Interactions Between Macroprudential and Other Policies

Panel on “Policy Interactions: Different Points of View” at the SUERF/Narodowy Bank Polski Conference on “Challenges of Interactions Between Macroprudential and Other Policies”

Discretion: Any views expressed are only the authors’ own and should not be regarded as views of the ECB or the Eurosystem.

Philipp Hartmann
European Central Bank

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Let’s start with defining different policies

- Macroprudential policy: public policies that aim at ensuring systemic financial stability, i.e. at containing systemic (financial) risk
- Systemic (financial) risk: risk that financial instability becomes so widespread that it impairs the functioning of a financial system to the point where economic growth and welfare suffer materially (ECB 2009)
- Microprudential policy: public policies that aim at ensuring the stability of individual financial intermediaries or markets
- Monetary policy: central bank interest-rate or balance-sheet policies that aim at stabilising inflation at a low level (dual mandate also output or employment)

→ Economic (not legal) perspective today
How I shall proceed

1) Definitions of different policies
2) Macroprudential (MaP) and microprudential policy (MiP)
3) Macroprudential and monetary policy (MoP)
4) Macroprudential and fiscal policy (FiP)
5) Macroprudential and social policy (SoP)
6) Concluding remarks
MaP and MiP have important composition relationships that call for a special institutional setup

- Economically not really separate policies
- Composition relationship
  - Stability of individual intermediaries or markets are components in systemic stability
  - Many policy instruments that can be used for both (although, legally, they can be allocated to one or the other)
- But the two policies may not always go in the same direction, even though also important complementarities
- Examples
  - In the financial upturn systemic stability calls for the build-up of buffers whereas individual stability does not
  - In the financial downturn systemic stability calls for the release of existing buffers whereas individual stability may call for maintaining them or building new ones
- Different solutions for achieving consistency between the two
  - Both in the same authority
  - Both reporting to a joint decision-making committee
  - “Lighter” forms of coordination may risk inconsistencies (e.g. one undoing the other)
- Institutional setup is key, also for burden on financial industry
MaP and MoP share important interactions but this does not necessarily mean strong coordination

Model-based estimation of welfare effects of coordinated or uncoordinated macroprudential and monetary policy

<table>
<thead>
<tr>
<th></th>
<th>Coordinated</th>
<th>Uncoordinated</th>
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<tbody>
<tr>
<td>Inflation stability</td>
<td>-0.04%</td>
<td>-0.00%</td>
</tr>
<tr>
<td>Financial stability</td>
<td>+0.72%</td>
<td>+0.61%</td>
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<tr>
<td>Total</td>
<td>+0.68%</td>
<td>+0.61%</td>
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Notes: Based on a non-linear dynamic stochastic general equilibrium model with nominal and financial frictions, calibrated to the US and solved using global methods. Welfare effects are expressed in annual consumption changes compared to an economy with flexible prices, no monetary and no macroprudential policy. “Coordinated” refers to the short-term interest rate and an occasionally binding regulatory leverage cap, as they would be jointly set by a welfare-maximising social planner. “Uncoordinated” refers to the short-term rate being set such that inflation is stable at its structural rate and the regulatory leverage cap such that pecuniary externalities do not lead to large fluctuations in intermediaries’ financing of non-financial firms.


Types of interaction (e.g. IMF 2013)
- By attenuating potential side effects of monetary policy targeted macroprudential policy can protect “room for manoeuvre” for monetary policy
- Monetary policy could try to lean against the build-up of financial imbalances (“leaning against the wind”) – more controversial
- After negative financial shocks macroprudential policy can support monetary policy through releasing buffers previously built and unclog transmission channels
- Monetary policy can counter macroprudential side effects on growth

To which extent should they be coordinated (e.g. left-hand chart)?
- Different cycles?
MaP and FiP share important interactions as well and the present weight of MaP may be too low

Development of average bank equity around the removal of the tax advantage of debt

- Two major examples
  - Sovereign-bank nexus (including guarantees for public banks)
  - Tax-deductability of interest rates
- Tax policies are firmly in the hands of finance ministries (outside the control of prudential authorities)
- Tax advantage of debt promotes leverage of (financial and non-financial) companies
- System-wide structural factor for financial stability risks
- A few countries experimented with removal of the tax advantage and experienced financial stability benefits (case of Belgium in the left-hand chart)

Notes: Treated are 33 Belgian banks which benefited from a tax allowance for corporate equity (ACE) in 2006 and control banks are 99 other EU banks not affected by this change in Belgian tax policy. Equity ratios are defined as total equity over total assets.
Source: Schepens (2016).
Some MaP-SoP interactions call for enhanced dialogue and, notably, intelligent housing policies

Reallocation of mortgage credit in Ireland around the introduction of LTV and LTI limits

- Some macroprudential measures can get in conflict with social measures aimed at facilitating poorer peoples’ access to credit
- Can be pronounced in housing markets, for example
- LTIs may prevent low-income households from owning their dwelling (e.g. example from Ireland in left-hand chart)
- Political economy trade-offs may contribute to inaction bias when a property bubble builds up
- Understanding between prudential and social (and other) authorities
- Intelligent housing policies needed (e.g. Rajan 2010)

Notes: Each point in the “heat map” indicates the change of mortgage issuance in the post-policy period (Feb 2015 to Jan 2016) compared with the pre-policy period (Feb 2014 to Jan 2015; in %). Distance from the lending limits is in terms of an aggregate measure of loan-to-value (LTV) and loan-to-income (LTI) ratios relative to the policy limits.

Concluding remarks

• There are important interactions between macroprudential and many other policies

• But macroprudential is not a special policy in this regard

• There needs to be a carefully designed institutional setup for dealing with the composition relationship with microprudential policy

• Two views on the relationship with monetary policy
  – Each should primarily pursue its own objective(s) (e.g. IMF 2013, Svensson 2016)
  – Monetary policy needs to take side effects on financial stability into account, potentially even “leaning against the wind” (e.g. Borio 2014, Stein 2013)

• It is a challenge to ensure enough emphasis on the macroprudential perspective in the interaction with fiscal and social policies

• Caveats: I have not particularly addressed many relevant issues
  – Other policies (competition policy (CoP), structural policy etc.)
  – Peculiarity of the euro area/European banking union that monetary policy is at the area-wide level and a large part of macroprudential policy at the country level
  – Specific issues for some emerging market or central and eastern European economies (large capital flows relative to country size, influenced - inter alia - by foreign monetary policies; foreign currency financing and lending, etc.)
Selected literature 1

- Acharya, Bergant, Crosignani, Eisert and McCann (2018), The anatomy of the transmission of macroprudential policies, mimeo., University of Michigan, November.
Selected literature 2

- International Monetary Fund (2013), The interaction of monetary and macroprudential policies, Washington, 29 January.
- Lautenschläger (2014), The interplay between macro-prudential, micro-prudential and monetary policies at the ECB, speech at the Sveriges Riskbank, Stockholm, 13 November.
- Mendicino, Nikolov, Suarez and Supera (2019), Bank capital in the short and in the long run, mimeo., ECB, this conference.
- Osinski, Seal and Hoogduin (2013), Macroprudential and microprudential policies: toward cohabitation, IMF Staff Discussion Note, SDN 13/05, June.
Selected literature 3

- Stein, J. (2013), Overheating in credit markets: origins, measurement, and policy responses, speech at the Federal Reserve Bank of St. Louis, St. Louis, 7 February.
- Vinals, Mancini-Griffoli and Nier (2018), Three cooks or three wise men? The interplay between monetary, macroprudential and microprudential policies in supporting financial stability, in Hartmann et al. (eds.), *The Changing Fortunes of Central Banking*, Cambridge University Press, 135-152.
Annex
**Bank profitability implications of negative policy rates: positive effects offset negative ones so far**

Simulated deviations of banks’ return on assets from a no policy scenario (all monetary policy measures, p.p.)

- NB: Sizeable differences across countries and individual banks
- ECB Banking Supervision’s SREP stress tests found that most European banks could weather a 200 bp interest rate shock (ECB 2017)
- Many other dimensions than banks (ESRB 2016, CGFS 2018):
  - Profitability and solvency of life insurers and pensions funds
  - Search for yield (real estate, fixed income)
  - Accelerated transition to market-based financial structure

**Notes:** Capital gains based on data on a consolidated basis for 68 euro area banking groups included in the list of significant institutions under direct ECB supervision and in the 2014 EU-wide stress test. Other estimates based on aggregate banking statistics. Euro area aggregate calculated as average of the countries included in the sample, using the ECB’s consolidated banking data for weighting. NII stands for net interest income and EL for excess liquidity. **Sources:** Altavilla et al. (2018).
Property price developments are within (or below) regular ranges and below historical boom dynamics

Post-crisis real house prices compared to boom periods and normal ranges (Q4 2013 and historical troughs normalised to 100)

- No general property bubble in the euro area
- A few countries and/or large cities have nevertheless high property price growth now
- In some countries risks may be particularly pronounced in commercial real estate
- A number of prudential policy actions have been taken in those cases

Notes: Real house price indexes based on residential property price and consumer price indexes of euro area countries between 1975Q1 and 2018Q1. Identification of troughs and peaks following Harding and Pagan (2002). Red dotted line refers to the median for all upswings covered in the fourth quartile (historical “booms”). Grey area refers to the range of all upswings covered in the second and third quartile (historically “normal” upswings).
Sources: BIS, ECB, Fed Dallas, OECD and ECB calculations.