

Countercyclical capital regulation in a dynamic general equilibrium model

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Abstract

This study considers a dynamic stochastic general equilibrium model where financial intermediaries are subject to a countercyclical capital regulation. We use the model to assess the stabilizing effect of such a regulation on a real economy. The calibrated results provide evidence that a countercyclical capital regulation has an influential stabilizing effect. During a boom, a financial intermediary needs to bring in many new stockholders who are not familiar with banking, which aggravates the moral hazard problem. Hence, the capability of extending the intermediary's lending in a boom is suppressed by countercyclical regulation. Our result also indicates that strengthening outside capital requirement has stabilizing effect too. These results partly provide support for the current macroprudential regulation, but suggest the required improvement.