EUROPEAN CENTRAL BANK
EUROSYSTEM

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Monetary and Macroprudential Policies

3 February 2016

Presentation at the SUERF/Deutsche Bundesbank/IMFS Conference

Monetary Policy (MP) and Macropudential Policy (MaP)

Objectives:

- **MaP** Broad set of targeted instruments to tackle systemic risk in the financial sector, where it emerges → Financial stability
- **MP** Interest rate: broad impact on all asset prices, sectors and countries in MU; business cycle-related goal → Price stability

Relationship between the two primary objectives:

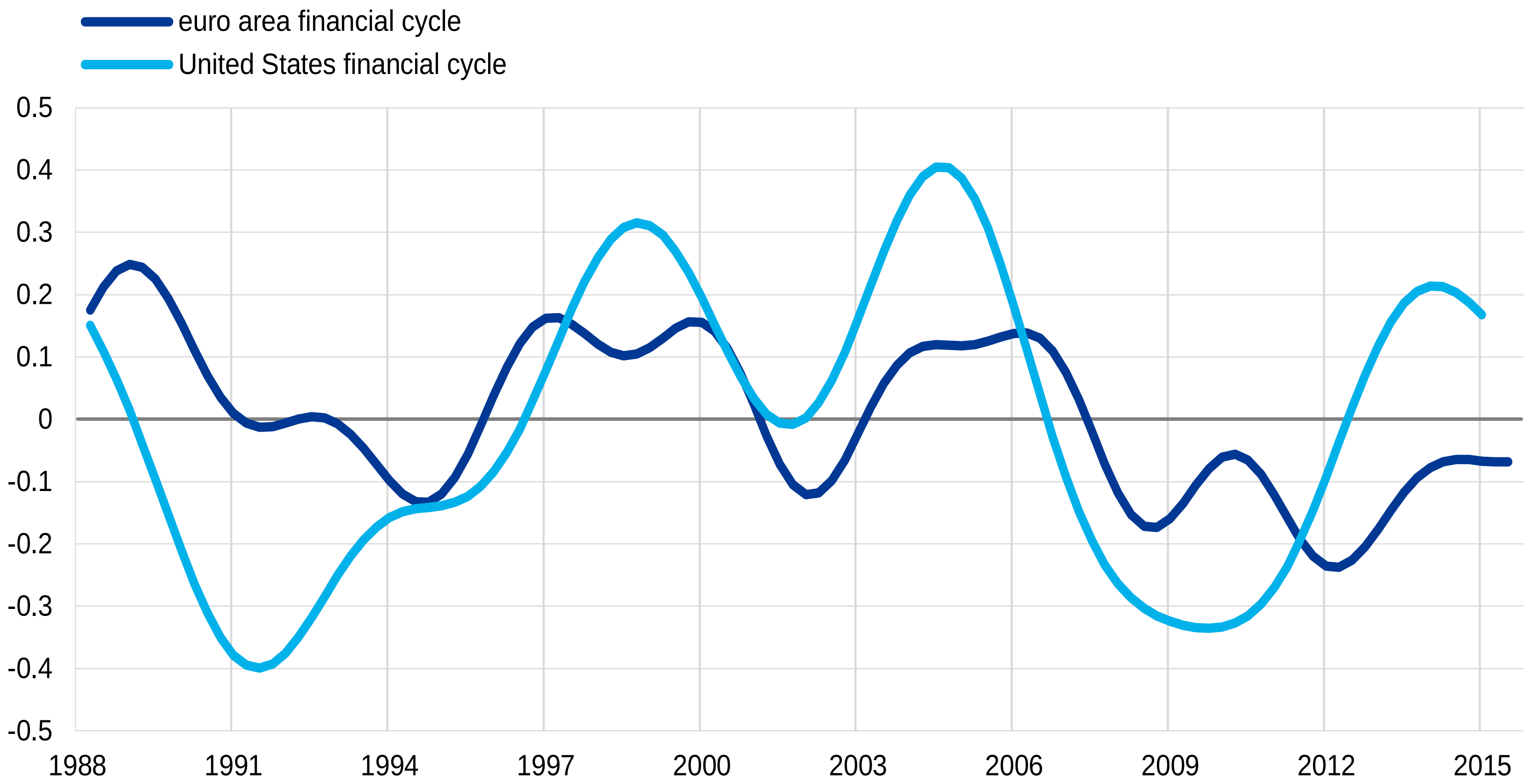
- no long run trade-off: self-reinforcing goals
- short run trade-off: business and financial cycles “disconnect”, depending on nature and intensity of shocks and transmission channels (e.g. risk taking)

MaP potential to reduce the MP´s trade-off:

- smoother financial cycle; increased resilience of intermediaries; reduced amplification channels through regulation; sector-, asset-, country-specific actions
- real trade-off only in case of generalised, credit-led asset price tensions; need full understanding of costs and benefits of deviating from primary objective

Financial cycle estimates

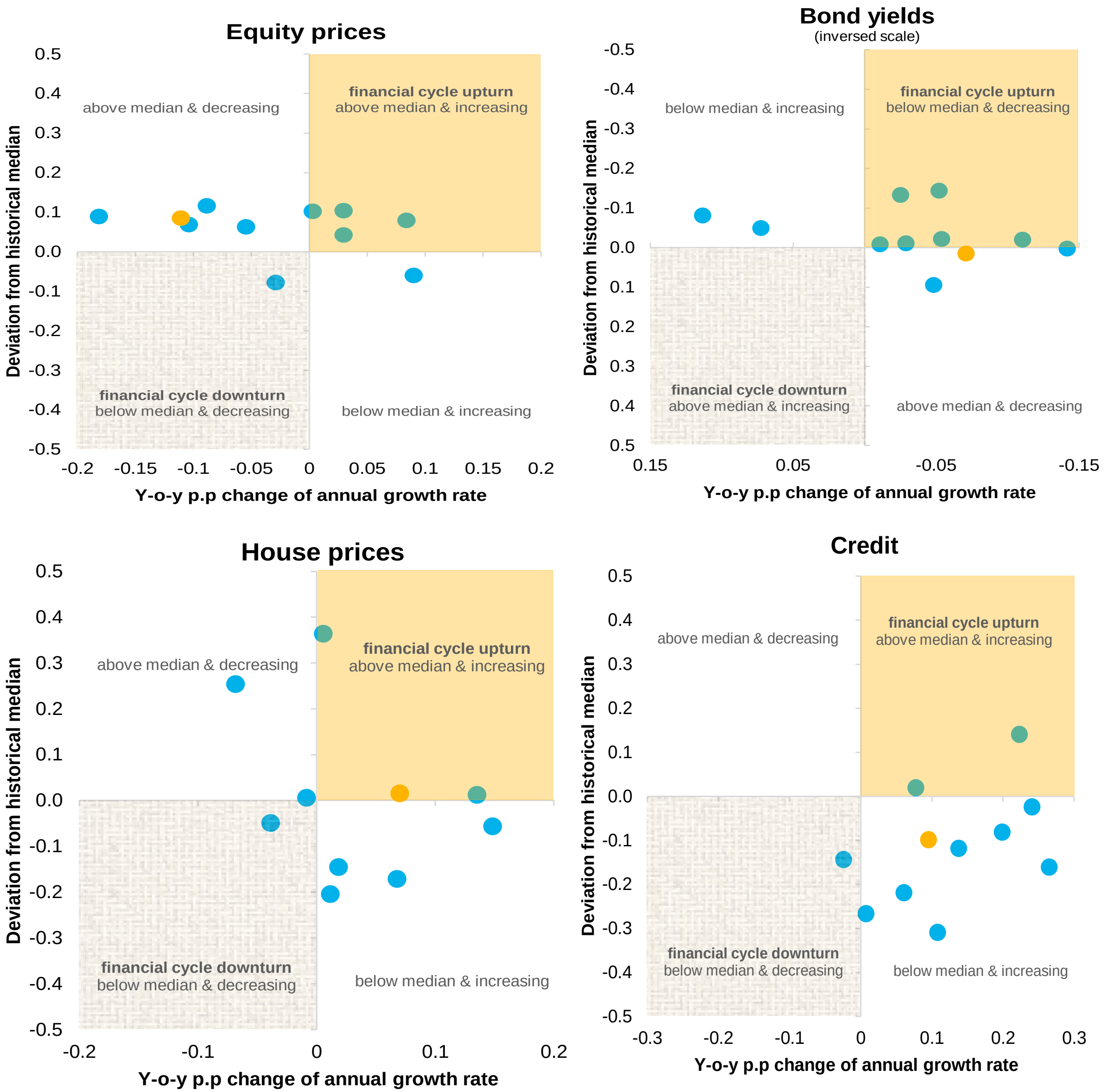
Financial cycles in the euro area and the United States
(normalised deviations from historical median)



Source: ECB calculations. Methodology: Schüler, Y., Hiebert, P. and Peltonen, T., "Characterising the financial cycle: a multivariate and time-varying approach", Working Paper Series, No 1846, ECB, 2015.

Note: The financial cycle for the United States runs until Q1 2015, the cycle for the euro area until Q3 2015.

Financial cycle in the euro area: main components

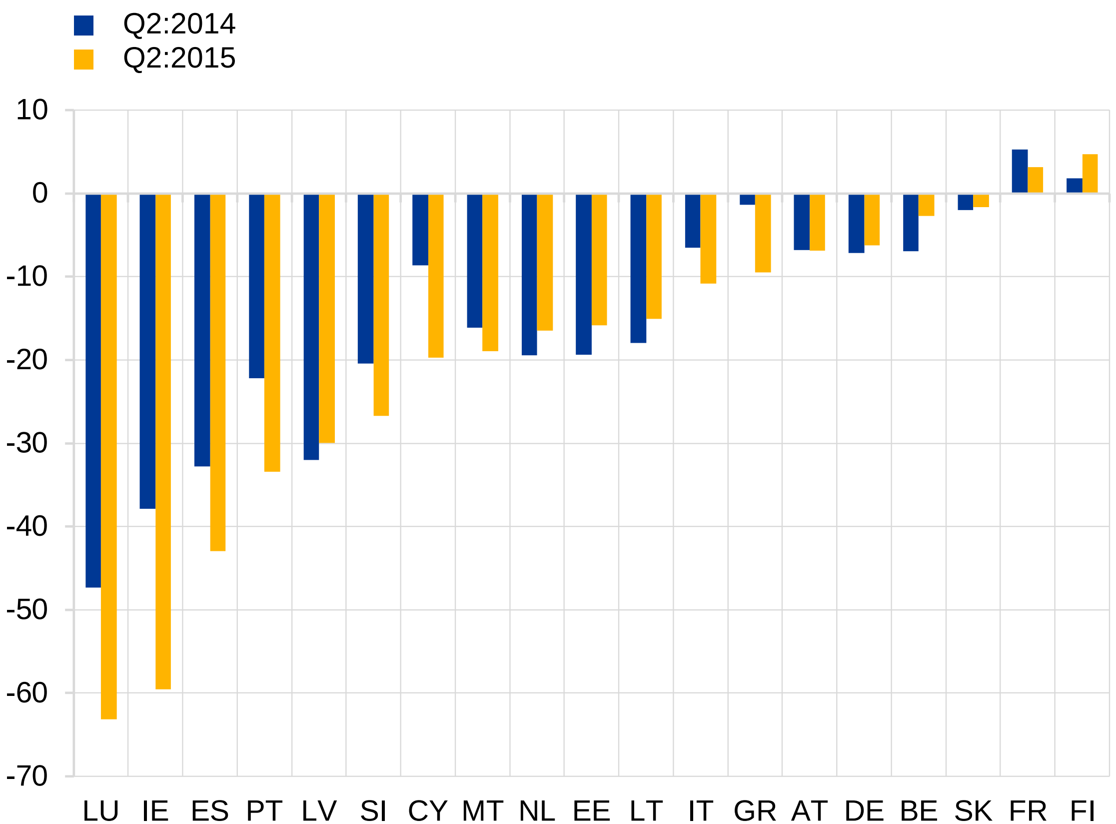


- Equity markets valuation in line with historical average
- Compression of risk premia visible in bond markets (sovereign; APP)
- Credit cycle still depressed in most countries
- Real estate markets more differentiated across countries
- No credit-led exuberance in asset markets

Source: ECB calculations. Methodology: Schüler, Y., Hiebert, P. and Peltonen, T., "Characterising the financial cycle: a multivariate and time-varying approach", Working Paper Series, No 1846, ECB, 2015.

Note: the yellow mark refers to euro area aggregate values.

Total credit-to-GDP gaps
percentage points



Source: ECB calculations.

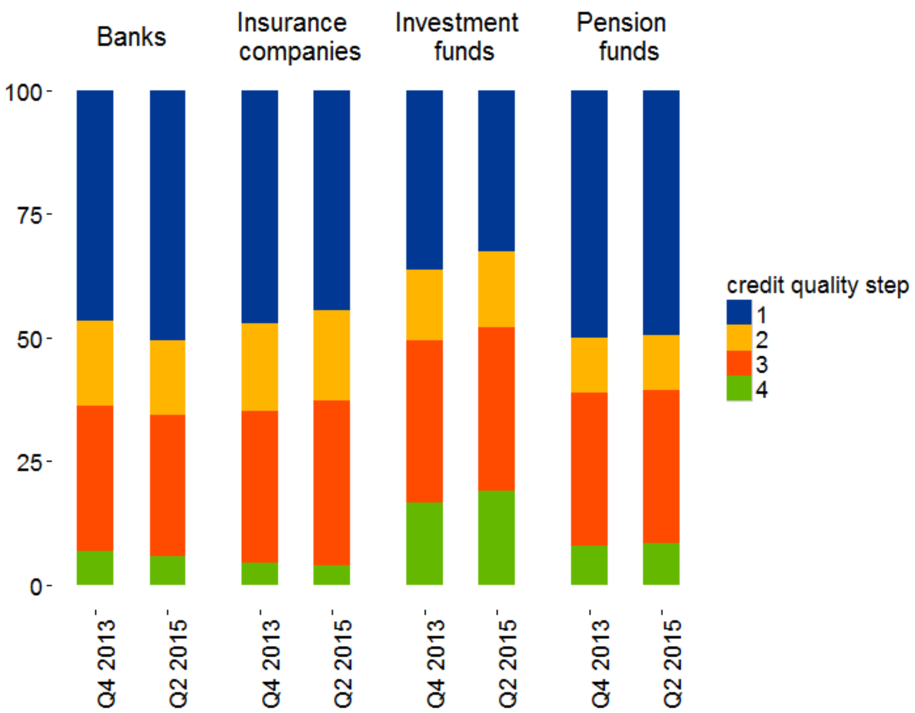
Macroprudential measures for real estate activated in the SSM since 2013

	LTV limits (reduces LGD)	**Income-based limits** (reduces PD)	**Max. maturity restriction** (reduces long-term interest rate sensitivity)	Floors to risk-weights
Belgium				RRE (5% add-on on IRB banks)
Cyprus	70%, 80%	DSTI: 35-60%		
Estonia	85%, 90%	DSTI: 50%	30 years	
Finland	90%, 95% (from July 2016)			
Ireland	70%, 80%, 90%	LTI: >3.5		CRE (brought to 100%)
Latvia	95%			
Lithuania	85% (2011)	DSTI: 40%-60% w/ interest rate sensitivity test at origination	30 years	
Luxembourg				75% RW if LTV>80%
Malta	70%			
Netherlands	102% (1pp decline p.a. to 100% in 2018)		30 years	
Slovakia	90%, 100%	Internal DSTI limits* (max. 100%) w/ interest rate sensitivity test at origination	30 years*	

* Recommendation: to be received by the national law in March 2016

Share in nominal debt securities holdings by sector and rating category

(Q4 2013 – Q2 2015 ; percentages)

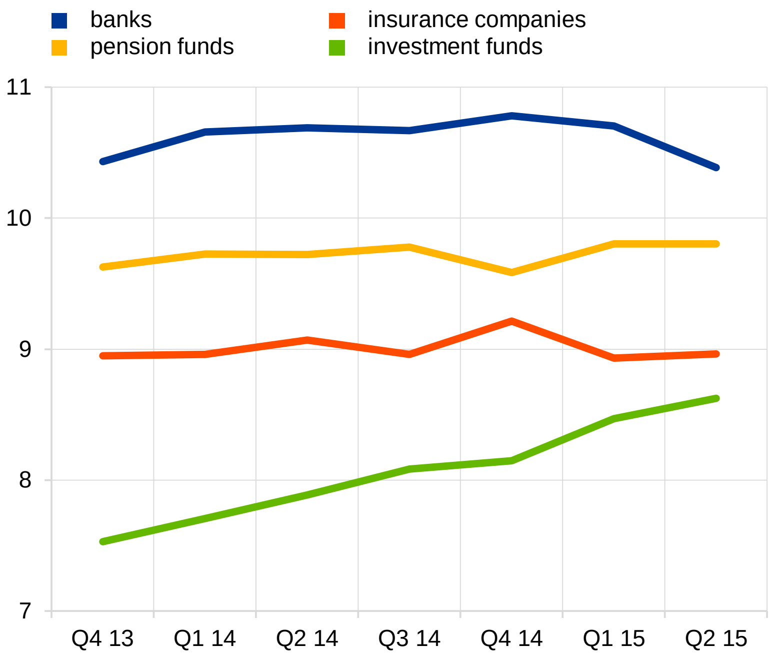


Source: ECB and ECB calculations.

Notes: Credit quality steps are defined in accordance with the Eurosystem credit assessment framework (ECAF), which provides a harmonised rating scale classifying ratings into three credit quality steps. The first category includes securities rated from AAA to AA-, the second from A+ to A- and the third from BBB+ to BBB-. A fourth category is added which includes all rated securities with a rating below credit quality step three.

Residual maturity of debt securities holdings

(Q4 2013 – Q2 2015; weighted average)



Source: ECB and ECB calculations.

Notes: All “alive”, rated and non-rated euro and foreign currency-denominated debt securities are included. In order to estimate the average, residual maturities are weighted by the nominal amount held of each security by each sector over the total debt holdings of each sector.

Conclusions

Limits of MaP: toolkit should be completed

MP: costs of deviating (too much and too long) from primary objective may be large also from a financial stability perspective

… in any event …

no case for MP in the euro area to change its course