



BANK OF CANADA  
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# Bank of Canada Monthly Research Update

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March 2019

This monthly newsletter features the latest research publications by Bank of Canada economists. The report includes papers appearing in external publications and staff working papers published on the Bank of Canada's website.

## PUBLISHED PAPERS

### In-Press

Cociuba, Simona E. & Malik Shukayev & Ueberfeldt, Alexander, “Managing risk taking with interest rate policy and macroprudential regulation”, *Economic Inquiry*, Vol. 57(2), pages 1056-1081, April 2019.

### Forthcoming

Chernoff, Alex & Albouy, David & Lutz, Chandler & Warman, Casey, “Local Labor Markets in Canada and the United States”, *Journal of Labor Economics*

## STAFF WORKING PAPERS

Adam, Klaus & Matveev, Dmitry & Nagel, Stefan, “Do Survey Expectations of Stock Returns Reflect Risk Adjustments?”, Bank of Canada Staff Working Paper 2019-11

## STAFF DISCUSSION PAPERS

Bédard-Pagé, Guillaume, “Non-Bank Financial Intermediation in Canada: An Update”, Bank of Canada Staff Discussion Paper 2019-2

## ABSTRACTS

### *Managing risk taking with interest rate policy and macroprudential regulation*

We develop a model in which a financial intermediary’s investment in risky assets—risk taking—is excessive due to limited liability and deposit insurance, and characterize the policies that implement efficient risk taking. In the calibrated model, combining interest rate policy with state-contingent macroprudential regulations—either capital or leverage regulation, and a tax on profits—achieves efficiency. Interest rate policy mitigates excessive risk taking by altering the return and the supply of collateralizable safe assets. In

contrast to commonly used capital regulation, leverage regulation has stronger effects on risk taking and calls for higher interest rates.

### *Local Labor Markets in Canada and the United States*

We examine local labor markets in the U.S. and Canada from 1990 to 2011 using comparable household and business data. Wage levels and inequality rise with city population in both countries, albeit less in Canada. Neither country saw wage levels converge despite contrasting migration patterns from/to high-wage areas. Local labor demand shifts raise nominal wages similarly, although in Canada they attract immigrant and highly-skilled workers more, while raising housing costs less. Chinese import competition had a weaker negative impact on manufacturing employment in Canada. These results are consistent with Canada's more redistributive transfer system and larger, more-educated immigrant workforce."

### *Do Survey Expectations of Stock Returns Reflect Risk Adjustments?*

Motivated by the observation that survey expectations of stock returns are inconsistent with rational return expectations under real-world probabilities, we investigate whether alternative expectations hypotheses entertained in the literature on asset pricing are consistent with the survey evidence. We empirically test (1) the notion that survey forecasts constitute rational but risk-neutral forecasts of future returns, and (2) the notion that survey forecasts are ambiguity averse/robust forecasts of future returns. We find that these alternative hypotheses are also strongly rejected by the data, albeit for different reasons. Hypothesis (1) is rejected because survey return forecasts are not in line with risk-free interest rates and because survey expected excess returns are predictable. Hypothesis (2) is rejected because agents are not always pessimistic about future returns, instead often displaying overly optimistic return expectations. We speculate as to what kind of expectations theories might be consistent with the available survey evidence.

### *Non-Bank Financial Intermediation in Canada: An Update*

Non-bank financing provides an important funding source for the economy and is a valuable alternative to traditional banking. It helps enhance the efficiency and resiliency of the financial system while giving customers more choices for their financial services. Unlike banking, it is not prudentially regulated. The Bank of Canada regularly monitors entities and activities classified in non-bank financial

intermediation, particularly those that involve a material degree of maturity, liquidity and credit transformation, a potential source of systemic risk. In this paper, we provide an update of our monitoring in this area, including insights obtained from new data sources.

## UPCOMING EVENTS

Darrell Duffie (Stanford), 2 April 2019  
Organizer: Jean-Sébastien Fontaine (FMD)

Mathieu Parenti (Université Libre de Bruxelles), 9 April 2019  
Organizer: Alexander Chernoff (INT)

B. Ravikumar (Federal Reserve Bank of St. Louis), 12 April 2019  
Organizer: Lin Shao (INT)

Daniel Andrei (McGill Desautels), 18 April 2019  
Organizer: Guihai Zhao (FMD)

Stela Rubinova (World Trade Organization), 23 April 2019  
Organizer: Alexander Chernoff (INT)

David M. Arseneau (Federal Reserve Board), 25 April 2019  
Organizer: Corey Garriott & Jason Allen (FMD)

Alexander Bick (Arizona State University), 1 May 2019  
Organizer: Natalia Kyui (CEA)

Yueran Ma (Chicago Booth), 2 May 2019  
Organizer: Guihai Zhao (FMD)

Michael Waugh (New York University), 3 May 2019  
Organizer: Walter Steingress (INT)

Toni M. Whited (University of Michigan), 9 May 2019  
Organizer: Jason Allen (FMD)

Michael Kiley (Federal Reserve Board), 10 May 2019  
Organizer: Laurent Martin (CEA)

Olivier Coibion (University of Texas at Austin), 16 May 2019  
Organizer: Lerby (Murat) Ergun (FMD)

Gregory R. Duffee (John Hopkins University), 23 May 2019  
Organizer: Jean-Sébastien Fontaine (FMD)

Oleksandr Talavera (Swansea University), 31 May 2019  
Organizer: Oleksiy Kryvtsov (INT)

Cedric Tille (The Graduate Institute Geneva), 7 June 2019  
Organizer: Gurnain Pasricha (INT)

Adriana Z. Robertson (University of Toronto), 13 June 2019  
Organizer: Corey Garriott & Jason Allen (FMD)

Linda Tesar (University of Michigan), 21 June 2019  
Organizer: Daniela Hauser (CEA)

Domenico Giannone (Federal Reserve Bank of New York), 27 June 2019  
Organizer: Rodrigo Sekkel (FMD)

Ben Lester (Federal Reserve Bank of Philadelphia), 12 September 2019  
Organizer: Jean-Sébastien Fontaine (FMD)

David Berger (Northwestern), 13 September 2019  
Organizer: Anthony Landry (CEA)

Lucian (Luke) Taylor (Wharton), 26 September 2019  
Organizer: Jon Witmer (FMD)

Giorgio Primiceri (Northwestern), 27 September 2019  
Organizer: Joel Wagner (CEA)

Patrick Augustin (McGill Desautels), 3 October 2019  
Organizer: Corey Garriott (FMD)

Catherine Tucker (Massachusetts Institute of Technology), 19 November 2019  
Organizer: Shota Ichihashi (CEA)