Fabio Panetta: Micro and macroprudential supervision in the euro area

Introductory remarks by Mr Fabio Panetta, Deputy Governor of the Bank of Italy, at the conference “Micro and Macroprudential Supervision in the Euro Area”, Università Cattolica del Sacro Cuore, Milan, 24 November 2015.

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1. I am pleased to welcome you all to today’s conference on micro- and macro-prudential supervision in the euro area. First of all, let me voice my warm thanks to Università Cattolica del Sacro Cuore for hosting the event. The conference focuses on two developments that are reshaping the European financial landscape: the creation of a single micro-prudential supervisor in the euro area, namely the Single Supervisory Mechanism (SSM), within the broader context of a prospective Banking Union; and the institution of a new macro-prudential framework.

Banking Union represents a strong, vigorous response to the financial crisis. It rests on three pillars: the SSM itself, a Single Resolution Mechanism and the harmonization of existing national deposit guarantee schemes. The idea underlying the design for Banking Union was to restore confidence in the European banking sector and to preserve and enhance financial integration. The ultimate objectives are safeguarding financial stability and ensuring efficient resource allocation within the euro area so as to support economic growth.

In this context, the new macro-prudential framework definitely has a crucial role to play. The crisis has made it clear that a narrow focus on the soundness of individual banks can cause supervisors to overlook emerging threats to the stability of the entire financial system. Macro-prudential policies are designed to smooth the financial cycle in both expansionary and contractionary phases, working counter-cyclically to prevent the emergence of systemic risks.

The toolkit available to banking supervisors is now larger but also more complex. The incentives of micro- and macro-prudential authorities tend to be aligned during economic expansions, but they may well diverge in downturns. When the economy is weak, it is more difficult to strike the right balance between micro- and macro-prudential policies. In my view, this is one of the main challenges that European policymakers face today.

These are the reasons why Banca d’Italia, in its capacity as central bank in charge of banking supervision and financial stability, has organized this conference. We have invited two eminent, authoritative speakers to address us on these two topics. Danièle Nouy is Chair of the Supervisory Board of the SSM and an experienced banking supervisor and regulator both in France and internationally; and Claudio Borio, Head of the Monetary and Economic Department of the Bank for International Settlements, is one of the world’s leading researchers in the field of financial stability and macro-prudential policies.

Please bear with me, before I leave the floor to Danièle and Claudio, for a few introductory remarks on the topics of the conference.

2. Since its inception, one year ago, the SSM has made remarkable progress. Within the span of just months, a sketchy organization chart has been converted into a fully-fledged institution, with over a thousand professionals from different countries and varied backgrounds. The SSM has developed quickly into an integrated system based on close cooperation between the European Central Bank and national supervisors. Together, throughout the year we have been dealing with both bank-specific and system-wide supervisory issues. A good deal of effort has been devoted to establishing the basis for a common, fair supervisory framework.

In its short life to date, the SSM has already helped in the stabilization of the Eurozone, which is a prerequisite for growth. The Comprehensive Assessment enhanced transparency and dispelled doubts about the resilience of Europe’s major banks. Together with national
and European policies – above all the monetary policy measures decided by the Governing Council of the ECB – the SSM is contributing to the normalization of credit conditions for firms and households.

The important steps already taken need to be followed by further progress on several fronts. The overarching issue is to forge ahead towards European integration. We should not forget that the financial crisis was originated by the lack of progress in European integration following the launch of the euro. The project for Banking Union helped to defuse the crisis and set the process back in motion. We must not make the same mistake twice. The process of integration cannot be allowed to stall again.

Moving from broad principles to more practical issues, a number of challenges lie ahead for the Single Supervisory Mechanism. Let me mention a few.

a. The SSM will need to establish common regulatory and supervisory practices, consolidating the level playing field and removing the barriers that prevent the integration of the European banking sector. A good instance of the effort that will be required to achieve this goal is the SSM’s work on options and national discretions, directed to overcoming the residual differences in the national implementation of the CRR and CRDIV rules. A public consultation on a draft text was launched just a few days ago.

b. Reinforcing cooperation and trust among the actors involved, from the ECB to the National Competent Authorities, is also crucial to our success. The Banca d’Italia, like the other NCAs, is fully committed to the SSM. Being part of “something bigger” is a challenge that we already faced with the launch of the monetary union, but the single supervisory mechanism is if anything an even greater challenge. If they are to contribute effectively to the monetary policy-making process, the members of the Governing Council need to understand the economic conditions that prevail on average in the Eurozone. The members of the Supervisory Board have to make decisions bearing on over 120 large banks. Considering that before the launch of the SSM each NCA was responsible for only a handful of these banks, you realize just how great the additional analytical effort imposed on NCAs under the new regime actually is. It will require substantial investment in human capital and deep-going organizational changes.

c. Since its launch, the SSM has focused its supervisory action mostly on banks’ capital position. Concentrating on the construction of a strong capital base was fundamental to restoring confidence, which had been severely undermined by the financial crisis. Now that the comprehensive assessment has demonstrated that the European banking system is solid, it is essential to avoid inducing pro-cyclical behaviour by banks, which would curtail lending to the economy.

Given that the SSM covers 123 major euro-area banks, its micro-prudential decisions may have macroeconomic consequences. This poses significant challenges for both micro- and macro-prudential authorities, at a time when little is still known – in theory as well as in practice – about the functioning of macro-prudential policies. There is broad agreement that at present the main danger to financial stability stems from low real and nominal economic growth. The ECB’s programme of quantitative easing is directed to countering these risks. In most countries and on average in the Eurozone, aggregate credit growth remains subdued. The credit-to-GDP gap – the main indicator laid down by the Basel rules as a guideline for activation of the countercyclical capital buffer – is well below its historical average, but in recent months we have nevertheless witnessed several national macro-prudential decisions that resulted in a further tightening of financial conditions. Naturally, there are reasons for these decisions; since a full discussion of these developments would take me too far afield here, let me just emphasize that the decisions are a good example of the complex way in which monetary, micro-
and macro-prudential policy decisions interact. A number of regulatory developments complicate matters still further: to mention only a few, consider the ongoing phase-in of the capital rules, the adoption of stringent liquidity requirements, the introduction of the TLAC framework, and the implementation of the BRRD.

3. The question, in conclusion, is how we should steer micro- and macro-prudential tools towards the objectives of stability and growth. Our answer will be crucial for the euro area and Italy, where banks play a predominant role. I am sure that Danièle and Claudio will help us to advance our understanding of this critical issue.

My own answer is strong, close coordination. Ensuring consistency between micro- and macro-prudential policies — and, based on what I have just said, monetary policy as well — is absolutely necessary to support the economic recovery. As I have already observed, guaranteeing a strong capital base was essential to regain full confidence in the solidity of the European banking system and to provide adequate financial support to the real economy. But capital strength cannot be the sole line of defense against the risk of bank instability; if it were, the job of supervisors would be much easier than it is. What is more, the particular path by which stronger capitalization is attained is not a matter of indifference. Micro- and macro-supervisors need to devise a balanced, coordinated modus operandi. The best guarantee that such an arrangement can be achieved in the Eurozone is the institutional set-up, which assigns macro-prudential powers to national competent authorities as well as to the ECB Governing Council and the SSM Supervisory Board.

Events like this conference can certainly make a valuable contribution to the current debate. Thanks again to Università Cattolica, to the speakers and to all of you for your participation.