Monetary and Macroprudential Policies as Team-Mates: The Czech National Bank Case

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MaP and MP: Joint conduct, coordination, or just separate policies?

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- Czech National Bank (CNB) approach – coordination pursued, mostly both policies going in same direction throughout cycle.
- MaP gradually tightened after its establishment in 2014, loosened after Covid-19 outbreak, then tightened again in 2021 (applies to both capital and BBM measures).
- MP rather loose until 2017 (FX commitment from Autumn 2013 to April 2017) and again supportive during Covid-19 period, decisive tightening from 2nd half 2021 with FX intervention support after May 2022.

CNB's concerted relaxation and tightening of policies in recent years (1)

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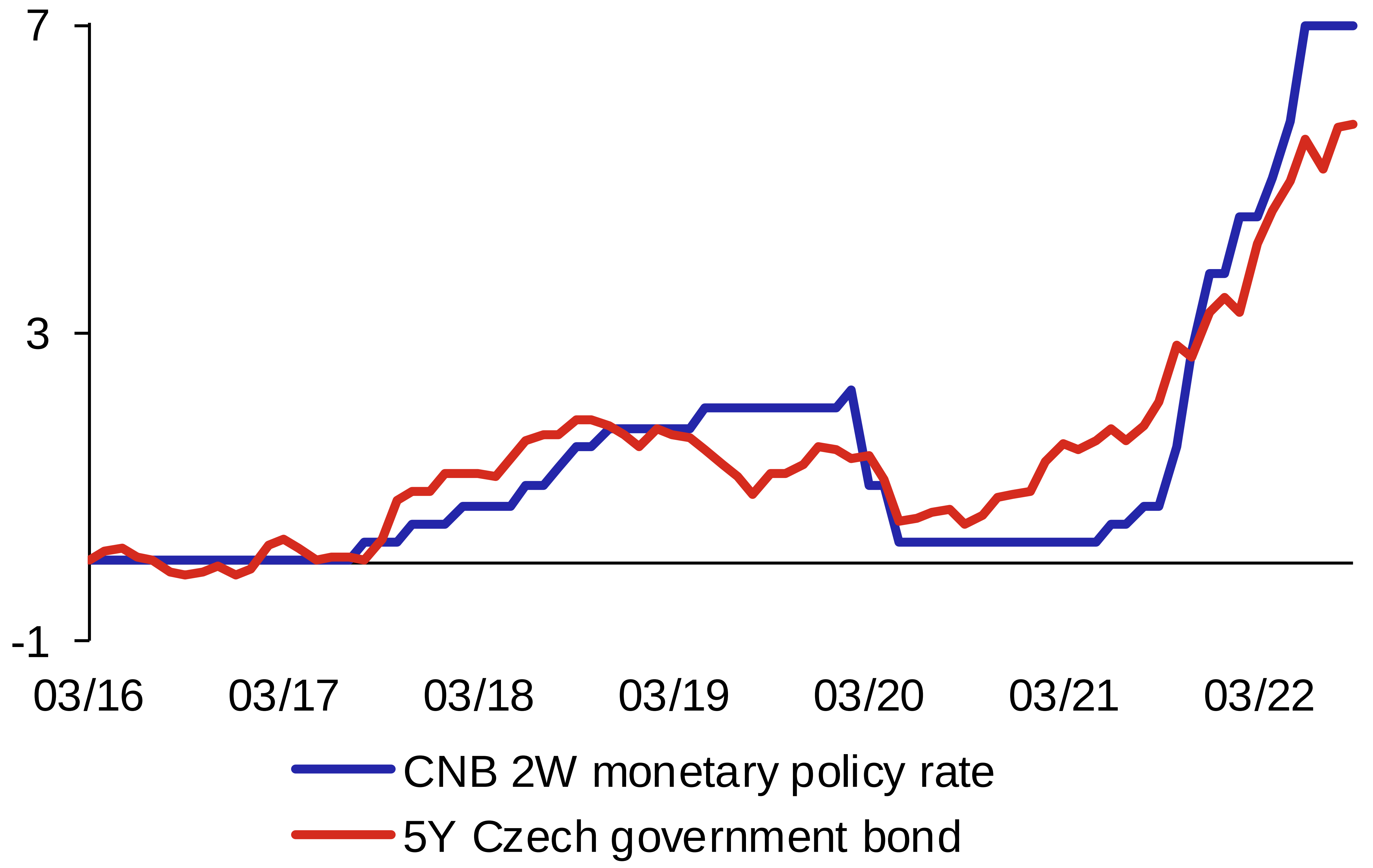
Monetary policy rate and 5Y GB yield in the Czech Republic

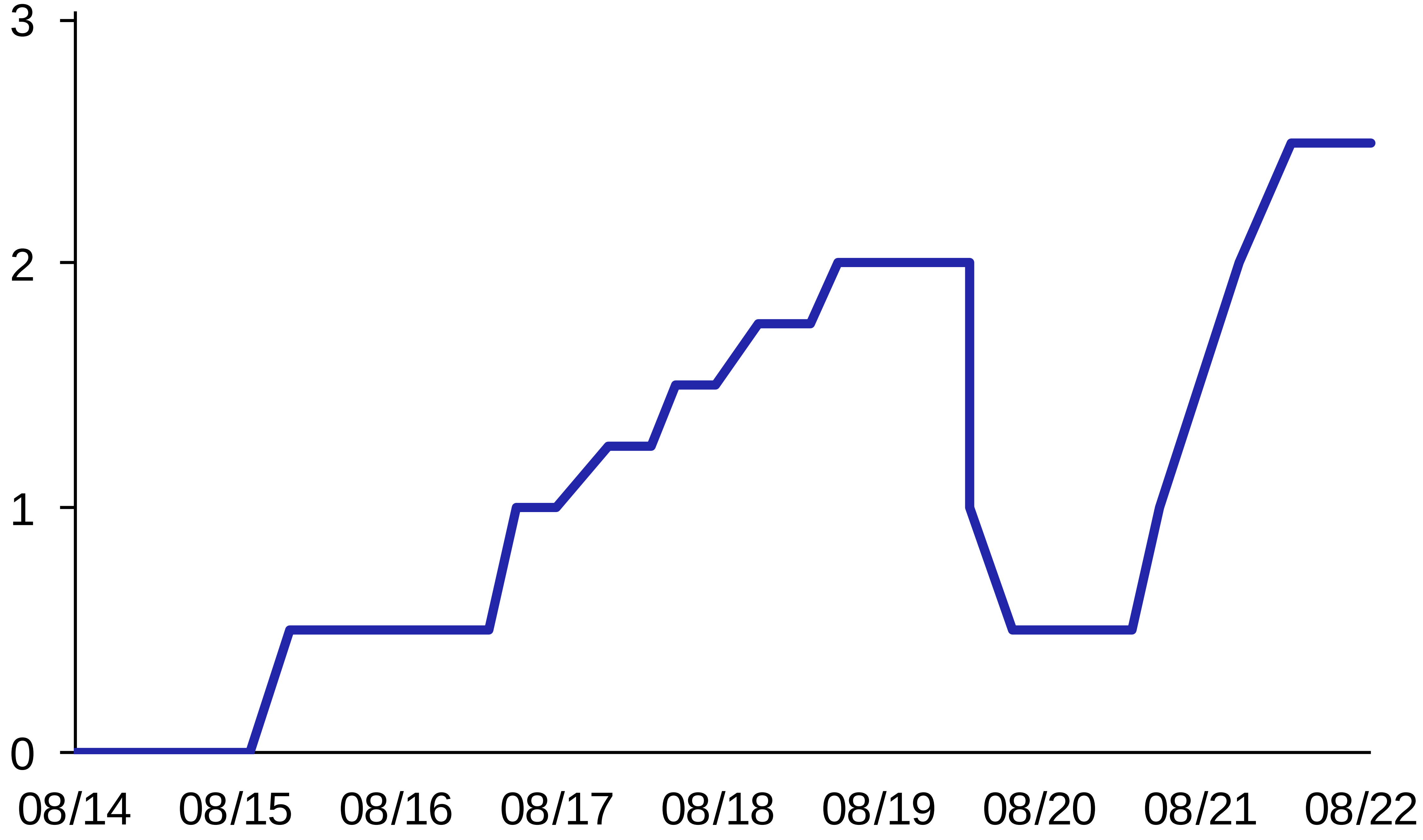
(%)



Source: Refinitiv, CNB

Pending CCyB rate

(%)



Source: CNB

Why do I think MP and MaP should be two sides of same coin these days? (1)

- Predominant macroeconomic models of last three decades have turned out to be incomplete, oversimplified, naive (Maradona “theory” of interest rates) and somewhat misleading in critical times.
  - Lack important features of macroeconomics (kind of applied micro?) and employ controversial/purpose-built features (homogeneous agents).
  - Forecasting and simulation exercises in some cases resemble technical analysis of financial markets, not fundamental analysis of macro-economy.
- Unpleasant consequences:
  - Apparent failures in forecasting macroeconomic dynamics, understanding scope of disinflationary and inflationary pressures, spotting structural shifts in inflationary forces.
  - Inflation-forecast targeting thus pursued more in academic papers than in reality.
  - MP makers have tended to respond primarily to recent data on inflation, directing them potentially from one extreme to another.

Why do I think MP and MaP should be two sides of same coin these days? (2)

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- MP-making has not been resistant to time inconsistency.
- Productivity growth and related r* concept (theoretically questionable, empirically dishonest?) have been used as opportunistic explanation of why interest rates should be low no matter what is happening in economy (so far actual inflation is not high).
  - “New economy” idea (25 years ago) – interest rates can be kept low since increase in productivity means that inflationary pressures will not arise despite stronger economic activity and lower unemployment.
  - “Secular stagnation” view (a few years ago) – interest rates should be kept low since decrease in productivity has lowered r* and thus also inflationary potential given policy rate level.
- Focus on short horizons in conducting MP has us enabled to disregard risk of multiple equilibria outcomes – risk that strongly expansionary monetary policy reflected in fast credit growth could end up in both inflationary and deflationary situations.

MaP as side door to MP?

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- Attempts to employ financial factors in predominant models through reaction function/policy rules (Woodford, BIS economists,…) have not been particularly successful.
  - Key focus on credit and asset markets thus makes MaP alley for returning into central banks' policies (i) credit and wealth distribution associated with asset markets (post-Keynesian topics) and (ii) money (monetarist tradition).
  - BBMs and partially capital tools may erect at least some barriers to credit/money growth if higher interest rates are not available.
  - Concentration limits and public finance stress testing could theoretically constrain credit/money creation from public sector.
- Idea of buffers employed by MaPs can be extended to MP in SOEs.
  - CNB records recursive episodes of analysts saying that its FX reserves are too large and subsequently expressing doubts about their sufficiency.
  - "It's fine to have an FX buffer, don't burn it," we hear these days. Used to hear "Do not buy FX, you're printing too much money".

Lessons from recent macroeconomic shocks

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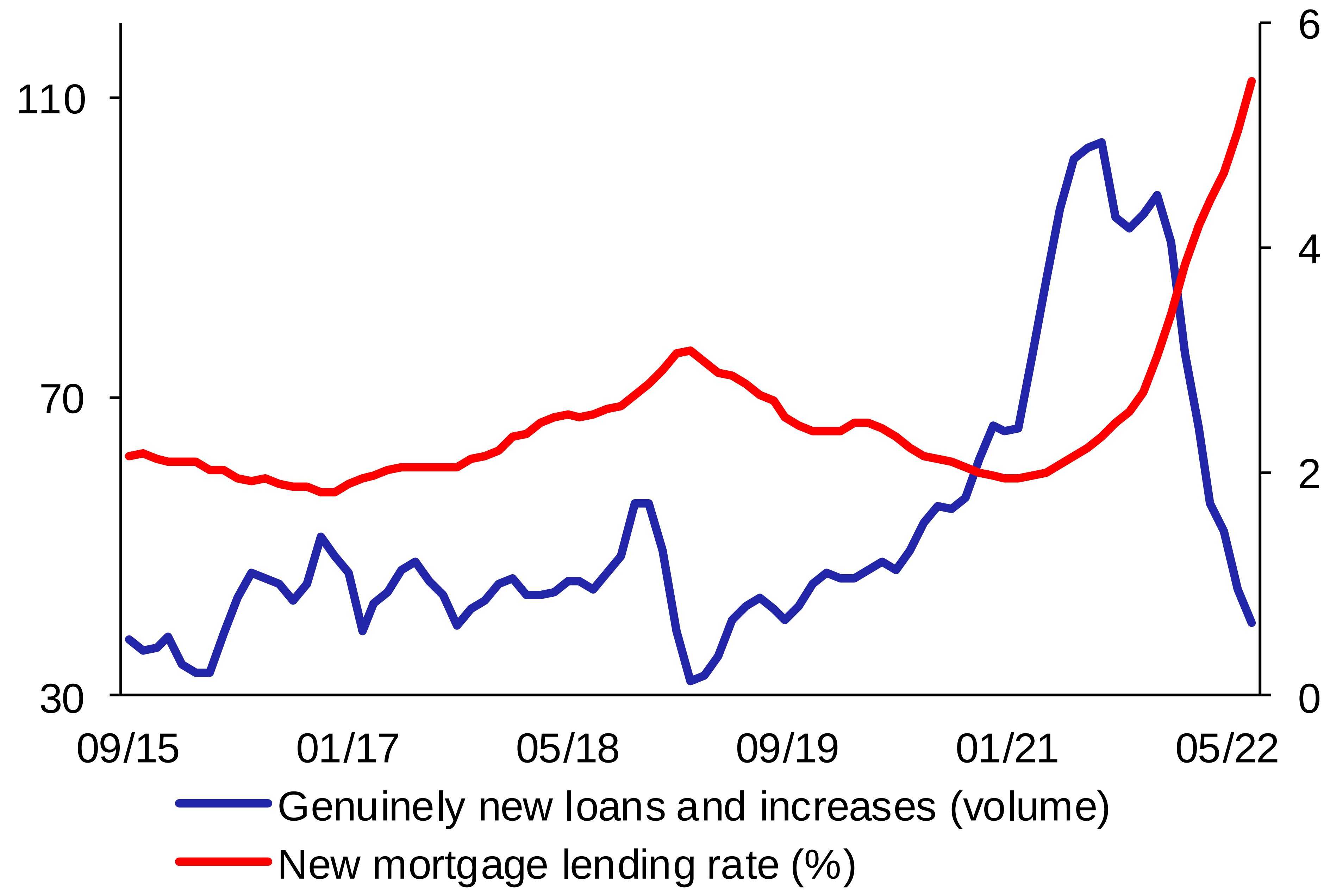
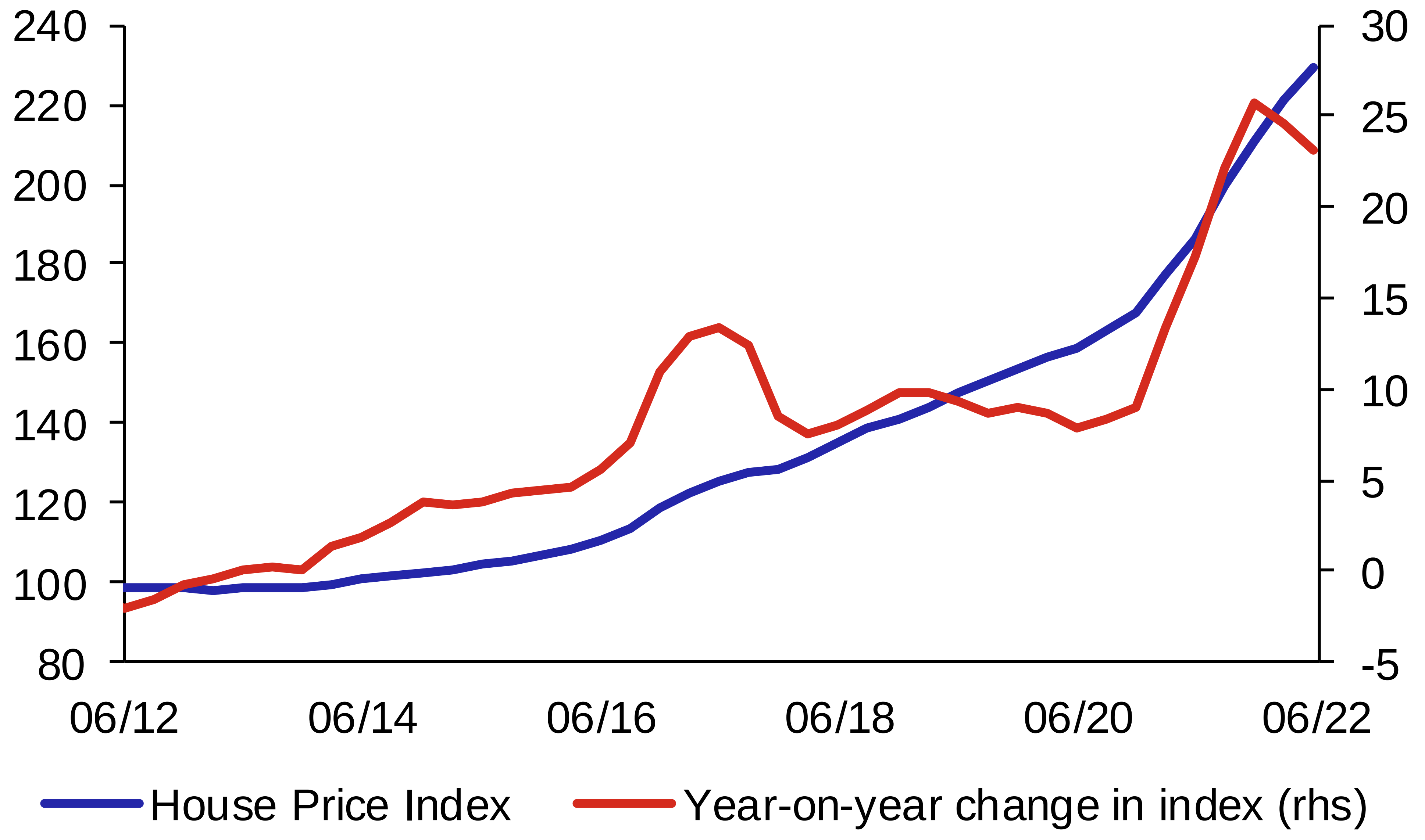
- Mix of extra loose monetary and fiscal policies may create fear of inflation (not to be mixed up with expectations of inflation).
  - Portfolio shift to bricks and mortar should be of no surprise.
  - Both tougher BBMs and higher interest rates needed, still not providing guarantee of trend reversal without assistance from other policies.

Three-month totals of new mortgages and lending rates
(CZK billions 3M; right-hand scale: in %)



Source: CNB

Transaction prices of residential property in the Czech Republic
(2010 = 100; right-hand scale: %)



Source: CZSO

Thank you for your attention

Recommended reading based on CNB's research:

Frait, J., Malovaná, S., Tomšík, V. (2015): The interaction of monetary and macroprudential policies in the pursuit of the central bank's primary objectives. Financial Stability Report 2014/2015, Czech National Bank, pp. 110–120.

Malovaná, S., Frait., J. (2017): Monetary policy and macroprudential policy: Rivals or teammates? Journal of Financial Stability, vol. 32, October 2017, pp. 1–16.

Malovaná, S., Hodula, M., Gric, Z., Bajzík, J., (2021): Macroprudential Policy in Central Banks: Integrated or Separate? Survey Among Academics and Central Bankers, CNB Research and Policy Note 4/2021.

Malovaná, S., Bajzík, J., Ehrenbergerová, D., Janků, J. (2020): A Prolonged Period of Low Interest Rates: Unintended Consequences, CNB Research and Policy Note 2/2020.

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