Macro-prudential policy: what instruments can be effective?

Finance Focus Breakfast, 6 March 2013

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The finance focus breakfast provided an excellent occasion to share some updates and discuss the latest advancements of macro-prudential policies (MPPs) starting from the UK experience. In December 2012 the UK Parliament approved a Financial Services Bill establishing the Financial Policy Committee (FPC). The FPC is formally in charge with identifying, monitoring and taking action to remove or reduce systemic risks to the stability of the financial system.

The discussion starts with a remark on how carefully the definition of the governance structure has been conducted, as to assure both transparency and efficacy. Remarkable, and unusual, features are the presence of four external members out of the eleven entitled to vote and the fact that, even if participating to the meetings, the HM treasury representative cannot vote. Another FPC's point of strength is the use of both micro and macro competences through the notable expertise of its members, which allows the FPC to assume powers beyond the mere formulation of general recommendations.

After referring to *leverage ratio* as future possible instrument, the two main tools actually adopted are then introduced: Countercyclical capital buffer (CCB) and Sectorial capital requirements (SCRs). While the CCB involves setting capital requirements no matter the origin of the lending, the SCR refers to specific types of exposures and is generally more flexible than the first tool. Admittedly, more flexibility has both positive and negative connotations. On the one hand, SCRs can be used to target certain strategic sectors of the market, for instance, the flow of new lending. On the other hand, if the target is incorrect, there is a concrete risk for the tool to be ineffective at best and damaging at worse. Therefore, a good deal of balance is reached as tools at both aggregate and sectorial levels are employed.

On the use of core indicators, it is stressed that, while it serves both *internal* and *external* purposes in guiding the decision making, they are not intended to substitute the judgment of the committee. Moreover, those are meant to be mainly raw series as to assure a straightforward inspection[1]. About the transmission mechanisms, two possible channels are envisaged: a *direct* one, which affects resilience through Banks' capital ratios, and an *indirect* one, which affects expectations and credit conditions first. Then, the existence of positive spillovers cross-board is highlighted with the *caveat* that negative spillovers might equally arise and market depression spread across other countries in case the tools are not used correctly. As implicitly suggested, some form of international coordination is then desirable. Finally, the timeline for the policy procedures would be rather volatile as some political pressure (especially from lobbies) can be expected to slacken the process.
Then the open issues today are presented, as compared to 2010, while it is stressed how the use of MPP tools can be effective only if timely appropriate. Moreover, emphasis has been put on the

[1] For instance, neither de-trend nor de-seasonal corrections will be considered.

salience of good communication and ability to create expectations.

In the Q&A section, a shared concern on the international dynamics of cross-board spillovers has been raised. On this matter, while underlining the precautionary nature of the FPC's stance, it is recognizes how its scope has mainly, but not exclusively, a national dimension. Another relevant issue, which partially follows up on the previous one, was the use and availability of data. It is recognized the necessity to be on top of a broad set of international data, especially when investigating how risk builds up in the market. Then, on a comparison with the US, it is outlined how, while most of advancements overseas refer to data analysis, in UK more attention has been paid to the types of tools to employ. Finally, while only a preliminary work has been done on pro-cyclicality, the issue is recognized to be still a big item on the agenda.

In conclusion, as a note of caution, UK legislation is recognized to be not specific enough to intervene directly into FPC's functioning which, as being at the very beginning of the process, is likely to involve some risks and possibly some mistakes.

Event notes by Giuseppe Daluiso