Macroprudential policy and its relationship with monetary policy: the complex European framework
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What is financial stability?

- Systemic risks in financial systems arise if distress in one institution or a group of financial institutions threatens the functioning of the entire financial system:
  - **Domino effects** due to direct contractual linkages
  - **Informational contagion** leading to runs on assets of other financial institutions, even without any direct contractual linkages
- **A financial system is all the more stable ...**
  - ... the **less distorted** investment decisions are and
  - ... the **stronger risk buffers** and capitalization of financial institutions.

- **Macroprudential policy aims at strengthening the resilience of the financial system and at reducing systemic risks.**
Macroprudential policy-making takes place under a high degree of uncertainty.

- Most macroprudential instruments are new and largely untested.
  - What are appropriate objectives and (intermediate) policy targets?
  - What data are needed for the surveillance of financial stability?
  - Which theoretical models guide policymaking?

- This uncertainty entails risks ...
  - ... of an inaction bias and the quest for “more data” and “more analysis”.
  - ... of (ab)using macroprudential policies for other policy purposes.

- A clear strategy for (ex-post) policy evaluation is needed.
Unlike monetary policy, a well-defined policy cycle for macroprudential policy has yet to be established.

- Establishing such a **policy cycle** requires
  - **Availability of data**: Needs to be planned *before* the measure is implemented
  - **Quantification of policy target(s)**: Map indicators into measurable targets
  - **Identification of intermediate objectives** (e.g. credit growth)
  - **Assign instruments to objectives** (e.g. liquidity ratios, capital buffers, risk weights) (*Ex ante evaluation*)
  - **Ex-post evaluation** (based on pre-specified policy objectives)
In June 2015, the German Financial Stability Council recommended new housing-related instruments.

- Regulation of the real estate markets is under **national responsibility**.
- Proposed instruments apply to residential real estate: Reduce the probability that losses materialize and improve the ability to absorb losses.
  - Loan-to-Value Ratio (LTV)
  - Debt-to-Income Ratio (DTI)
  - Debt-Service-to-Income Ratio (DSTI)
  - Amortization requirements
- **Recommendation foresees ex post evaluation** ("impact analysis")
  - Compulsory, two year interval (upon activation)
  - Conducted by Bundesbank and/or independent by researchers
  - Recommendation requests **legal basis for data collection**
Assessing the effects of macroprudential policies:
The International Banking Research Network

- The IBRN brings together researchers from 25 central banks as well as international organizations (BIS, ECB, IMF) to analyze issues pertaining to international banking.

- Teams use micro-data to perform rigorous empirical studies, which can be compared across countries.

- The 2015-initiative investigates the impact of (macro-)prudential policies on cross-border banking lending. Key findings:
  - Capital requirements, loan-to-value caps, and reserve requirements do spill over internationally through banks.
  - Affiliates of foreign banks most important for policy spillovers. Less evidence of inward transmission via home-country global banks.
  - Banks’ responses to regulatory changes are heterogeneous, and accounting for these differences increases significance.
Summing Up

- Macroprudential policy – like monetary policy – requires a well-defined policy cycle, including impact assessments.
- Policy evaluation requires legal mandates and availability of sufficiently granular data.
- Balancing international and national responsibilities is crucial:
  - International standards versus national discretion
  - Notification and reciprocity
  - Standards for policy evaluation
  - Ensuring data availability and access