



Macroprudential policy complements ECB monetary policy¹

Ladies and Gentlemen,
Many players contribute to financial stability. If you take a broad view, financial stability policy encompasses macroprudential policy as well as microprudential supervision and regulation, recovery and resolution frameworks as well as deposit guarantee schemes. All these areas provide important contributions to financial stability, but it is the broad consensus – at least since the Financial Crisis – that macroprudential policy is the most important area in preventing – or at least mitigating – financial stability risks (Bank for International Settlements, 2011; International Monetary Fund, 2013; Smets, 2014).

Monetary and macroprudential policy complement each other

A lot has been said on the similarities, the differences, and the interplay on these two policy fields. I would like to compare their relationship to a game of doubles in tennis. To be successful, both players need to adapt to the other player's game. If one player storms to the net, the other player must follow as soon as possible. Otherwise, they risk not being able to put the ball away or even getting passed. Both players share the same goal – in tennis it is the win, in monetary and financial policy it ultimately is a long-term and stable increase of people's prosperity and well-being. However, this common goal is reached via different intermediate objectives.

In my opinion, monetary and macroprudential policy areas are complementary. Price stability contributes to financial stability and vice versa. Nevertheless, monetary policy has potentially unintended consequences that can be

tackled with adequate macroprudential measures. Currently, there are two main examples for this interplay.

First, low or even negative interest rates squeeze interest rate margins of banks due to the so-called zero lower bound on deposits and thereby negatively affect bank stability. This assertion is corroborated by research by colleagues of the OeNB (Kerbl and Sigmund, 2016). In Austria, for example, the structurally low profitability of Austrian banks was one reason – among others – for implementing the systemic risk buffer (Financial Market Stability Board, 2018).

Second, the current low interest rates fuel booms in various asset markets: e.g. equity markets, bond markets, and real estate markets. In the euro area, macroprudential policy allowed a number of countries to address these partly unintended consequences, as borrower-based measures and higher risk weights for mortgages were introduced to deal with systemic risks stemming from real estate markets (European Systemic Risk Board, 2019).

Moreover, the revised ESRB Regulation now explicitly stipulates that implications of monetary conditions for financial stability fall under the ESRB's macroprudential oversight mandate to ensure that there are no taboo topics in the ESRB in the future. This is an important precedent for macroprudential policy in general.

Monetary and macroprudential policy have different intermediate objectives

Consistent with their complementary function, monetary policy and macroprudential policy have different interme-

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mediate objectives. That of monetary policy in the euro area is price stability: Prices should increase at a rate of below, but close to 2% year-on-year. That of macroprudential policy in the euro area is the reduction and mitigation of systemic risks.

To be more specific, monetary policy impacts the debt funding rates of banks, while macroprudential policy primarily impacts the spread between banks' debt funding costs and their loan rates (IMF 2013). Initially, monetary policy targets the risk-free rate of interest via the so-called interest rate channel. Recently, asset purchase programs have extended the objective function to the risk premium of bonds, including bank bonds, via the so-called risk-taking channel. Contrary to that macroprudential policy aims at shifting the costs of systemic risks back from the public to the banks, i.e. it wants to make sure that loan rates cover all costs of capital, liquidity and risks. Thereby it influences the spread between debt funding and loan rates.

requirements impede banking lending. Quite a few studies show that this is not the case. Gambacorta and Shin (2016) found that a presumed tension between increasing bank capital and bank lending is more apparent than real and that better capitalized banks improve the bank lending channel of monetary policy transmission: Higher bank capital is associated with greater lending. This is because better capitalized banks have substantial lower funding costs. Schmitz et al. (2017) estimated that a 100 basis points increase in regulatory capital ratios is associated with a decrease of bank funding costs of about 105 basis points. Another recent paper by the Periès et al. (2019) strikes a similar note by finding that countercyclical macroprudential interventions are supportive of monetary policy conduct through the cycle. Therefore, an allegedly apparent and often raised conflict does in fact not exist.

Different objectives require separate sets of instruments

To sum up, the complementary nature of both policies justifies separate objectives. This implies that I favor that both objectives are pursued by two separate sets of instruments – also known as “Tinbergen Rule”. Alternatively, “leaning against the wind” would overburden monetary policy with a dual objective of maintaining consumer price stability and preventing asset price bubbles. To achieve the latter, interest rates would have to increase quite sharply, which is very likely to endanger the former at this juncture.

The principle of separate sets of instruments is even more important in a monetary union where asymmetric financial cycles across member states exist (Periès et al. 2019). Therefore, the national mandate of macroprudential policy is essential to allow national

authorities to deal with country-specific consequences of a single monetary policy for the euro area.

Closing remarks

Monetary policy and macroprudential supervision can be combined very effectively. However, as in a team of tennis doubles – to come back to the initial metaphor – excellent communication, the clear allocation of responsibilities and team spirit are preconditions.



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Macroprudential policy supports monetary policy's transmission mechanism

Some argue that there is a conflict between macroprudential measures – most importantly capital buffers – and the transmission mechanism of monetary policy. They suggest that higher capital