

## **Dimitar Bogov: Policy nexus and the global environment – a new consensus emerging from the crisis?**

Address by Mr Dimitar Bogov, Governor of the National Bank of the Republic of Macedonia, at the 2nd Research Conference “Policy nexus and the global environment – a new consensus emerging from the crisis?”, Skopje, 26 April 2013.

\* \* \*

Ladies and Gentlemen,

Dear guests,

Let me wish you welcome on our second Research Conference that we usually organize on the day of the monetary independence anniversary of the Republic of Macedonia. The subject of this year’s conference we believe is highly topical, in line with the ongoing lively discussions among central bankers, research and academic institutions worldwide.

The global economy in the last couple of years undergone remarkable changes, both from institutional and policy design setup. We witnessed financial market turbulences, banks failures and sovereign debt crisis with strong contagion around the world economy that was almost unique by its size, and the global economy is still struggling to recover. After five years of global crisis we could say that we experienced a lot, and hopefully, we learnt a lot. One of the main lessons of the crisis was exactly related to the topic of the conference – the need of policy nexus as a kind of a consensus emerging from the crisis.

What is the policy nexus about?

At the initial stage of the financial crisis the importance of the macro prudential policies in the overall policy mix was highlighted and therefore, a lot of attention has been put on the monetary and macro prudential policy nexus, conveying the main message that the price stability and financial stability are interconnected. With the appearance of the sovereign debt and banking crisis in the last couple of years in the euro area, it was quite obvious that the poor public finances management could also impose threats to the financial system. The financial instability and weak public finances can potentially have adverse effects on the financial markets, imposing distortions in the monetary policy transmission mechanism, and resulting in serious macroeconomic imbalances. The required policy nexus is becoming a necessary precondition for designing and implementing a sound macroeconomic management.

Under situation that was more specific than usual, when the role of traditional instruments was limited, the monetary policy turned to unconventional policy measures. Although the monetary policy in the region has not been constrained by zero lower bound on interest rates, the central banks also turned towards unconventional monetary policy tools, having in mind the potential risks of repeated deterioration of the external imbalances and inflationary pressures or aiming at supporting other objectives (including credit growth). While listing the experiences of unconventional measures among the central banks, we can distinguish between: measures for increasing and changing the composition of the assets in the balance sheet of the central banks in different forms and with high heterogeneity across the countries, and measures for influencing agents’ expectations by strong commitment by the central banks for keeping low interest rate for a longer time horizon.

In the public finances domain, the strengthening of fiscal discipline and the need of careful monitoring of fiscal sustainability can be taken as the core preventing arms against fiscal imbalances that highlight this crisis. The fiscal consolidation is already on the list of objectives within the EU and it will require serious efforts and internal adjustments for reaching this goal. In the midstream of the crisis, the need of fiscal adjustment imposed the confronting issue of the adverse impact over recovery and growth dynamics that was really

one of the tight spot in the crisis management. The fiscal stimulus obviously supported the recovery in the countries where there was a room for it, but looking forward, the need for fiscal consolidation should be taken seriously.

The financial stability, not only nationwide, but also in international framework, is quite often quoted as a common good. Attention should be paid to the risk distribution among financial institutions, as well as to the aggregate risk level evolution. The regulatory response to the crisis was oriented towards strengthening the banks' soundness as well as designing treatment of systemically important banks which certainly require a special attention by the authorities. Systemic risk requires systemic and comprehensive solutions, including changes in the institutional setup. In the EU it was done by establishing crisis management mechanisms, strengthened governance aimed to monitor and prevent against any macroeconomic imbalances, as well as to move towards the banking union. The EU member states and institutions face many challenges when making the new institutional setup operational and when making the necessary adjustments in a reasonable time framework. In addition, all other countries face the challenge of converting the lessons from the crisis into policy actions.

#### The changing role of central banks

During the crisis, the role of the central banks moved from traditional way of monetary policy implementation towards combining the monetary and financial stability objectives, both being complementary components of macroeconomic stability. The set of instruments became more complex because of the unconventional measures, designed to bridge the period of extraordinary circumstances affecting the effectiveness of standard instruments, and aiming to strengthen the financial stability or economic recovery. Due to the variety of those unconventional measures across the countries, it is still difficult to assess their impact, although the experiences of countries could confirm the quite largely accepted consensus that the "monetary stimulus" really supported the economy. However, we should be aware that at one point in the future their contribution will be overwhelmed and we will need to take appropriate action on time in order to impede any reverse effects.

In the policy design and decision making process under the current dynamic environment, the strengthening of analytical tools and the enhancement of knowledge on the policy nexus are extremely important. The interplay of monetary, fiscal and macro prudential policies is a quite new area, seeking for deeper research work to support the decision making process at the central banks and other policy makers, to provide appropriate advices and policy recommendation and therefore, to prevent from underlying risks. The aim of our conference is to contribute towards building knowledge and exchanging views on the policy nexus issue. Having in mind the quality of papers that are going to be presented today, I truly hope that we will make our contribution towards this aim.

I wish you a successful conference and fruitful discussion!

Thank you.