



BANK FOR INTERNATIONAL SETTLEMENTS

Comments on “Interactions between Monetary and Macprudential Policies in an Interconnected World” by Stijn Claessens

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Bank for International Settlements

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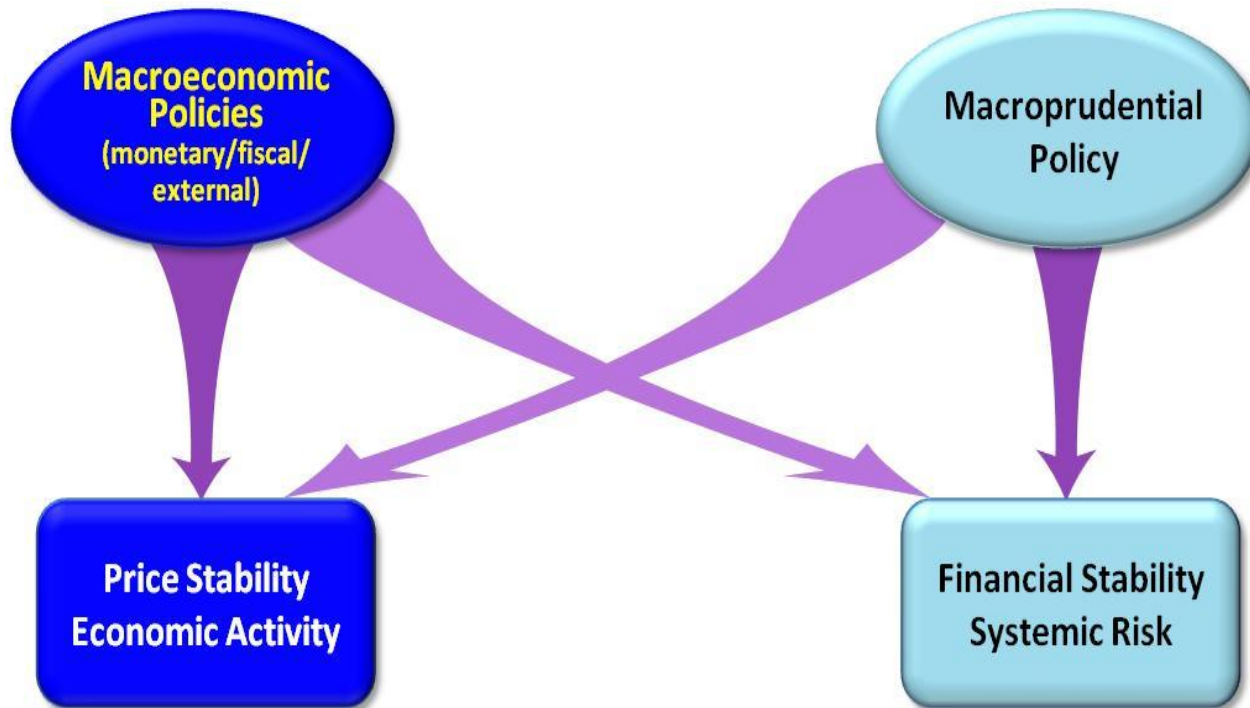
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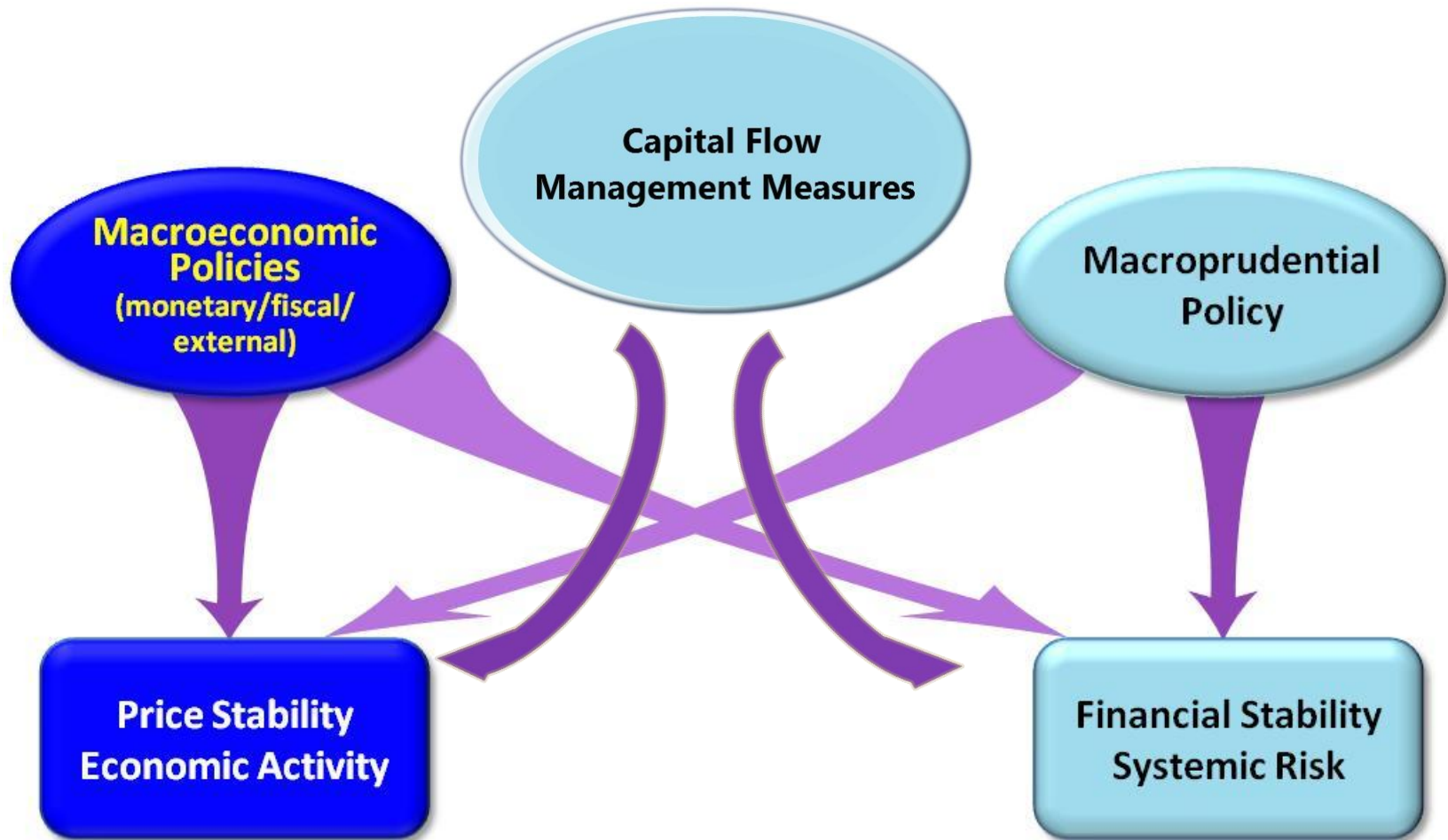
The Paper – A comprehensive review of the issues

- Part 1: How macroprudential/monetary policies can impact each other's domain.
 - When one constrained, the other can help
 - CB can help coordinate the two
- Part 2: The International Dimension
 - Dealing with exchange rate objectives
 - Dealing with MP spillovers: Macropru and coordination
 - Capital flow management tools (CFM)
 - Domes macropru vs. FX macropru vs. CFM

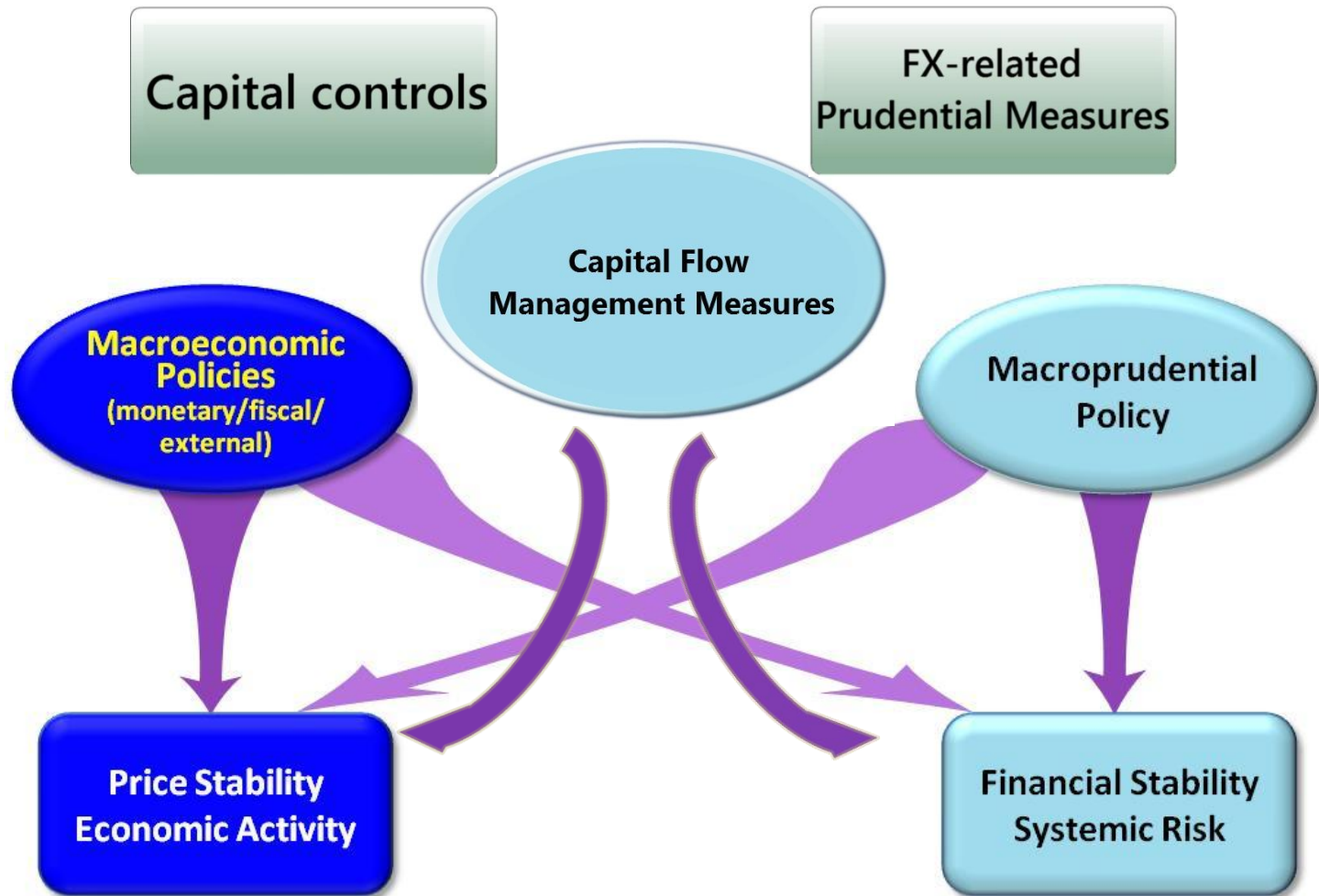
The Focus: Monetary and Macroprudential Policy Interactions



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Some additional points to be made here

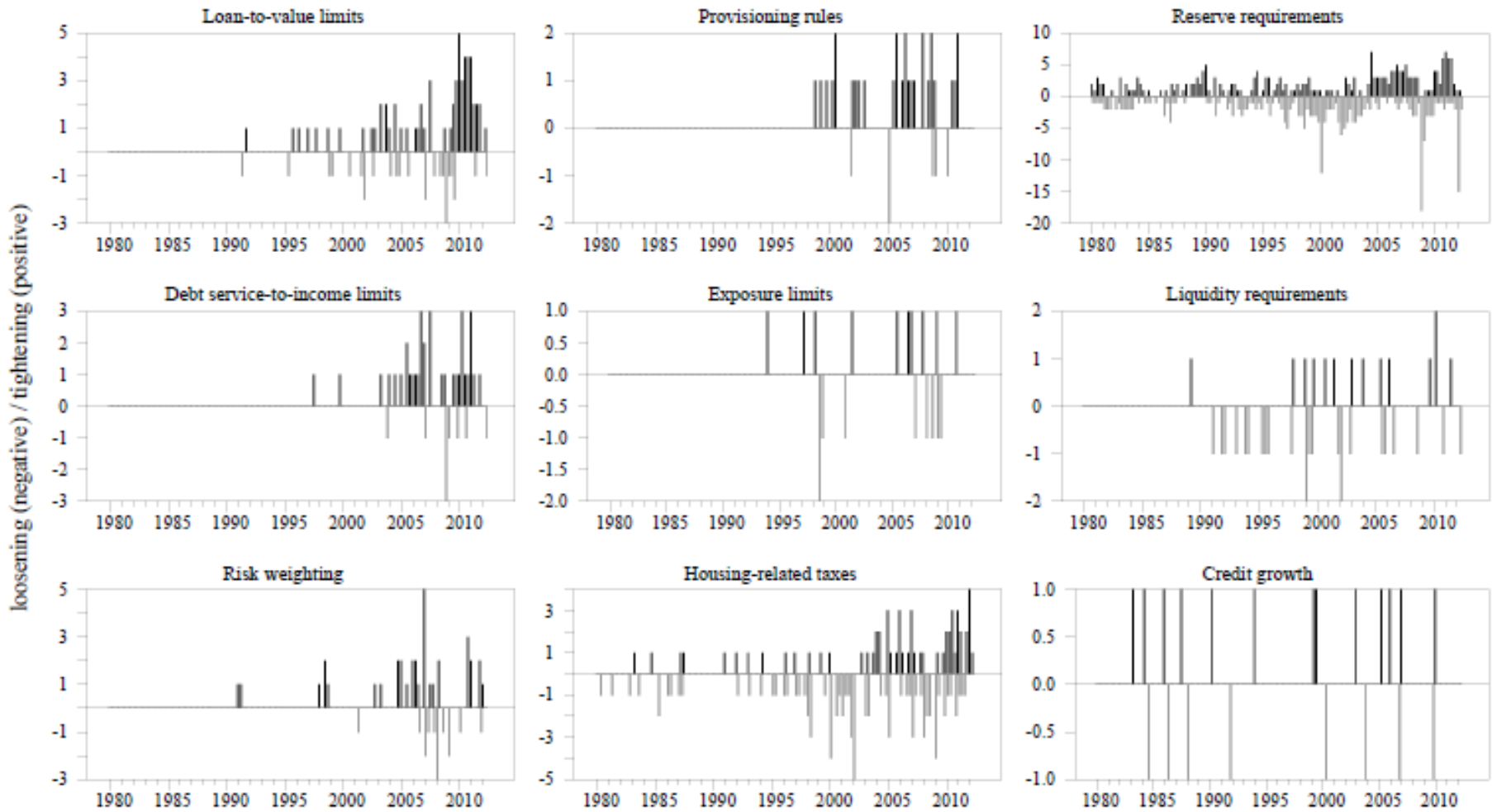
- Classification of Macroprudential Tools
- Term premia
- International coordination

Macroprudential Measures aimed at Housing Markets: 1980-2013

	Asia & Pacific (13)		Central & Eastern Europe (15)		Latin America (7)		Middle East & Africa (4)		Western Europe (19)		North America (2)		All Economies (60)	
	absolute number	per decade	absolute number	per decade	absolute number	per decade	absolute number	per decade	absolute number	per decade	absolute number	per decade	absolute number	per decade
Reserve requirement	201	7.5	218	8.4	87	7.9	6	1.1	109	2.6	20	3.1	641	5.4
Credit	9	0.3	7	0.3	0	0.0	0	0.0	7	0.2	0	0.0	23	0.2
Liquidity	30	1.1	4	0.2	6	0.5	0	0.0	13	0.3	0	0.0	53	0.4
General credit total	240	9.0	229	8.8	93	8.4	6	1.1	129	3.0	20	3.1	717	6.1
LTV	56	2.1	11	0.4	2	0.2	0	0.0	21	0.5	4	0.6	94	0.8
DSTI	20	0.7	12	0.5	1	0.1	1	0.2	9	0.2	2	0.3	45	0.4
Risk weighting	14	0.5	19	0.7	5	0.5	3	0.5	9	0.2	0	0.0	50	0.4
Provisioning	16	0.6	10	0.4	6	0.5	1	0.2	4	0.1	0	0.0	37	0.3
Exposure limits	11	0.4	8	0.3	0	0.0	0	0.0	1	0.0	0	0.0	20	0.2
Targeted credit total	117	4.4	60	2.3	14	1.3	5	0.9	44	1.0	6	0.9	246	2.1
Housing-related tax	50	1.9	23	0.9	0	0.0	0	0.0	70	1.6	5	0.8	148	1.3
Total	407	15.2	312	12.0	107	9.7	11	2.0	243	5.7	31	4.8	1111	9.4

Source: Kuttner and Shim (2013)

Figure 2: Credit and housing-related tax policies over time



Source: Kuttner and Shim (2013)

Some pre-crisis “unconventional wisdom”

- Andrew Crockett, 2000, “Marrying the micro- and macro-prudential dimensions of financial stability,” BIS Speeches, September.
- Claudio Borio, 2003, “Towards a macroprudential framework for financial supervision and regulation”, BIS Working Papers no 128, February
- William White, 2004 “Making macroprudential concerns operational,” BIS Speeches, October.

Classification of macroprudential tools (Shin, 2012)

	Policy Tool	Advantages	Drawbacks
Asset Side Tools	Loan-to-Value (LTV) cap	Low administrative burden	Ineffective during rapid housing boom
	Debt service-to-Income (DTI) cap	Ties loan growth to wage growth	High administrative capacity needed for data on income
	Loan-to-Deposit Caps	Low administrative burden	Distorts bank funding Not applicable to foreign banks
	Reserve Requirement	Low administrative burden	Ineffective with low interest rates, burdens central bank
Liabilities Side Tools	Levy on non-core bank liabilities	Price based measure. Acts on broad liability aggregates	Needs legislation. Cannot narrowly target FX vulnerability
	Levy on FX-denominated bank liabilities	Price-based measure Enhances monetary policy Counters FX risk	Needs legislation Narrow base of levy
Bank Capital-Oriented Tools	Countercyclical capital requirements	Conforms to Basel III	Difficulty in calibration Level playing field issues
	Forward-looking provisioning	Modifies bank incentives	Objections from accounting standard setters
	Leverage cap	Modifies bank incentives	Not price based Open to circumvention Vulnerable to bank FDI

Taxonomy of prudential measures in relation to capital flow measures

	Capital controls (targeting non-residents including foreign bank branches)	Foreign currency-based policy measures (applied to both residents and non-residents)	General prudential tools with domestic focus
Asset-side tools	LTV cap for mortgage loans extended to non-residents Reserve requirements on non-residents' liabilities	Reserve requirements on foreign-currency liabilities Foreign currency liquidity ratio (eg, LCR) Limits on net open position of banks' foreign currency holding	LTV cap DTI cap Loan-to-deposit cap Reserve requirements on local currency liabilities Local currency LCR
Liability-side tools	Levy on non-core bank liabilities	Levy on foreign currency denominated bank liabilities Limit on banks' short term foreign currency borrowing to a certain percentage of capital	
Bank capital-oriented tools		Higher risk weights on foreign currency denominated loans to borrowers whose income is in local currency Leverage cap on FX derivatives positions of banks	Countercyclical buffers Forward-looking provisioning

10-Year Treasury Yield Decomposition

Chart 2. Decomposition of 10-Year Treasury Yield



Note: Decomposition of 10-year zero-coupon Treasury yield based on the term structure model of D'Amico, Kim, and Wei (2010).

Source: Federal Reserve Board; Barclays PLC; staff calculations.

Source: Bernanke (2013).



The Additional Instruments Open to CBs (Stein 2013)

- Central bank sales and purchases of securities are another policy instrument, complementing changes to the policy rate or changes to forward guidance.
- While maintaining the expectation of low interest rates, central bank balance sheet policies change the tradeoff between short-term and long-term finance, and reduce the role of maturity transformation is propagating systemic distress.
- If conventional regulatory policy is having a hard time reining in risk taking, the Federal Reserve can aim to flatten the yield curve from both sides and diminish the appeal of maturity transformation. In this way, unconventional monetary policies can be useful when financial and monetary stability are in conflict.

International Coordination

International Coordination and Basel III

- **The countercyclical capital buffer of Basel III**
 - The indicator and control cross-border problems
 - Each jurisdiction responsible for calculating countercyclical capital buffer applicable to all credit exposures in its jurisdiction
 - Reciprocity: Supervisors of foreign banks should apply surcharge on exposures as supervisors in the host jurisdiction demands of local banks.

Assessing consistency and outcomes of the rules

Overview of assessment outcomes

Assessed member jurisdiction	Publication date of assessment	Number of regulatory changes, amendments, and clarifications made by a member jurisdiction during the assessment	Overall assessment grade
Japan	October 2012	5	Compliant
Singapore	March 2013	15	Compliant
Switzerland	June 2013	22	Compliant
China	September 2013	90	Compliant

References

- Basel Committee on Banking Supervision (2010), "An Assessment of the long-term economic impact of stronger capital and liquidity requirements" August.
- Bech, M, L Gambacorta and E Kharroubi (2012): "Monetary policy in a downturn: are financial crises special?", *BIS Working Papers*, no 388, September.
- Bernanke, B. (2013): "Long-term interest rates". Remarks at the Annual Monetary/Macroeconomics Conference: The Past and Future of Monetary Policy, Federal Reserve Bank of San Francisco, San Francisco, California
- Drehmann, M, C Borio and K Tsatsaronis (2012): "Characterising the financial cycle: don't lose sight of the medium term!". *BIS Working Papers*, no 380, June.
- Kuttner, K, I Shim (2013): "Taming the Real Estate Beast: The Effects of Credit and Housing-Related Tax Policies on House Prices and Credit." *BIS Working Paper*, forthcoming.
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