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Cross-Border Aspects of Macroprudential Policy

OPENING REMARKS

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I am glad and honoured to welcome you all to the fourth policy research conference of the European Central Banking Network, or the ECBN. As you may be aware, the aim of the Network, jointly established by the Bank of Slovenia and the Center for Economic Policy in 2015, is to promote and coordinate high quality research on topics that are of interest to central bankers.

The Network has been pursuing its mission by organizing two series of events: a workshop, which usually took place in the first quarter of the year, and a conference later in the year hosted by the Bank of Slovenia. Through presentations of leading academics and financial institutions' researchers, the workshop has represented the venue to define the methodological framework for a chosen topic for the subsequent conference, where researchers from various central banks have the opportunity to present country-specific research on the chosen topic. The workshop has been organized each year by a different participating central bank. The first three workshops were organized by the Central Bank of Turkey in Istanbul in March 2016, the Central Bank of Ireland in February 2017 and the Central Bank of Belgium in March 2018.

The first ECBN conference in 2015 was about credit and resources misallocation. The proceedings appear as an e-Book in a dedicated CEPR series. The main focus of the second research conference of the ECBN in September 2016 was on financial cycles and countercyclical capital buffer. The topic of last year's conference was the effectiveness of macroprudential policies. Finally, this year conference addresses the issues related to the Cross-Border Aspects of macroprudential policy.

Various aspects of high relevance relate to the international dimension of macroprudential policies. The first thing that a macroprudential policymaker should keep in mind is that systemic risk may propagate across countries through different channels, including banks' direct exposures to foreign sources of risk, like foreign lending and lending in foreign currencies, as well as indirect contagion through financial networks.

A natural consequence of the cross-border transmission of risk is the cross-country co-movement of asset prices, which is reflected into broader indicators of the financial cycle that combine asset prices with credit-related variables. Although financial cycles are heterogeneous across countries – a feature that justifies country-specific countercyclical policies – broad-based financial cycle indicators signal a non-negligible degree of cross-country synchronisation, as discussed at the workshop in Brussels, last March. The extent to which global and regional components of the financial cycle affect local financial systems is relevant to decide on the need for policy coordination.

Nonetheless, the shared wisdom suggests that countercyclical macroprudential measures should be taken at national level and mainly by the "host" rather than the "home" country *supervisors of the banking groups, since economic cycles across countries do not overlap. This is also true for the euro area, a suboptimal currency union characterized by structural differences across its members.*

However, macroprudential policies themselves create, or have the potential to originate, cross-border effects. The existence of cross-border effects of macroprudential policy, as well as the presence of global and regional components of the financial cycles, raise the question of the possible gains from policy coordination across countries.

A policy can spillover from the activating country 'outward,' being transmitted cross borders through subsidiaries and branches of bank groups. This deserves attention as the home country and the host country may be at the different phases of the cycle, for instance a tightening that is transmitted may adversely impact an already fragile economy. In EU, the European Systemic Risk Board provides a notification mechanism that ensures a minimum degree of policy coordination where the member states notify their planned actions in advance and provide an assessment of the expected potential cross-border effects.

Europe would benefit from further cross-border financial integration and geographically diversified banking groups. Public policies should evolve to support the process and not hinder it. Yet, the transformation brings new challenges, particularly for macroprudential policy.

Affiliates of foreign banking groups, both the branches and subsidiaries, can create leakages in macroprudential policy and undermine its effectiveness, by enabling "inward policy *spillovers". This is particularly true for the branches that are not regulated by the host countries. In Slovenia, the branches currently have a relatively small role and in the EU branching is not currently widespread. However, the recent focus on "branchification" echoes notable developments. For example, Nordea experience, its move to transform subsidiaries in the Nordic region into branches, may set an example for other groups.*

The new EBA guidelines, that entered into force by the beginning of 2018, is a step forward in this regard. Accordingly, the supervisory mandate in SSM is to be allocated between ECB and national competent authorities on the basis of "significance" of the branch. Yet, the macroprudential perspective is lacked and this is important because prudential policies need to take into account the macro environment, the state of the economy, in host countries. Therefore, the ESRB's reciprocation framework remains currently as the primary macroprudential policy tool targeting inward spillovers in SSM and beyond. While a few macroprudential measures are subject to mandatory reciprocity, in the remaining cases reciprocity takes the form of a voluntary arrangement.

A unified European deposit insurance scheme, which is planned as the third pillar of the Banking Union, will provide the risk-sharing mechanism that would enhance the incentives towards cooperation, that is increasing the role of the host authorities in micro and macro supervision, thus addressing the major issues discussed before. In absence of risk sharing mechanism, home supervisory authorities may be biased towards reducing the risks for the home country. This failure is captured by the so called "Financial trilemma" hypothesis, which asserts that financial stability, cross-border financial integration, and standalone national supervision are incompatible. This has the important implication that sustaining the *financial integration and reaping its benefits requires a credible coordination among member states. The efforts for completing the Banking Union already reflects a mutual understanding on this feature.*

Finally, since the research on the cross-border dimension of macroprudential policies is still limited, the ECBN conference is a good venue to learn about other countries' experience. The papers that are going to be presented cover the country-specific experience with the cross-country dimension of macroprudential policy. Given the relevance of the questions that these papers address, I expect an interesting debate will follow.

I wish you a fruitful and productive conference.