

1. What is the question of this paper?

Since there are macro-level spillovers arising from changes in aggregate dynamics and global interactions, how countries should coordinate macroprudential policies given these cross-border interactions?

2. Why should we care about it?

Economists and policy makers have debated the appropriate uses of macroprudential regulation to promote financial and macroeconomic stability. Furthermore, many economists have shown greater interest in using capital controls to mitigate the potential adverse consequences of volatile global flows. Nevertheless, while there is a rich literature studying the effects of macroprudential regulation and capital controls, less is understood about how countries should coordinate macroprudential policies given these cross-border interactions.

3. What is the answer?

This paper shows that macroprudential policy spillovers through international capital flows can lead to uncoordinated policy choices that are tighter than would occur with coordination. Namely, tighter macroprudential policy in country A (limiting leverage or capital inflows) stabilizes country A and endogenously increases the frequency with which A is relatively more wealthy than country B. Thus, tight policy in A provides incentives for B to choose tight policy as well so that B is not poor on average relative to A.

4. How did it get there?

This paper considers a symmetric two-country macro model in which countries have limited ability to issue state-contingent contracts in international markets. It theoretically considers how global spillovers through international capital markets can affect countries' policy choices when policies are not coordinated, using a two-country, two-good, stochastic macroeconomic model in which countries have limited ability to issue equity in international markets, based on Brunnermeier and Sannikov (2015).