Claudia Buch: Welcoming remarks - Macroprudential Conference 2019

Welcoming remarks by Prof Claudia Buch, Vice-President of the Deutsche Bundesbank, at the Macroprudential Conference 2019, Eltville, 21 June 2019.

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The Bundesbank is very proud to be hosting the Macroprudential Conference series for the first time, and I would like to take this opportunity to welcome you all here in Eltville. From my perspective, the tradition of these conferences, which were initiated by the Dutch National Bank and the Swedish Riksbank, has two particularly important features:

The first is close interaction between policymakers and academics. In many ways, macroprudential policymaking has entered unchartered territory, and policy developments have often leapfrogged analytical work. A close dialogue between researchers and policymakers is thus essential in order to understand how our existing policy tools are working, to identify whether we are missing any relevant channels, and to learn more about the functioning of the financial system, particularly in times of stress.

The second feature is the need for cooperation. It has been emphasised repeatedly that macroprudential policy is a necessary complement to microprudential supervision with regard to providing a system-wide perspective on the resilience of the financial system. This system does not end at national borders. International cooperation and coordination is thus crucial when it comes to macroprudential policymaking.

Let me give you two examples which demonstrate that such policy coordination is in fact working – and highlight the value of interaction with academia.

1 Coordination of Macroprudential Policy nationally and in Europe

Macroprudential policy is a core element of the post crisis reform agenda, and it plays a particularly important role in the European monetary union which lacks a single sovereign (Buch and Weigert 2018). It is not enough to focus on the sustainability of public debt – mechanisms are needed to safeguard the stability of the financial system. Such mechanisms ensure that private credit is sustainable and that the failure to service debt does not pose a threat to the stability of the financial system. Macroprudential policy has exactly that objective: Preventing the build-up of systemic risk, i.e. the risk of destabilising negative externalities in the financial system, and preventing excessive leverage of the private sector. Macroprudential policy takes a macroeconomic perspective on the financial sector's health and resilience. It complements monetary policy and microprudential supervision.

In Europe, macroprudential policy is a national task – involving close coordination at the European level. Understanding the coordination of macroprudential policy –at both the national and supranational level – is important: In a monetary union with a high degree of financial integration, risks can easily spill over across borders.

Let me give you an example: The German Financial Stability Committee recently recommended activating the countercyclical capital buffer and raising it to 25 basis points.[1] This recommendation is based on the analytical work of the Bundesbank, as President Weidmann explained this morning. We warn against over-optimism after a long period of good growth performance: credit risk might be underestimated, and market participants might overestimate the value of collateral. Interest rate risks are, obviously, closely correlated with these risks.

Responsibility for macroprudential policy in Germany is shared by the members of the Financial

Stability Committee (FSC): the Bundesbank, the Federal Financial Supervisory Authority (BaFin) as the macroprudential authority, and the Ministry of Finance as the chair of the Committee. The Committee can issue warnings and recommendations when there are financial stability concerns. The institutional set-up for the implementation of macroprudential policy often includes more than one institution. This brings more expertise and different views to the table, which ensures sound decision making. But the decision-making process may also be lengthened. This important issue has been highlighted in today's presentation by Nellie Liang. In her paper with Rochelle Edge, she finds that "countries with FSCs with stronger governance mechanisms are more likely to use the CCyB". As more evidence on policy decisions accumulates, and as more instruments will be used, we will certainly learn more about the design of macroprudential policy and governance structures.

An insightful example of the coordination and the political economy of macroprudential policy decisions at the national level is a recommendation that was issued by the German FSC in 2015. The Committee recommended that legislative action be taken with regard to macroprudential instruments for the housing market and, importantly, that a legal basis be created for the collection of sufficiently granular data on housing loans. Two years later, the German parliament passed legislation including two of the recommended policy instruments – loan-to-value-caps and amortisation requirements – while limits to debt-service and debt-to-income ratios were dropped from the proposal. Thanks to the close collaboration and close coordination of communication among FSC members we were able to convince lawmakers to include at least two of the recommended instruments. In this sense, the FSC acts as an important hub to exchange views and coordinate action under the heading of financial stability. This is something which would have been much harder to achieve without a sound legal mandate and a designated committee. However, the arguments for the two remaining instruments are still valid and there still remain data gaps to be closed.

Governing macroprudential policy decisions in Europe goes beyond coordination at the national level. Domestic policy decisions play an important role also for the European financial system. The European Systemic Risk Board (ESRB) and ECB with its Financial Stability Committee provide a cross-country view. The ESRB is the macroprudential oversight body for the EU. It can issue confidential or public warnings when it identifies significant systemic risks. Furthermore, the ESRB can issue recommendations for remedial action to address identified risks. The ECB has the right to top-up certain national measures, such as the CCyB, thereby limiting spill-over effects that might not be fully accounted for by national authorities.

This provides a laboratory for research on the effects of macroprudential policy coordination:

- How do national policymakers react to domestic and European financial stability risks?
- Which indicators should guide policymaking, and which surveillance tools should be used?
- What is the role of communication? How to explain complex issues like financial stability, systemic risks and macroprudential instruments, such as the CCyB? What can we learn from each other?

The examples given here show that macroprudential policymaking in Europe is embedded in a complex set of institutional arrangements, ensuring coordination between national institutions and countries. It may be too early to tell whether these institutional arrangements help to overcome the inaction bias inherent in macroprudential policy and whether they improve the surveillance of systemic risks. But as more evidence accumulates, we will certainly learn from our experiences and improve existing frameworks, if necessary.

2 Coordinating Reform Evaluation Internationally

A second example is the coordination of the FSB's currently ongoing ex post policy evaluations. Post-crisis financial sector reforms were agreed at a global level in order to make sure that certain minimum standards apply in all jurisdictions. At the same time, many macroprudential policies that were implemented after the global financial crisis were without precedent. This meant that macroprudential policies had to be implemented and calibrated with great uncertainty as to their actual effects. Now that many policies have been put in place and initial experiences have been gained, we are in a position to evaluate and thus improve our understanding of their effects. Policy evaluation provides information on whether policies achieve their objectives or whether unintended consequences materialise. Policy evaluation, however, is not a trivial task as it needs to answer three key questions:

1. Did the reform "cause" an outcome (attribution)?
2. Did the reform have similar effects across relevant markets, states of the world, or jurisdictions and regions (heterogeneity)?
3. Did the reform achieve its overall objective (aggregation/general equilibrium)?

These questions cannot be answered by taking a purely national perspective. Recent work at the Financial Stability Board (FSB) is a good example of how internationally coordinated evaluation has become part of the policy process: In 2017, during the German G20 presidency, the FSB developed a framework to evaluate the effects of the G20 post-crisis reforms of financial regulation (Financial Stability Board 2017). The FSB subsequently launched several evaluation projects. Three projects have already been completed or are close to being finished:[2]

- The first project provided evidence that post-crisis reforms generated incentives to centrally clear OTC derivatives.
- The second project showed no material negative effects of reforms on infrastructure financing.
- The third project analyses reform effects on the availability of funding for small and medium-sized enterprises. The recently-published consultation report showed no persistent negative effects of the G20 regulatory reforms on SME financing overall.

Ongoing evaluation work at the FSB deals with one of the G20's core objective – reducing the systemic and moral hazard risks associated with systemically important financial institutions.[3] A first evaluation plan has been published on the FSB's website.[4] Workshops will be held with stakeholders from academia, the financial sector, and representatives of civil society.

The Too-big-to-fail (TBTF) evaluation will address three main questions:

1. Were the reforms effective in reducing the perceived probability of the impact of failure of systemically important institutions? This question can be addressed by assessing changes in estimates of implicit funding subsidies and analysing progress in the resolvability of systemically important banks.
2. Are reforms resulting in altered bank behaviour in terms of changes in funding structures, asset allocation and risk-taking?
3. What are the broader effects of the reforms? Such effects include the functioning of the financial system, market fragmentation, cost and availability of financing to the real economy.

Focusing on the experiences of individual countries will not be sufficient to answer these questions. Financial systems differ with regard to their competitive structure and the types of institutions involved. Reform effects are thus likely to differ across countries. Research conducted by the International Banking Research Network, for instance, shows that prudential instruments sometimes spill over across borders through bank lending, and that international spillovers vary across prudential instruments and are heterogeneous across banks.[5] There appears to be no one channel or indeed, a specific direction of transmission that predominates in the context of spillovers. Understanding this heterogeneity and its implications for resilience is crucially important.

3 Summing Up

Macroprudential policy is a new policy field and offers lots of unchartered territory to be explored by basic academic research and policy-oriented and applied research. With the FSB evaluation framework and the evaluations initiated, policy makers also explicitly acknowledged the importance of academia to support evidence-based policy making and improve accountability. Therefore, I invite the academic research community join this evaluation process: Either by directly contributing to the on-going and envisaged projects or by critically following the process to ensure that analytical results and policy conclusions match.

References

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1 See German Financial Stability Committee (2019) and German Financial Stability Committee (2019a).

2 Consultative and final reports are available at: www.fsb.org/work-of-the-fsb/implementation-monitoring/effects-of-reforms/

3 See Financial Stability Board (2011). For details see the terms of reference (www.fsb.org/2019/05/evaluation-of-too-big-to-fail-reforms-summary-terms-of-reference/). The final report is scheduled for the G20 Presidency in 2020.

4 www.fsb.org/2019/05/fsb-launches-evaluation-of-too-big-to-fail-reforms-and-invites-feedback-from-stakeholders/

5 For details, see, voxeu.org/article/prudential-policies-crossing-borders