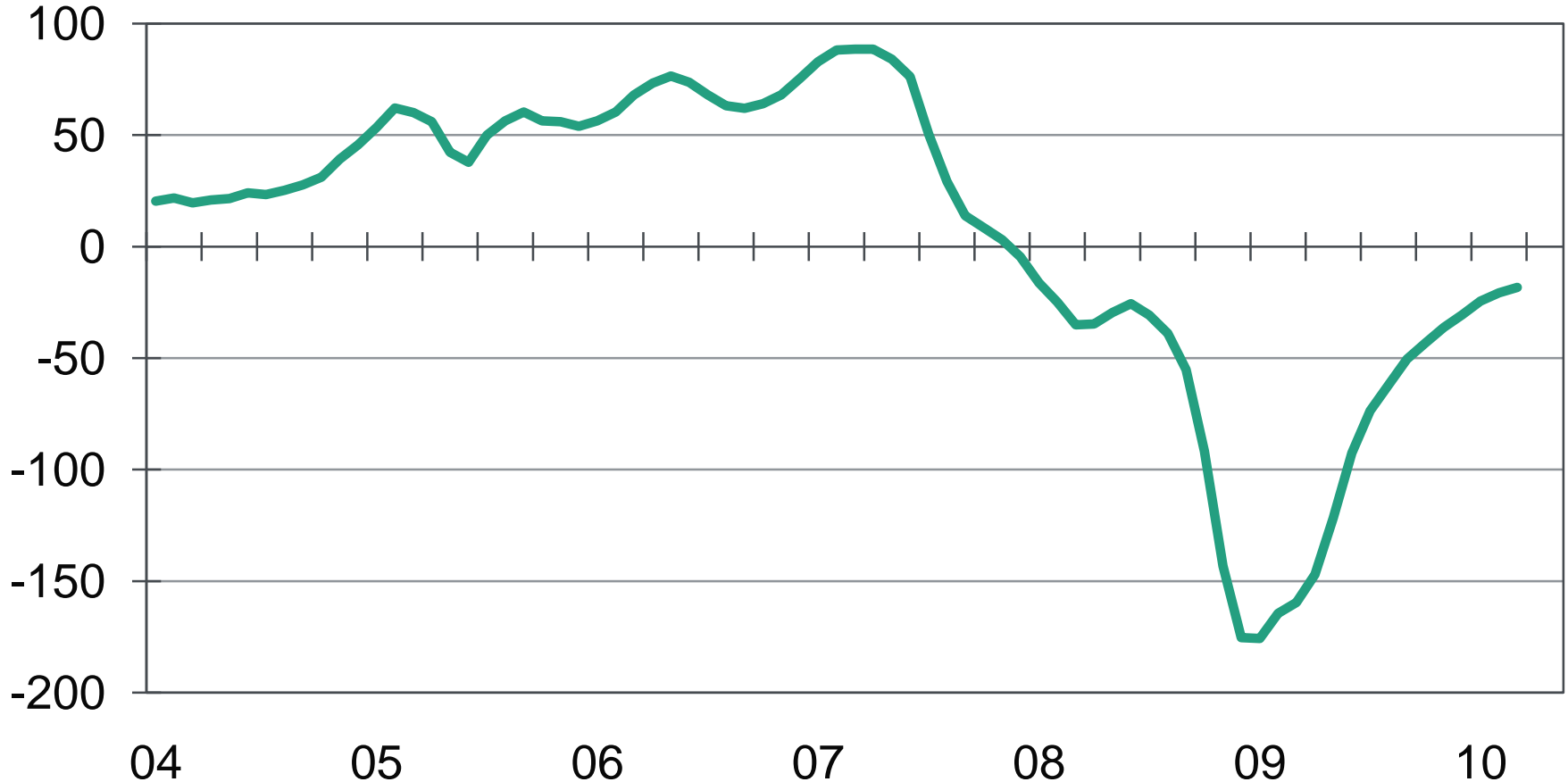
...But It's Not Easy



Sources: Federal Reserve Board, BEA Moody's Analytics

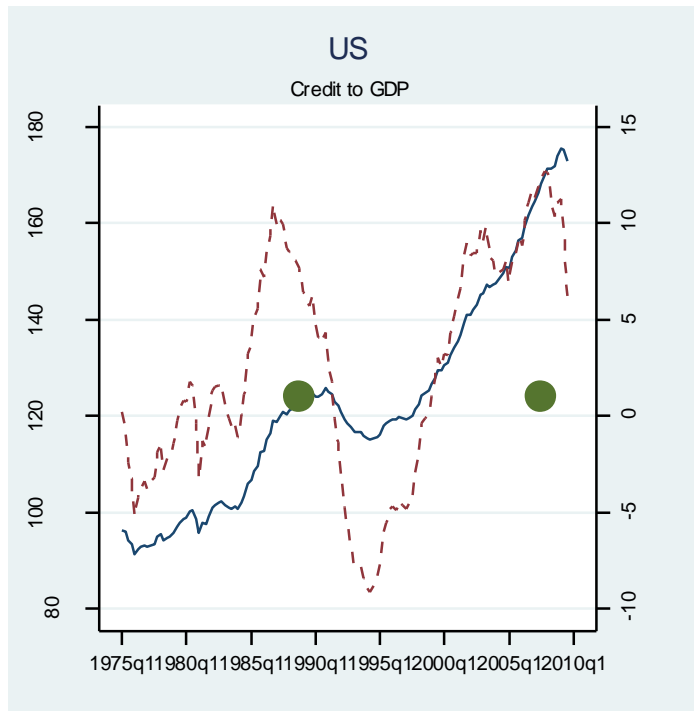
Expand the Fed's Reaction Function...

Contribution to funds rate due to asset bubbles, basis points

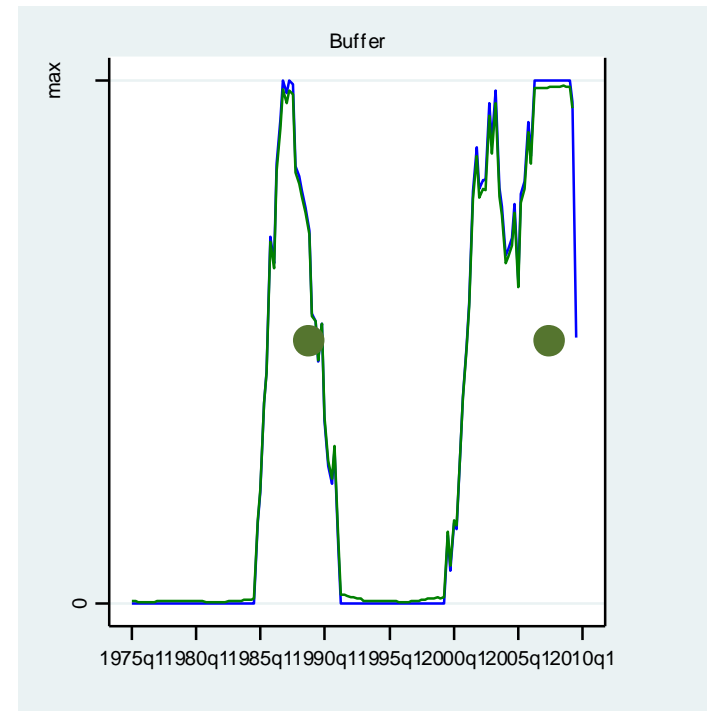


Sources: Federal Reserve, Moody's Analytics

...Adopt a Cyclically Adjusted Capital Buffer...



Blue line: credit to GDP ratio (left-hand axis). Red dotted line: credit to GDP gap (right-hand axis)



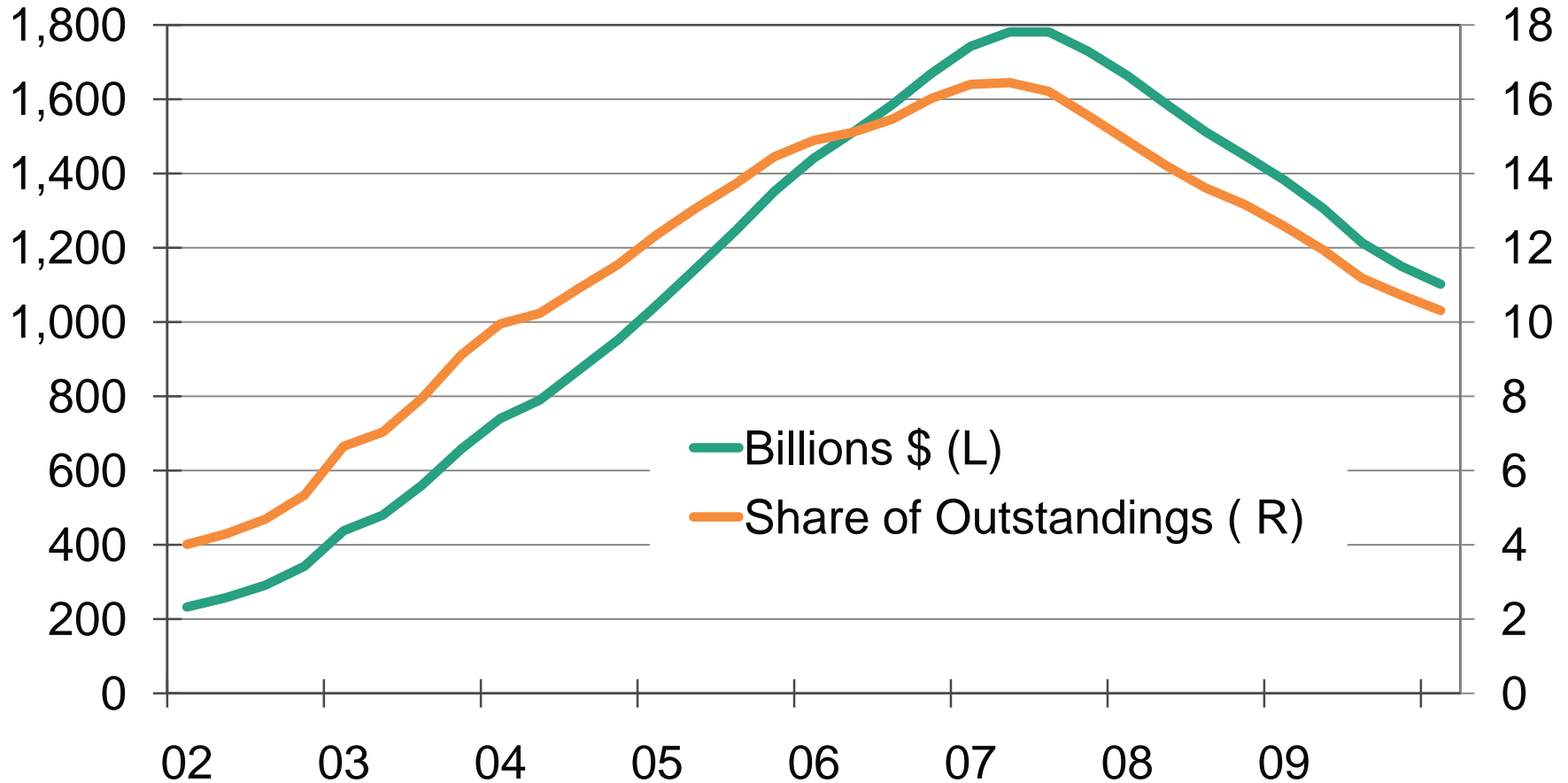
Blue line: buffer based on purely domestic exposures. Green line: buffer based on international exposures. International weights are based on aggregate exposures as reported by BIS banking statistics

Note: Ratio is broad credit to GDP ratio. Gap shows deviations of Ratio from its long term trend, calculated using a one-sided HP filter with a smoothing factor $\lambda=400,000$. The domestic buffer is buffer guide add-on for banks with pure domestic exposures. International buffer is buffer guide add-on for a hypothetical bank whose share of domestic and cross boarder lending is based on aggregate exposures for particular country. Country weights are based on BIS international banking statistics and fixed at 2006q4 weights to be able to calculate the international buffer guide add-on in earlier periods. Gap in this case is calculated using a one-sided HP filter with a smoothing factor lambda of 1,600.

Source: National data, IMF, BIS

...and Carefully Regulate At Origination

Securitized subprime, alt-A, and jumbo residential mortgage debt



Sources: MIS, Moody's Analytics

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