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MACRO-PRUDENTIAL POLICIES WITHIN A MULTI-COUNTRY MONETARY UNION

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The beauty of macro-prudential (macro–pru) policies

- Squaring the number of policy objectives with the policy instruments available.
- Especially relevant in a multi-country monetary union.

But caution. Two main messages of this presentation:

- Be clear on macro-pru objectives. Pru should probably predominate.
- Do not overplay the separation principle: policy coordination is a must.

The macro dimension vs. the pru dimension

- Macro-pru is conceived as *actions aimed at addressing risks stemming from macro-financial developments by employing (mostly although not exclusively) prudential tools*.

- Ambiguity as to the objective:

MACRO OBJECTIVE:	Mitigating macro-financial imbalances
	and/or
PRU OBJECTIVE:	Strengthening banks' ability to cope with macro-financial risks

The challenges of the macro objective

- Macro objective is much more challenging:
  - Limited ability to affect banks' strategies (e.g. credit standards)
  - Even if individual banks' strategies could be affected, less constrained banks and non-banks could take over [see Basten and Koch (2014) and Jiménez et al (2013)]
- Better aim at making banks more resilient to macro-financial shocks.

Conflicts of interest have had substantial influence on the design of policy frameworks

- Monetary policy (MP) vs. micro-prudential policies
- Micro-prudential vs. macro-prudential
- Micro and macro-prudential vs. resolution

In Europe, wide array of financial authorities: ECB – MP, ECB – BS, ESRB, EBA, SRB,… plus a constellation of national agencies.

Conflicts of interests exist BUT are they always so relevant?

- Wise to ignore financial stability for pure MP decisions?
- Wise to deal separately with instruments (micro-pru, macro-pru, resolution, …) that do actually share an ultimate financial stability objective?

Moreover, are synergies properly taken into account?

- Macro view relevant for identifying and addressing risks at firm-level.
- Supervisory analysis key to assessing aggregate financial risks and adequate macro actions.
- Micro-pru and resolution policies clearly complementary.
- System's liquidity management cannot be dissociated from pru analysis.

And little evidence that conflicts of interest were the problem

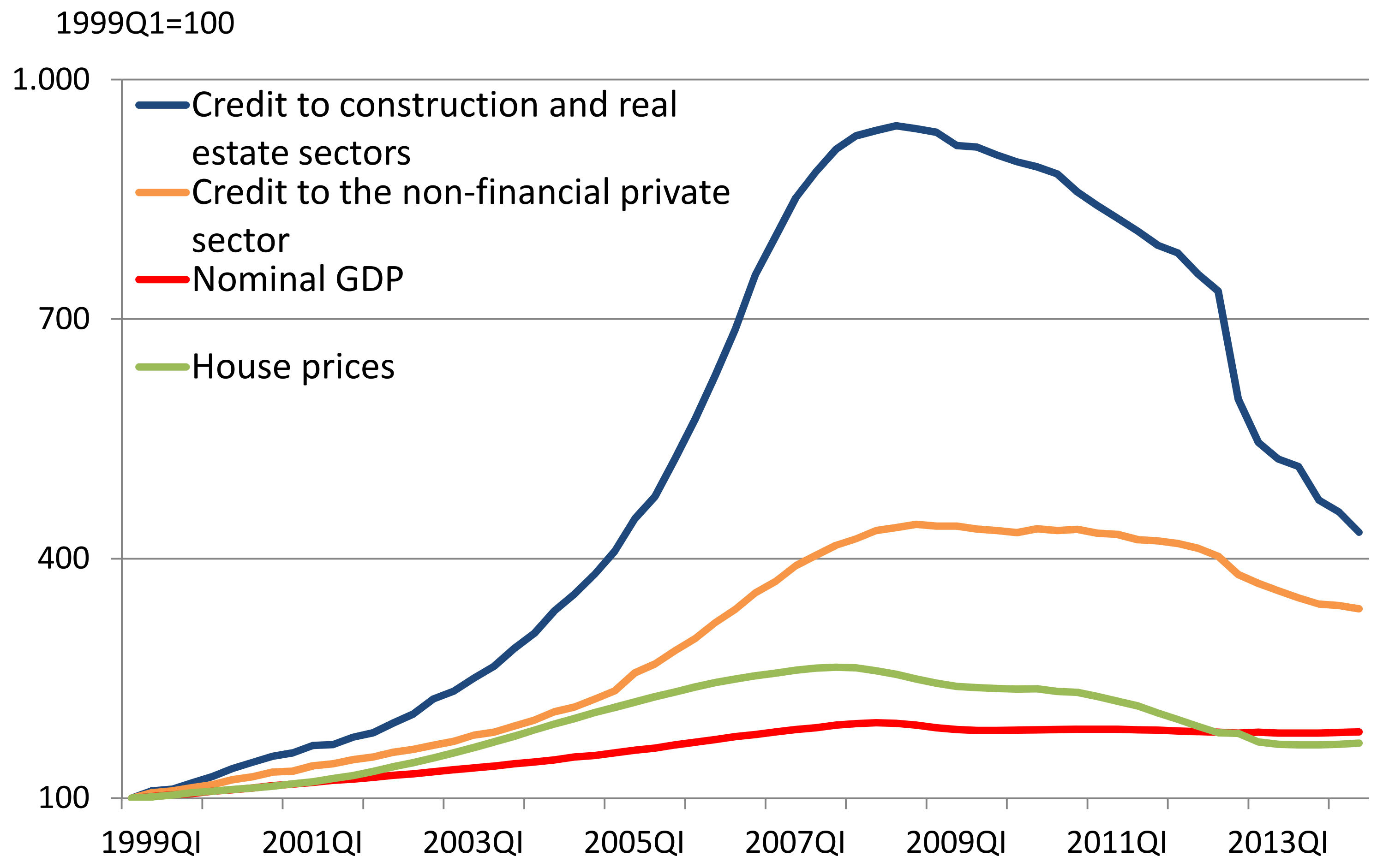
- Excessively narrow policy focus arguably much more relevant:
  - MP did not care sufficiently about financial imbalances
  - Micro-pru policies lacked sufficient macro perspective
  - Central Banks' liquidity management, at times, insufficiently coordinated with pru policies

Therefore, to fully exploit new macro-pru tools, need to frame them within a comprehensive and a consistent policy set-up

- The role of Central Banks is key to ensuring the desired comprehensiveness and consistency: take the separation principle as given, but apply it pragmatically

AN ILLUSTRATION: EXPERIENCE IN SPAIN WITH DYNAMIC PROVISIONS (1)

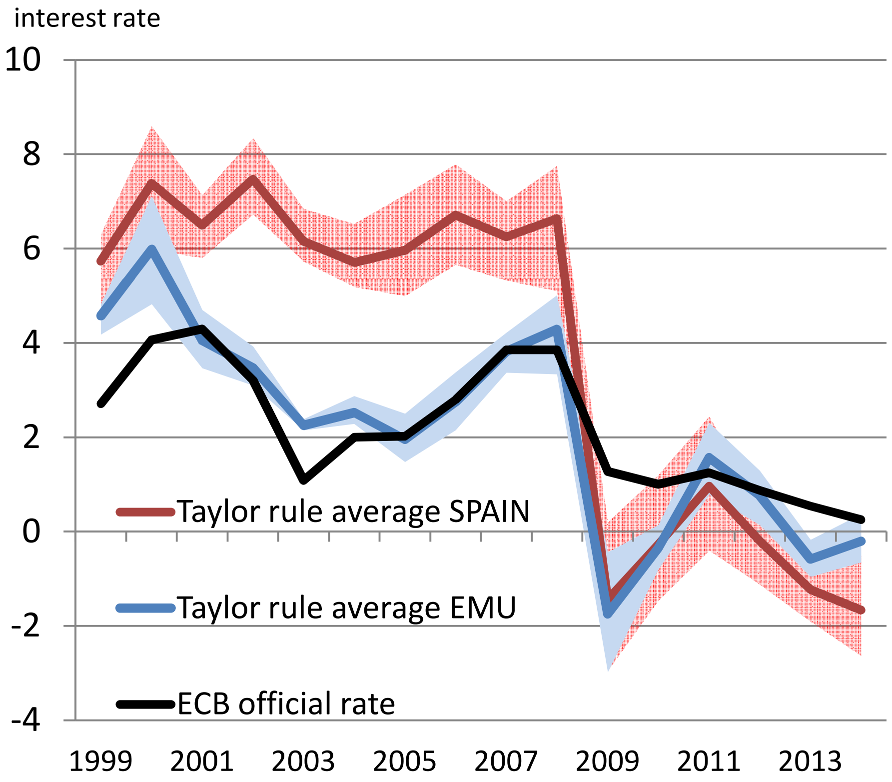
The facts: huge lending expansion … and lending bust



Source: INE, BE and own calculations

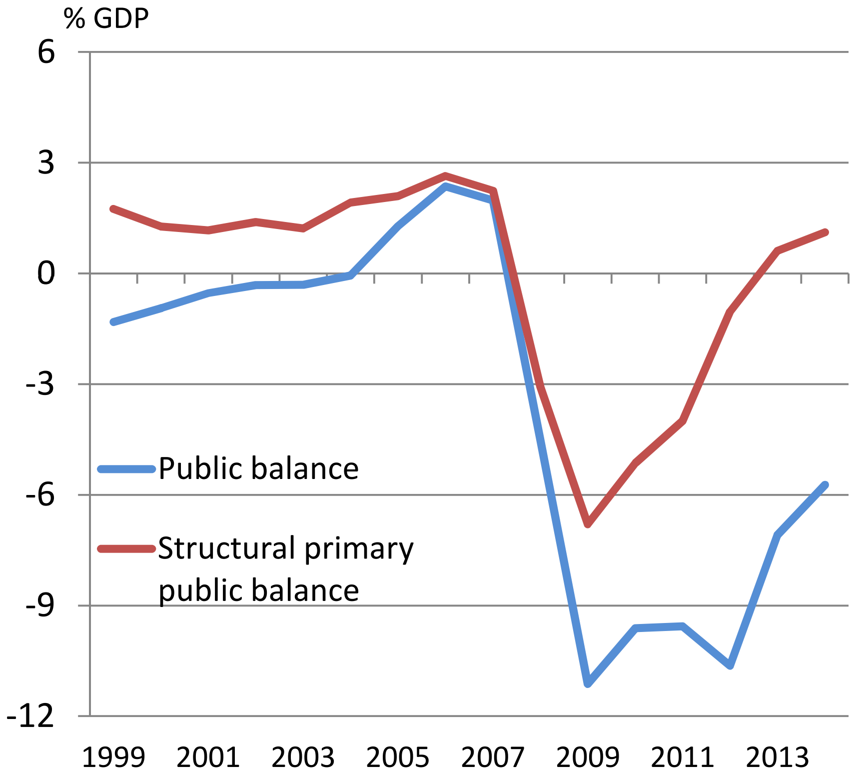
The causes: inadequate policy mix

Excessively lax monetary policy



Source: ECB, Eurostat and Estrada and Saurina (mimeo)

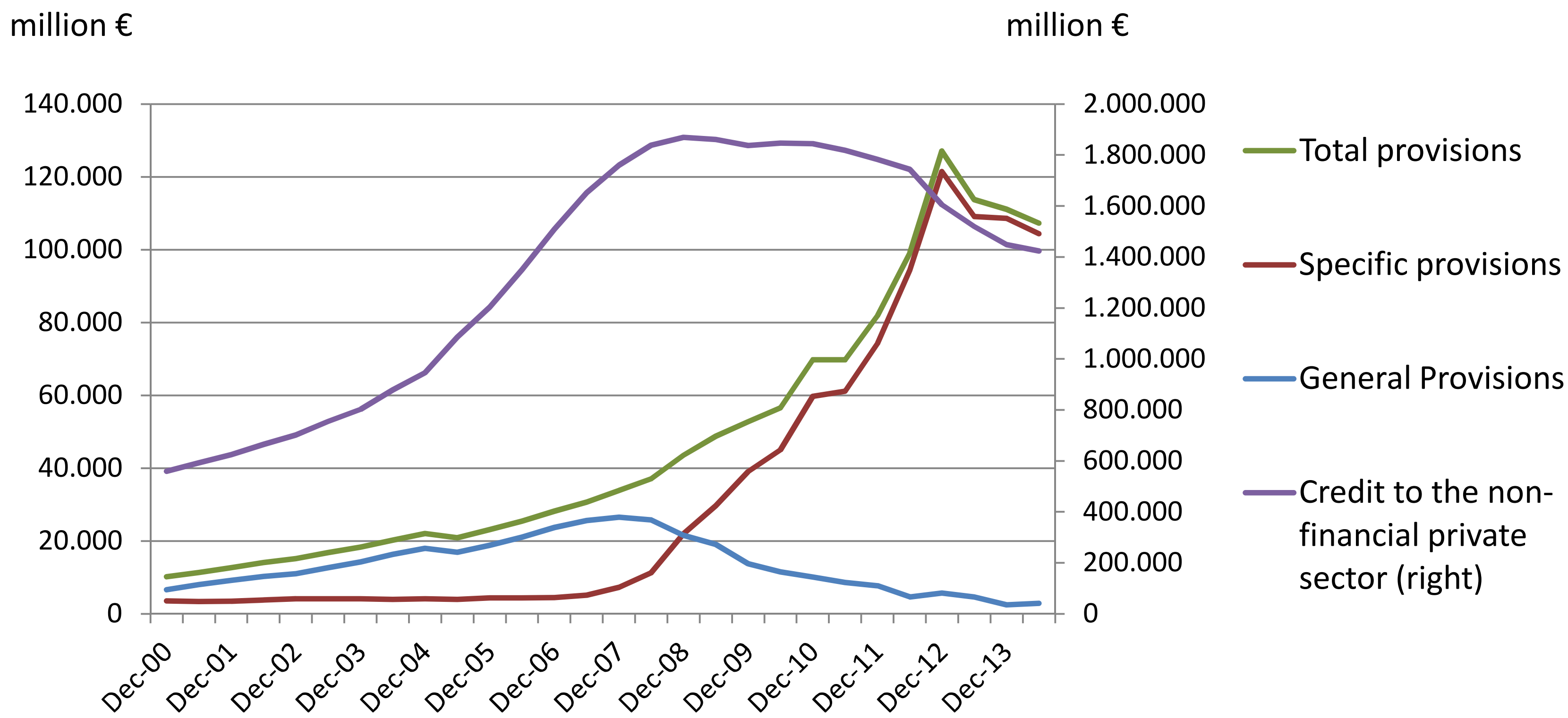
Insufficient fiscal adjustment



Source: AMECO

AN ILLUSTRATION: EXPERIENCE IN SPAIN WITH DYNAMIC PROVISIONS (3)

The role of dynamic provisions:
-Help smooth the provisioning effort (albeit moderately)
-But little impact on credit developments (at least during the expansion)



Source: BE

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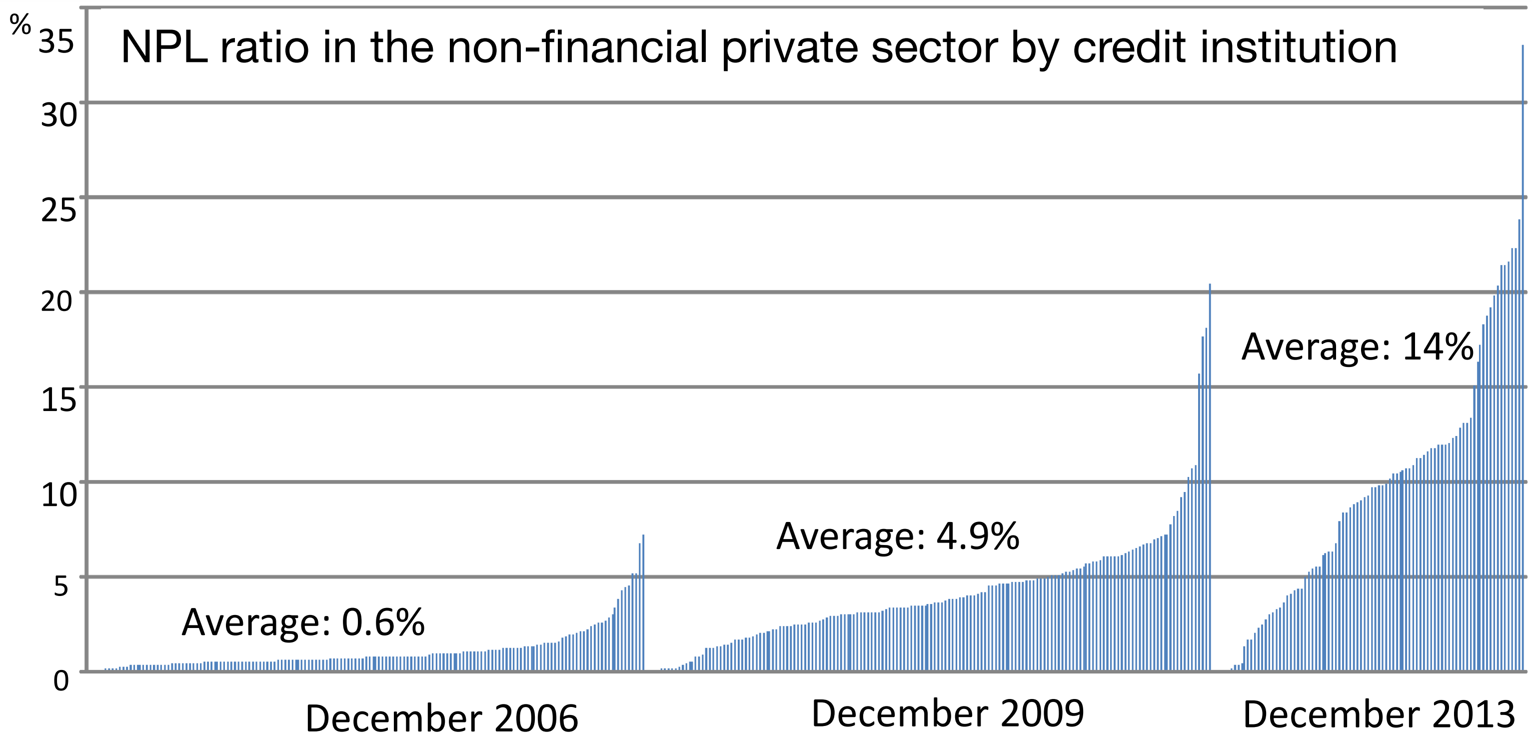
AN ILLUSTRATION: EXPERIENCE IN SPAIN WITH DYNAMIC PROVISIONS (4)

The limits of macro-pru:
working with averages while aggregate developments embed a relevant dispersion of risk management policies across banks



Source: BE and own calculations

Need to work hand-in-hand with micro-supervision

As a conclusion, countercyclical provisions:

- Useful device that together with stringent micro-policies increased resilience of the Spanish financial sector.
- Unable however to moderate huge credit expansion…
- …as other policies were significantly pushing in the opposite direction (no policy coordination).
- With the benefit of hindsight: an even more proactive macro and micro-prudential action would have been helpful.
- Macro-pru not a substitute of adequate policy coordination.

THANK YOU FOR YOUR ATTENTION