Editorial

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This volume comprises papers presented at the workshop *"How do monetary, micro- and macroprudential policies interact?",* which took place on December 2, 2019. The main idea of this workshop was to discuss the changing role of central banks in Europe, fueled by the insights into the optimal interaction of monetary, micro- and macroprudential policies which we have gained so far. The starting point is that the period on which we can base our findings is relatively short. For example, macroprudential policy making is still in its infancy, as are bank resolution schemes. Our insights are therefore bound to be vague and sometimes only anecdotal. And – not surprisingly – the topic tends to spark controversy among academics, central bankers and supervisors.

During the last decade, we have witnessed a redefinition of the role of central banks. In the decades before the global financial crisis (GFC), financial stability had increasingly been viewed as separable from monetary policy. Banking theory focused on the micro level, while finance celebrated the efficient market hypothesis within an increasingly deregulated financial environment. This narrowed down the scope for central banking. A new "consensus view" emerged that saw independent central banks as guardians of monetary stability, preferably as *inflation targeters.* In parallel, we witnessed a trend towards setting up equally independent guardians of financial stability in the form of supervisory authorities separate from central banks.

It was Charles Goodhart who pointed out that this narrowing-down of the central bank's scope in the pre-crisis period was historically abnormal and short-lived. And it ended with a crisis when it became apparent that macroeconomic stability together with the Great Moderation plus the illusion of efficient markets was no guarantee for financial stability.

Today, central banks are again searching for a consensus view. The scope of central banking has broadened considerably since the onset of the global financial crisis. With the interdependence between monetary and financial stability having been re-acknowledged, numerous central banks have also become responsible for micro- and macroprudential regulation. By definition, these functions are of a complementary nature. That is, they constitute a layer of tasks on top of central

[1] The Editorial is based on the opening address for the OeNB workshop "How do monetary, micro- and macroprudential policies interact?", December 2, 2019.

banks' traditional monetary policy tasks. Maintaining price stability continues to be central banks' primary objective.

The broadening of central banks' responsibilities was particularly significant in the case of the Eurosystem. Apart from setting a single monetary policy for the euro area, the ECB is today also responsible for supervising all euro area banks, some directly and some indirectly. Regarding centralized versus decentralized supervision, a hybrid structure has emerged. Centralization and strong coordination in supervising significant institutions ensures a level playing field, consistency and equal treatment among financial institutions. Ultimately, all national central banks (NCBs) are involved in microprudential supervision via the Single Supervisory Mechanism (SSM), which was set up under the auspices of the ECB and in which many NCBs act as the national competent authority.

Under the new governance framework for macroprudential policies, all NCBs are also involved in macroprudential supervision through the European Systemic Risk Board, with the ECB having been assigned top-up powers. Several NCBs act as the national designated authority and/or macroprudential authority.

There may be two opposing views on such a setup.

On the one hand, putting monetary policy, banking supervision and macroprudential policy under one roof may prove beneficial. The literature identifies numerous and complex interactions among these policy areas and each interaction has spillover effects on the other areas by affecting the behavior of banks and financial markets. One example is the effect that unconventional monetary policies may have on risk-taking behavior and the "search for yield." Conversely, prudential policies may indirectly affect the business cycle, and hence, monetary policy objectives. Such interactions seem to substantiate the view that having these policy areas under one roof allows for internalizing the spillovers mentioned above. An improved flow of information may be another argument: central banks, for instance, benefit from supervisory information when they assess monetary policy decisions or when they execute the lender of last resort function.

On the other hand, consolidating these policy areas in one institution may give rise to conflicts of interest as well as reputational risks. For example, the reputation of a central bank could suffer in the case of a bank failure. One serious concern with regard to potential conflicts of interest is that monetary policy decisions could be distorted, in the sense that attempts to preserve the stability of financial institutions could have a detrimental effect on monetary policy objectives.

The contributions in this volume give a comprehensive overview of the precise nature of the various interactions of monetary, micro- and macroprudential policies as well as the trade-offs and conflicts of interest that are involved. This should inform and help us in assessing alternative models of central bank governance. In addition, it is examined what the new responsibilities might entail for central banks' independence and legitimacy, which have traditionally formed a cornerstone of the Eurosystem.