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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 Centre 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

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Central Bank of Turkey in Istanbul in 2016, the Central Bank of Ireland in 2017 and the Central Bank of Belgium in 2018.

The first ECBN conference in 2015 was about credit and resources misallocation. The 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

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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 spill from the activating country 'outward,' being transmitted through cross borders direct lending or through the subsidiaries and branches of bank groups. This deserves attention as the home country and the host

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country may be at the different phases of the cycle, for instance a tightening that is transmitted may adversely impact an economy that is already in a downturn. In the EU, the European Systemic Risk Board provides a mechanism that ensures a minimum degree of policy coordination where the member states notify their planned actions in advance, provide an assessment of the expected potential cross-border effects and can ask for reciprocation of the measures introduced or that are going to be introduced.

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

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subsidiaries in the Nordic region into branches, may set an example for other groups.

The new EBA "guidelines on the supervision of significant branches", that entered into force by the beginning of 2018, is a step forward in this regard. Accordingly, the supervisory mandate in the Single Supervisory Mechanism 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 reciprocity framework remains currently the primary macroprudential policy tool targeting inward spillovers in the EU. 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 considered as the third pillar of the Banking Union, will provide the risk-sharing mechanism that would enhance the incentives towards cooperation and help 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"

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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.

While we recognize the possible gains from macroprudential policy coordination, the lack of regulation of reciprocity for most macroprudential instruments adopted in third countries is an open issue, especially for EU candidate or potential candidate countries - as emphasised by some papers that will be presented in these days. In fact, the significant foreign ownership of the banking systems in some of these countries exposes them to regulatory arbitrage and, at the same time, the high dependence from foreign investors exposes these countries to the risk of sudden stops. In particular, one paper - that will be presented tomorrow - document that mechanisms of coordination extended to non-EU countries, like the Vienna Initiative, can turn out very successful in preserving financial stability in these countries and avoiding balance of payment crisis.

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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 countries' experience. The papers that are going to be presented cover the country-specific experience with the cross-country dimension of macroprudential policies, including different mechanisms of international transmission of financial stability risk, the cross-border effects of macroprudential instruments and country-specific experience in case of presence or lack of cross-country coordination mechanisms. 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.