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Getting ready for the new European macro-prudential instruments

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The purpose of the seminar was to discuss the role of macro-prudential regulation in general and how the new macro-prudential authorities would make use of the new instruments included for instance in the CRR/CRD IV legislation.

Francesco Mazzaferro argued that the ESRB recommendations have influenced the setting up of new national macro-prudential authorities in many countries, even though the recommendations are not binding per se. He also outlined the main features of macro-prudential regulation. The final objective is the prevention or mitigation of systemic risks that endanger financial stability. This is supported by a host of intermediate objectives, which are meant to be attained by specific policy instruments. The next challenge is to operationalise the use of these instruments.

Aerdt Houben talked about the need to eliminate the inaction bias inherent in macro-prudential regulation arising from the view that there are short-term costs but the pay-off is distant and uncertain. This could be counteracted by the establishment of an organization with a clear mandate to be responsible for macro-prudential regulation. The appropriate policies would differ from country to country because there are strong differences in financial cycles and structures within Europe.

Mathias Dewatripont agreed with Houben that there is a danger of "excessive maximum harmonization", which would not consider differences between countries. Idiosyncratic macro-prudential regulations are necessary because the EMU has eliminated interest and exchange rate flexibility. The policy challenge is, however, considerable due to the long list of objectives, instruments and organizations that are involved. Additionally, Goodhart's law can reduce the information value of targeted objectives. Dewatripont also stressed that once a specific organization was set-up with macro-prudential regulation as its mandate, the inaction bias might turn to an over-action bias. Differences in national policies will, however, foster learning by experimentation. Concerning the appropriate indicators, Dewatripont argued that there was too much focus on credit growth. This was not the only threat to financial stability as shown by the Belgian experience with Dexia, which was caused by foreign shocks.

John Berrigan questioned whether policymakers should primarily increase the resilience of the system to financial cycles or try to manage these cycles. He also contrasted the need for new authorities for macro-prudential regulation with the incomplete internalization of the macro-prudential effects of the policies of existing institutions. Berrigan also stressed the challenge of coordinating national discretion in macro-prudential policy with the single rulebook.

The general discussion touched upon, for instance, the general need for macro-prudential policy. It was considered more essential, the larger was the distance between monetary policy and supervision. Nevertheless, the policy lessons from the crisis would take a long time to be fully learned as was the case after the Great Depression. Macro-prudential regulation was generally considered necessary, although its efficient implication would present a formidable challenge.

Event notes by Erkki Vihriälä