

**Macprudential 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.**

Macprudential 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