EUROPEAN CENTRAL BANK

EUROSYSTEM

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# The interplay between macro-prudential, micro-prudential and monetary policies at the ECB

Conference

Macroprudential Policy - Implementation and Interaction with other Policies

Stockholm, 13 November 2014

# Outline

## I. Conceptual interactions between macro-prudential, micro-prudential and monetary policy

I. Systemic vs. institutional dimension of policies

II. Main objectives, instruments, impact mechanisms

## II. The ECB's institutional setup

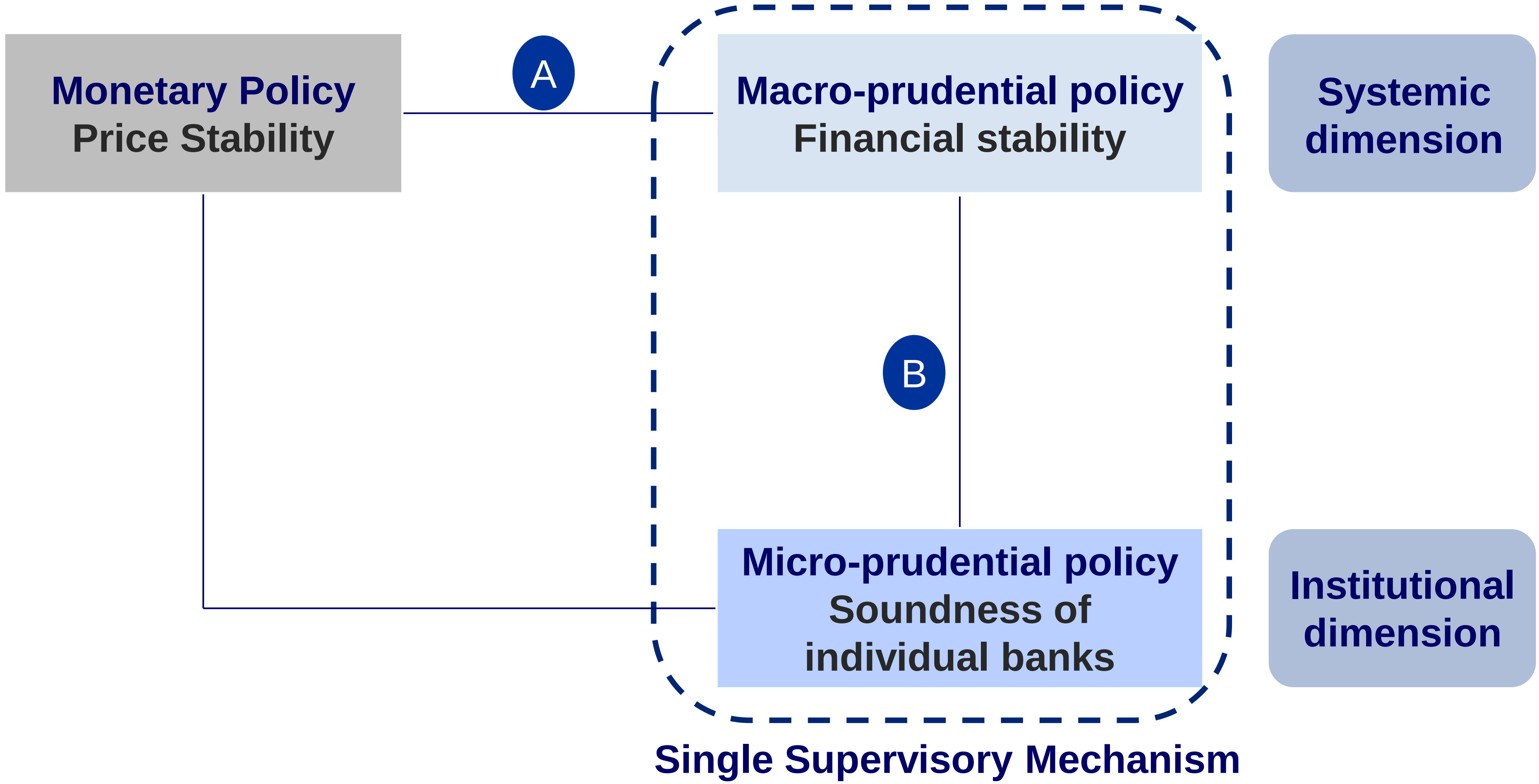
- Role of the Supervisory Board in micro and macro-prudential policy
- Role of the Governing Council in all three areas

## III. Macro-prudential tasks and tools of the ECB

- Coordination mechanism between national authorities and the ECB
- Macro-prudential instruments available for the ECB

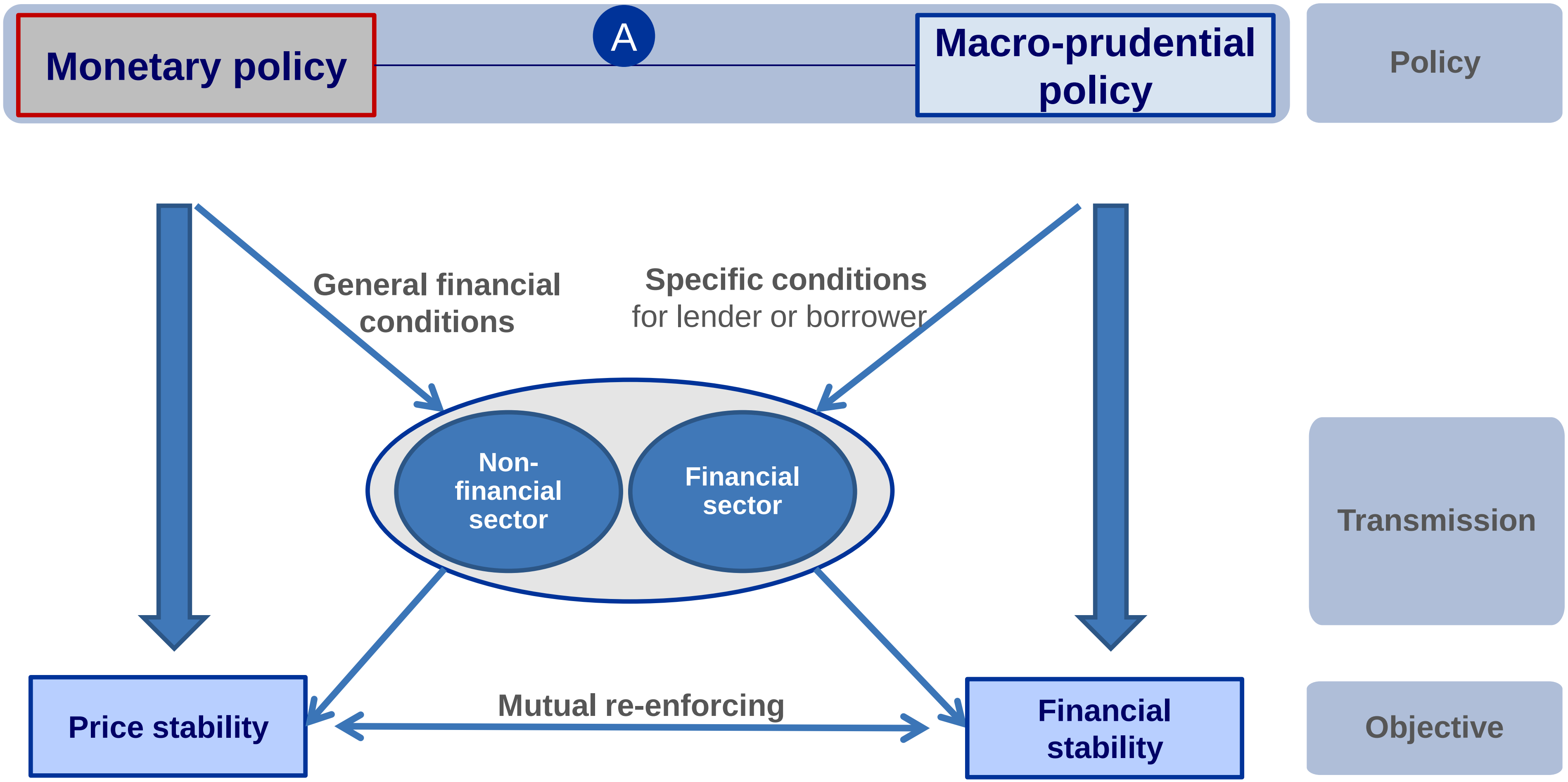
## IV. Areas for improvement

# I. Conceptual interactions



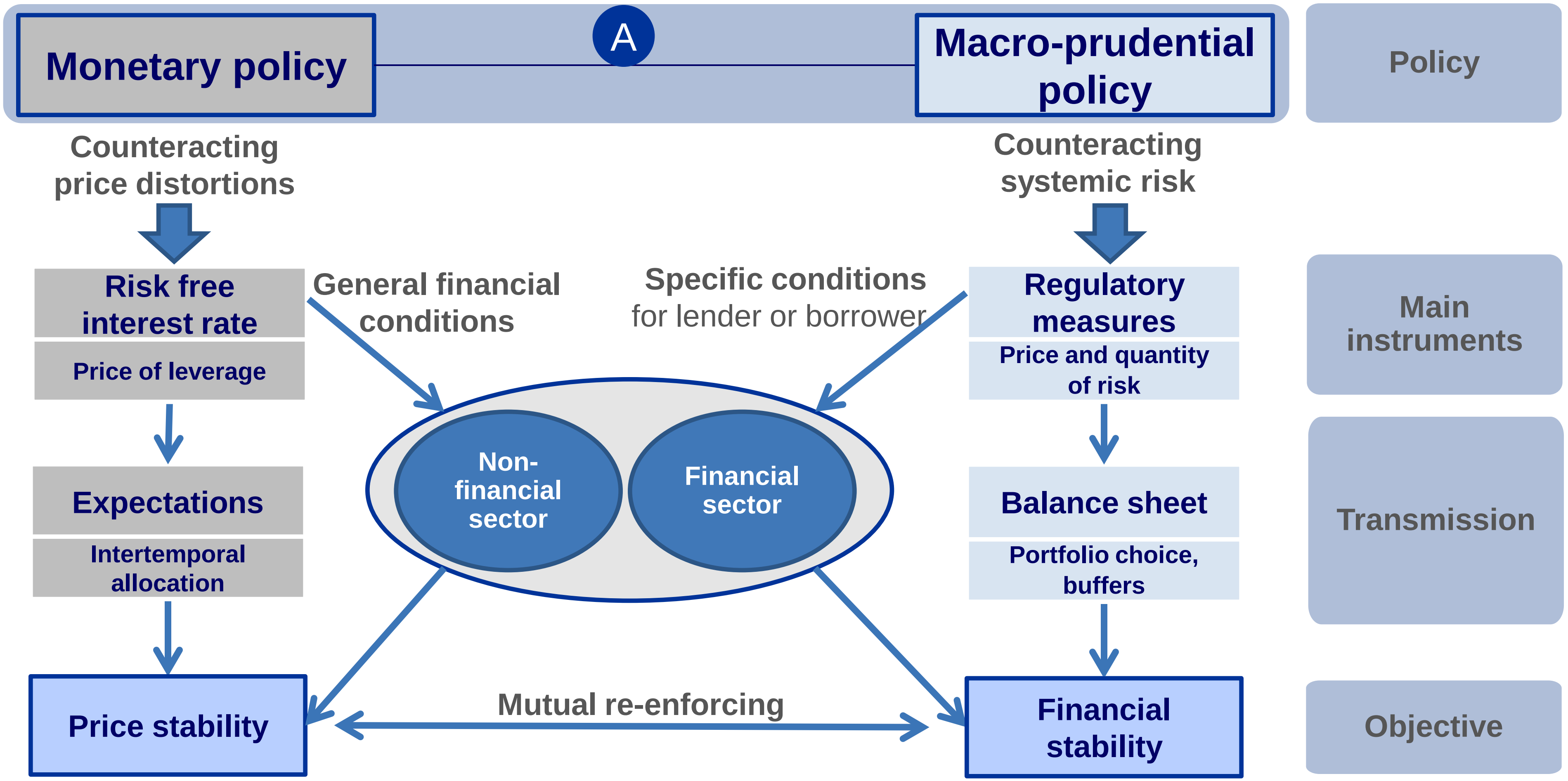
# I.A) Macro-prudential and monetary policy

- Price stability and financial stability are mutually beneficial and re-enforcing
- Monetary policy sets general financial conditions
- Macro-prudential policy is more specific and targeted to sectors and imbalances



# I.A) Macro-prudential and monetary policy

- Policies can have separate objectives and different instruments
- Policies interact in their transmission and affect each other's objective
- Potential policy conflicts need to be addressed by appropriate institutional set-up



## Interaction via bank lending rates

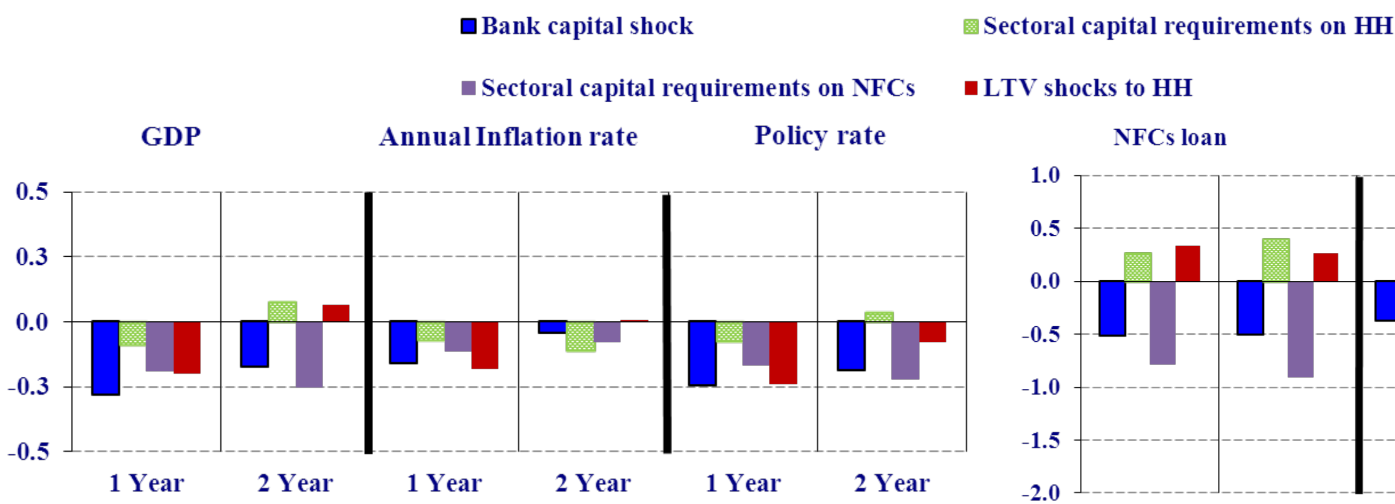
**Long-term lending rate is influenced by**

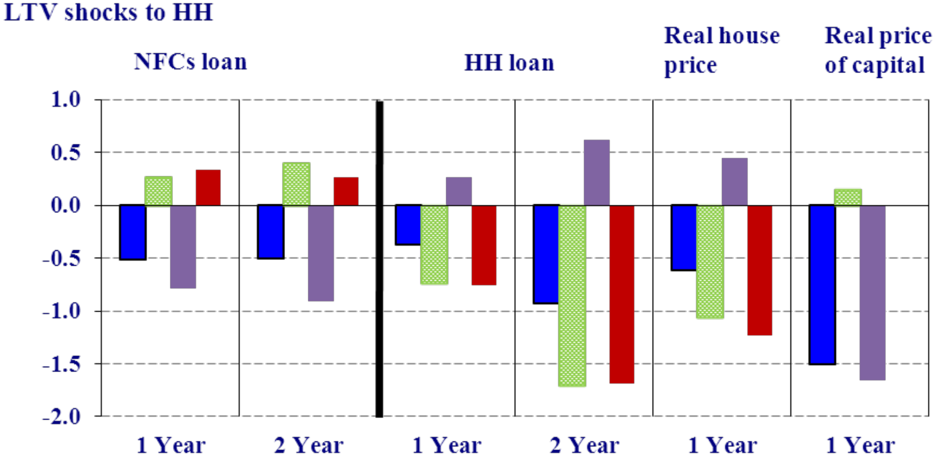
- Monetary policy rate (current and expected future) ⇒ Monetary Policy
- Term & risk premia, funding & capital costs ⇒ Macro-Prudential Policy
- Profit margins

**Different macro-prudential measures**

- may exert similar aggregate macroeconomic effects (LHS),
- are mitigated by an endogenous monetary policy response (LHS),
- but affect sectors and relative asset prices very differently (RHS).

**Transmission of Macro-Prudential policies in the euro area**
*(in percentage point difference from baseline)*




*Source: ECB calculations.*
*Note: Simulations are based on Darracq, Kok, Rodriguez-Palanzuela (2011) and allow for endogenous monetary policy adjustment. Bank capital shock is a 1.5 percentage point increase in the capital ratio. The sectoral shocks on households and non-financial corporations are calibrated to generate same sectoral lending spread as the system-wide capital shock.*

# I.B) Macro-prudential and micro-prudential policy

- **Background**: Legal basis in CRR/CRD IV
- **Instruments** available for macro- and micro-prudential purposes
  - Capital requirements
  - Other instruments
- **Positive spillovers** of having both under the same roof
  - Information exchange
  - Common understanding of mutual interactions
- **Negative spillovers**
  - Different objectives, time dimension and overlap of instruments

**The decision making mechanism should internalise potential spillovers between macro- and micro-prudential supervision.**

# II. Institutional setup

## General implementation

- **Governing Council** is ultimate decision-making body for monetary, micro- and macro-prudential policy

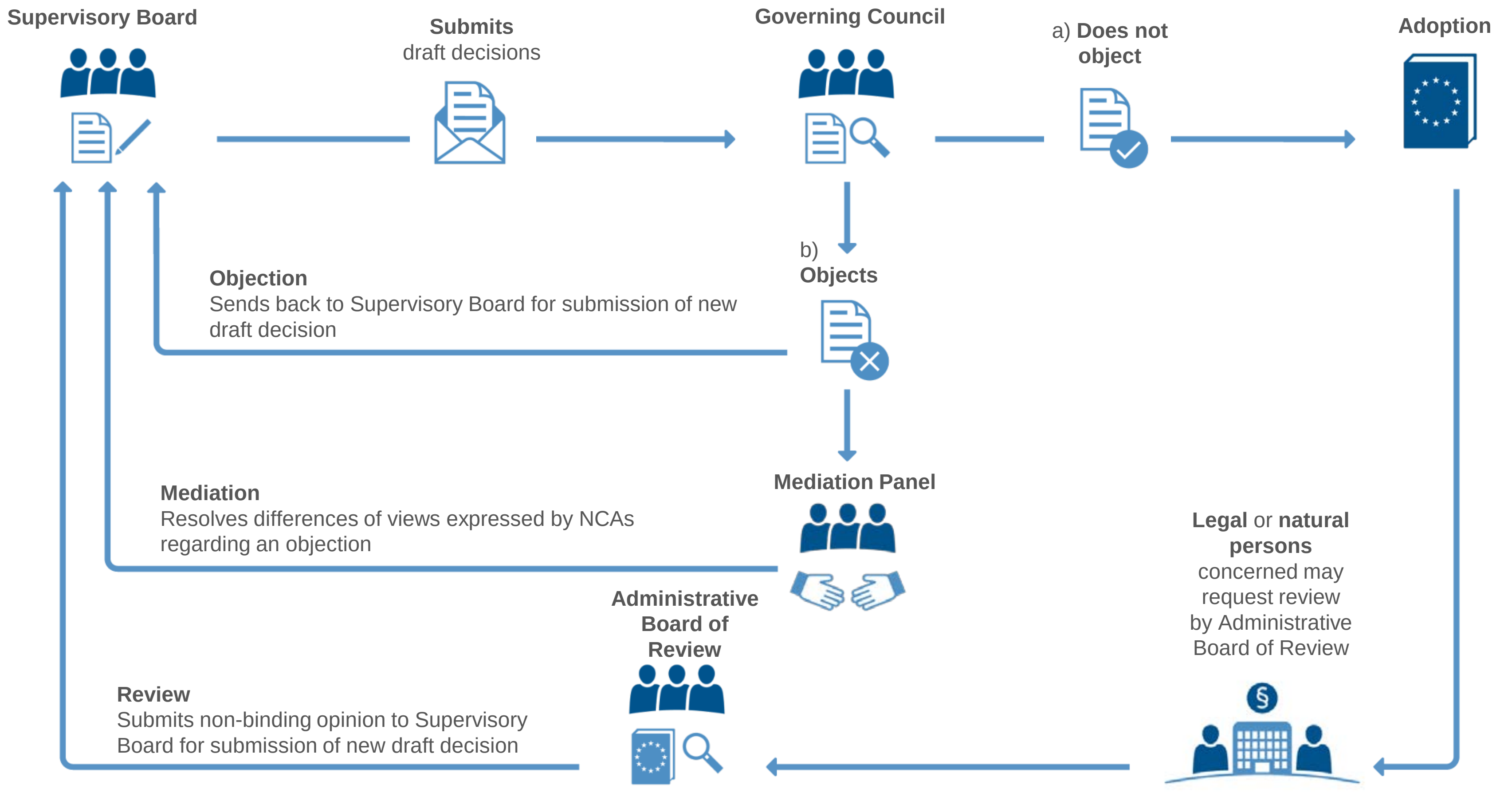
- **Supervisory Board** proposes micro- and macro-prudential measures

- **Potential conflict of interest** between monetary and supervisory policy calls for organisational separation of monetary policy and micro-prudential supervision

  1. Restricted information exchange for data, but separate analyses geared towards distinct objectives

  2. Separate decision-making process with non-objection procedure reduces possible conflicts of interest between monetary policy and supervisory objectives

## Detailed implementation



## I. Coordinating with national macro-prudential authorities

- The concerned authority of Member States shall duly notify its intention to the ECB prior to taking a decision.
- Where the ECB objects, it shall state its reasons in writing within five working days.
- The concerned authority shall duly consider the ECB's reasons prior to proceeding with the decision as appropriate.

## II. Taking macro-prudential actions

- The ECB may apply (instead of national authorities of the participating Member State)
  - higher requirements for capital buffers
  - apply more stringent measures aimed at addressing systemic risks

Measures are subject to procedures set out in CRR/CRD IV and SSM Regulation

# IV. Areas for improvement

## Completing the macro-prudential toolkit

- **Bank-oriented instruments**
  - Setting exposure limits to non-bank financial intermediaries
- **Non-bank instruments**
  - Extending the regulatory perimeter to systemic non-bank institutions and activities
- **Market-based instruments**
  - Steering margin and haircut requirements in securities lending
- **Improving financial sector governance**
  - Aligning incentives and compensation to prudent risk-taking and long-term returns

## Enhancing coherence between CRR/CRD IV and SSM Regulation

- Recognizing new institutional setup of macro-prudential policy in CRR/CRD IV with the ECB becoming a key player in macro-prudential policy within the SSM
- Clarifying and simplifying procedures between EU authorities and Member States

# Thank you for your attention