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Macroprudential and monetary policies in the era of Great Macrofinancial Volatility

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Great Macrofinancial Volatility in advanced economies

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- Faith at the start of the 21st century:
  - Continuation of the Great Moderation
  - “Use the right tool for the job” – monetary policy is here to take care of macro objectives & supervision/regulation ensures financial stability. Should not be mixed up

- Reality after the first quarter:
  - Major credit swings – leveraging, deleveraging and re-leveraging
  - Volatile and cyclical asset prices
  - Deflationary and inflationary shocks/waves

- Is the Great Macrofinancial Volatility (in advanced economies) the outcome of bad luck, obsolete theories or improper policies?

Banks 15 years after the start of reforms

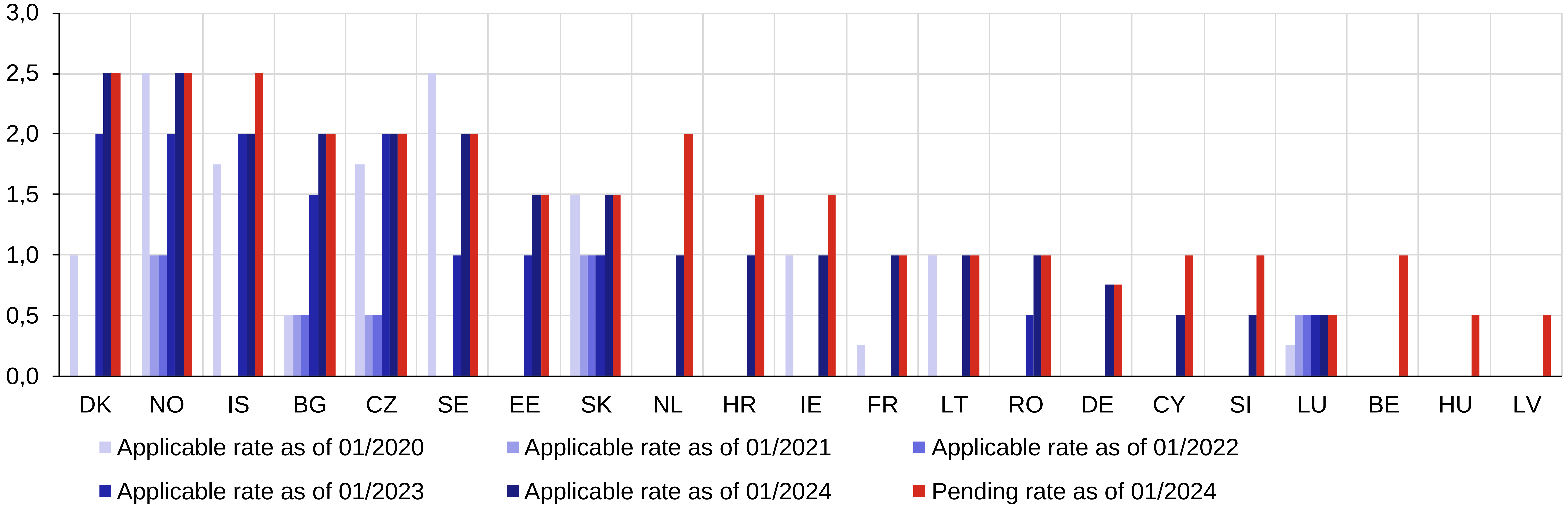
- The expectations we had regarding banks in 2009/2010:
  - Being less leveraged thanks to having more capital, brand new reserves, bail-inable near-capital and more appropriate risk weights
  - Managing liquidity risk in a quantitative/sophisticated manner
  - Becoming less dangerous owing to their size and interconnectedness, and better resolvable
  - Representing a lower risk and a lower return opportunity for investors
  - Creating provisions through the cycle
  - Keeping some distance from sovereign risk
  - Protecting themselves better from the financial cycle
  - No longer being a major source of the financial cycle
  - Being less exposed to property and less vulnerable to its riskiness
  - Supporting non-financial productive sectors more relative to financials

- Quite a lot has been achieved, in particular under the Basel reforms
  - But the system is not as countercyclical as initially hoped for

Countercyclical macroprudential policies – CCyB in EU

- CCyB applied in a number of European economies, in some cases in a truly countercyclical manner

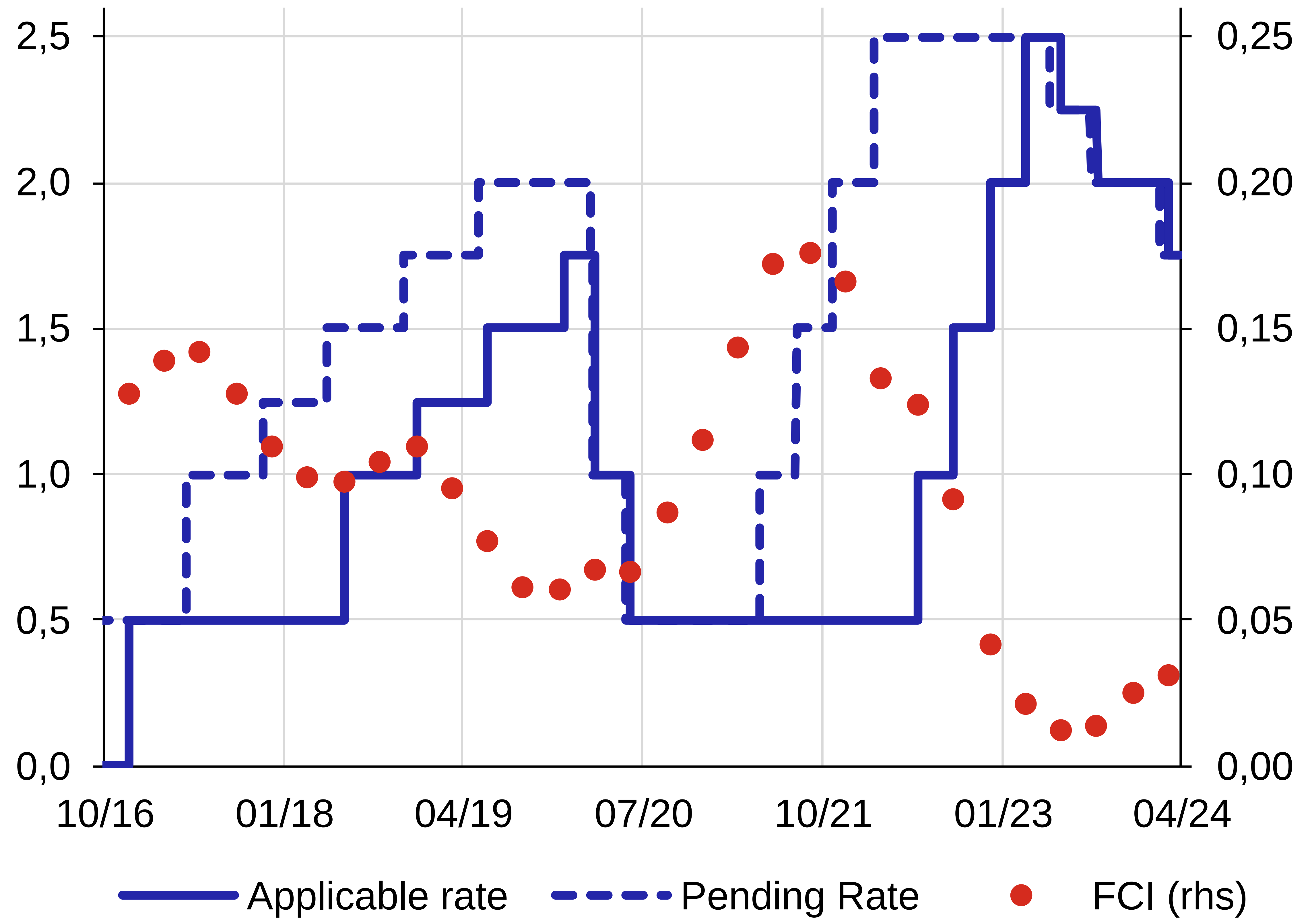
CCyB rates in selected European countries
(% of total risk exposure; month-end values)



Countercyclical macroprudential policies – CCyB in CZ

- CCyB rate in CZ based on position in financial cycle, cyclical movements in risk weights and potential cyclical losses identified by stress tests (Hájek et al., 2017)
- Standard/neutral non-zero CCyB rate officially applied (Plašil, 2019)
- Cuts in CCyB rates motivated by COVID concerns in 2020 and recently by decline in perceived risk (Holub et al., 2020)
- CCyB primarily communication tool to date (Kolcunová and Malovaná, 2019)

CCyB rate and financial cycle indicator in the Czech Republic
(% of total risk exposure; rhs: IFC in points)



BBMs – countercyclical policy or consumer protection?

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- BBMs now applied in a number of economies despite initial political resistance and pressures from the industry
  - Practices vary a lot
- No consensus on whether they represent countercyclical or structural policy, or just a consumer protection tool
  - Relaxed in some economies after the arrival of COVID (Hodula, Pfeifer and Ngo, 2024)
  - In CZ also relaxed recently in response to a slump in demand for mortgages owing to high lending rates, as CNB research reveals that BBMs could be unnecessary and costly during periods of low credit growth, specifically in the downward phase of the credit cycle (Gregor, 2024)

BBMs as countercyclical policy in CZ

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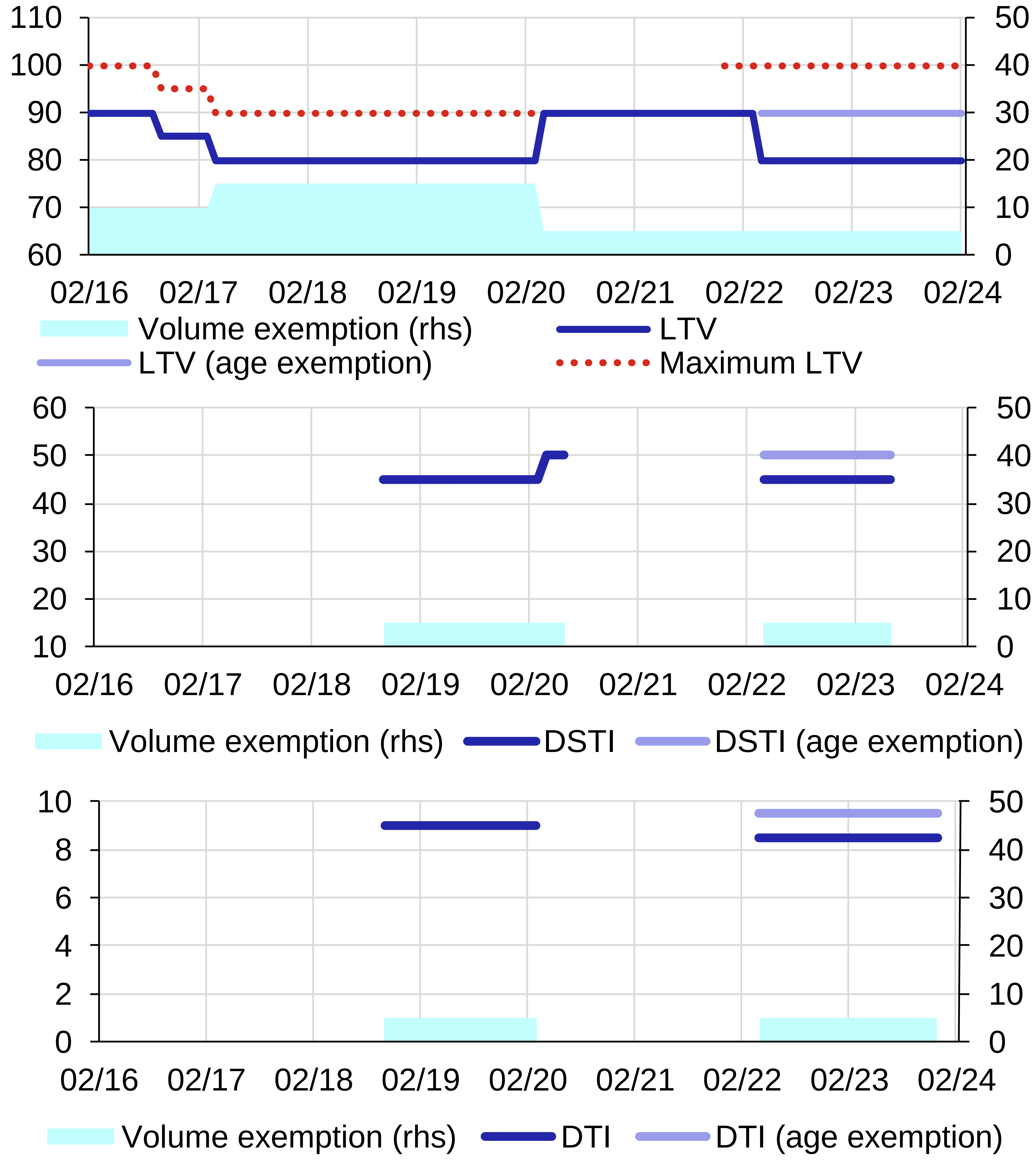
Upper limits on the LTV, DSTI and DTI ratios

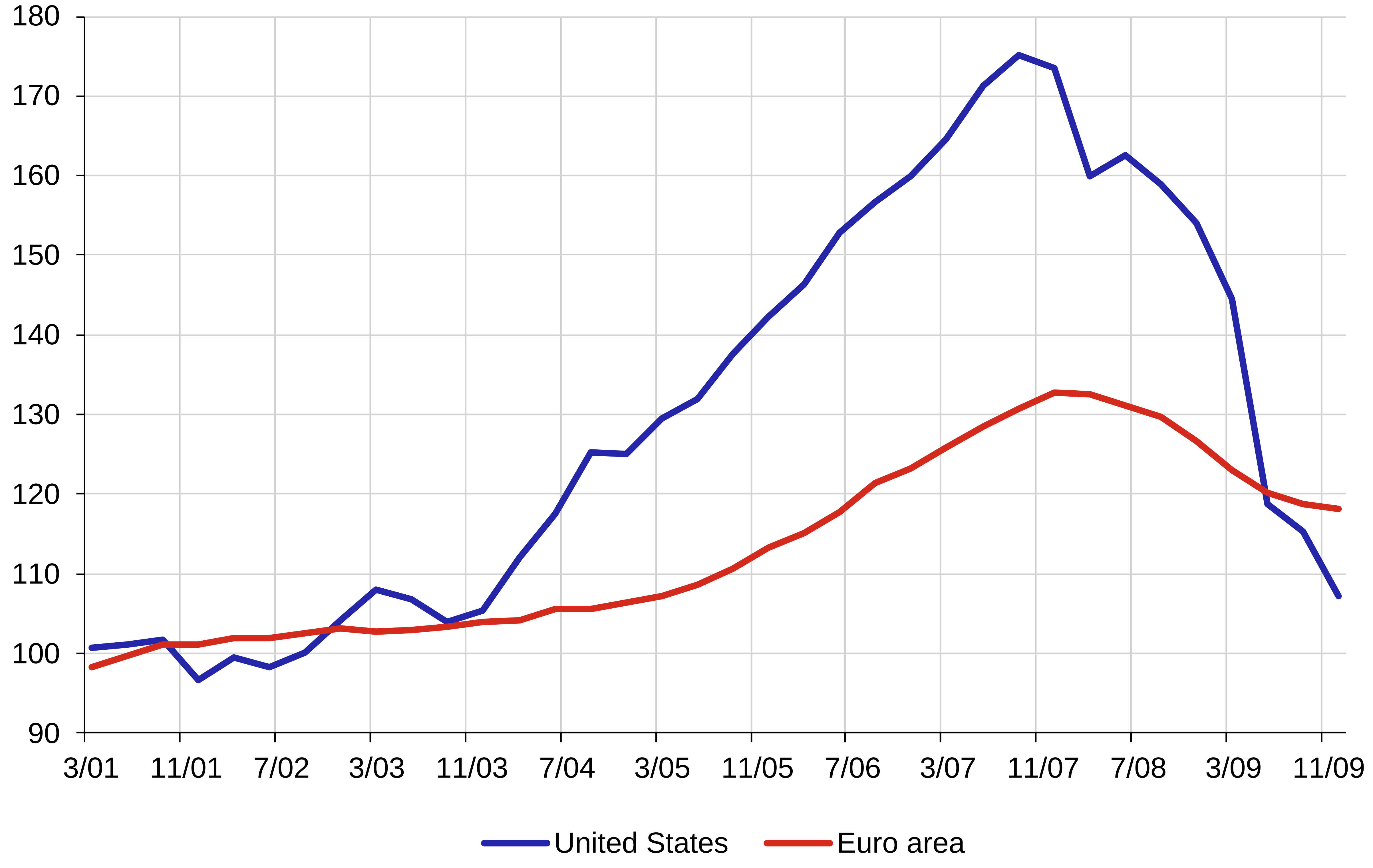
(LTV and DSTI in %, DTI in multiples of net annual income; right-hand scale: volume exemption in %)



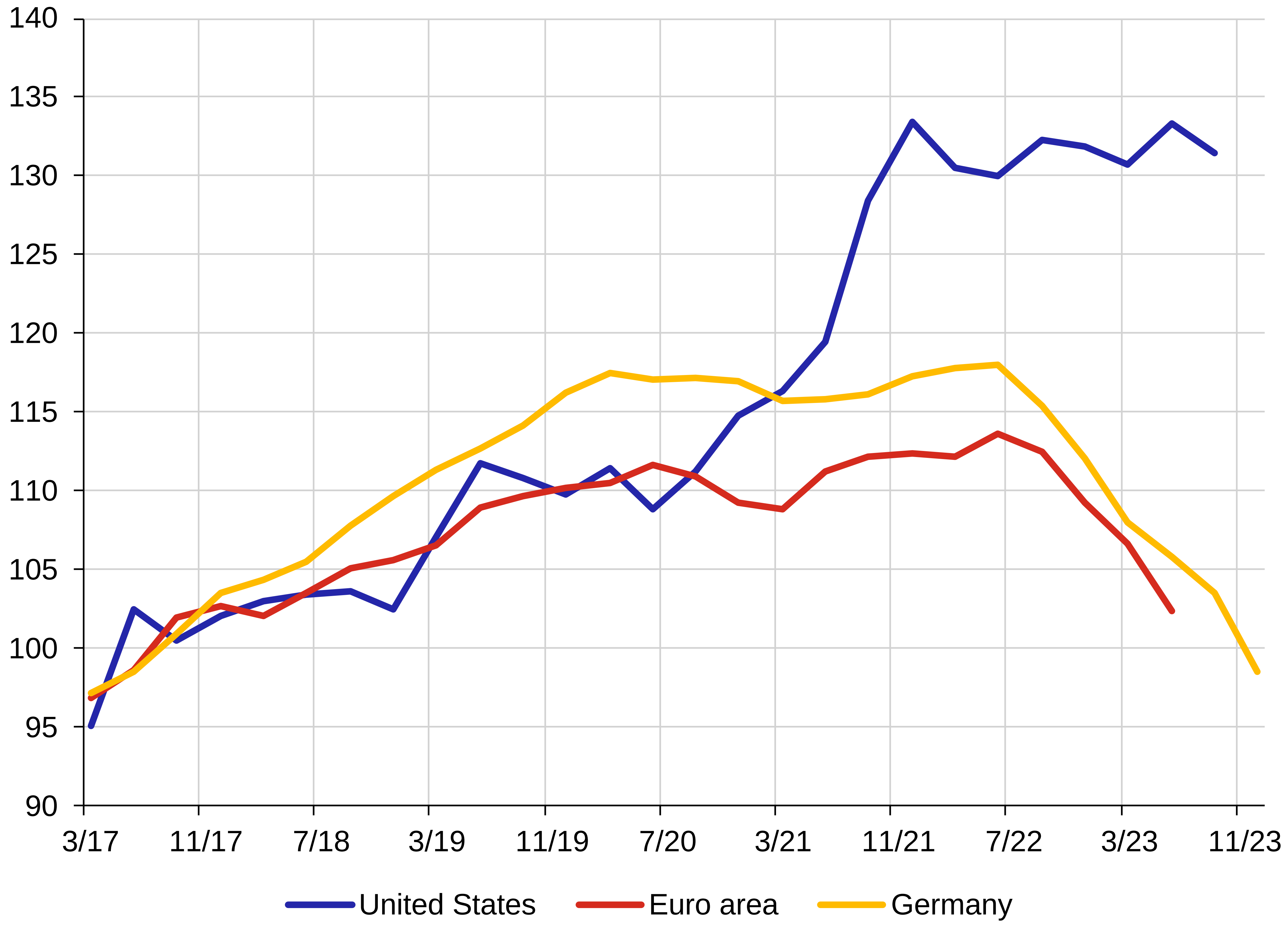
Cycles in property prices (1)

- Cannot be attributed to financial policies only…

Commercial properties prices
Index, 2001=100, nominal, source: BIS



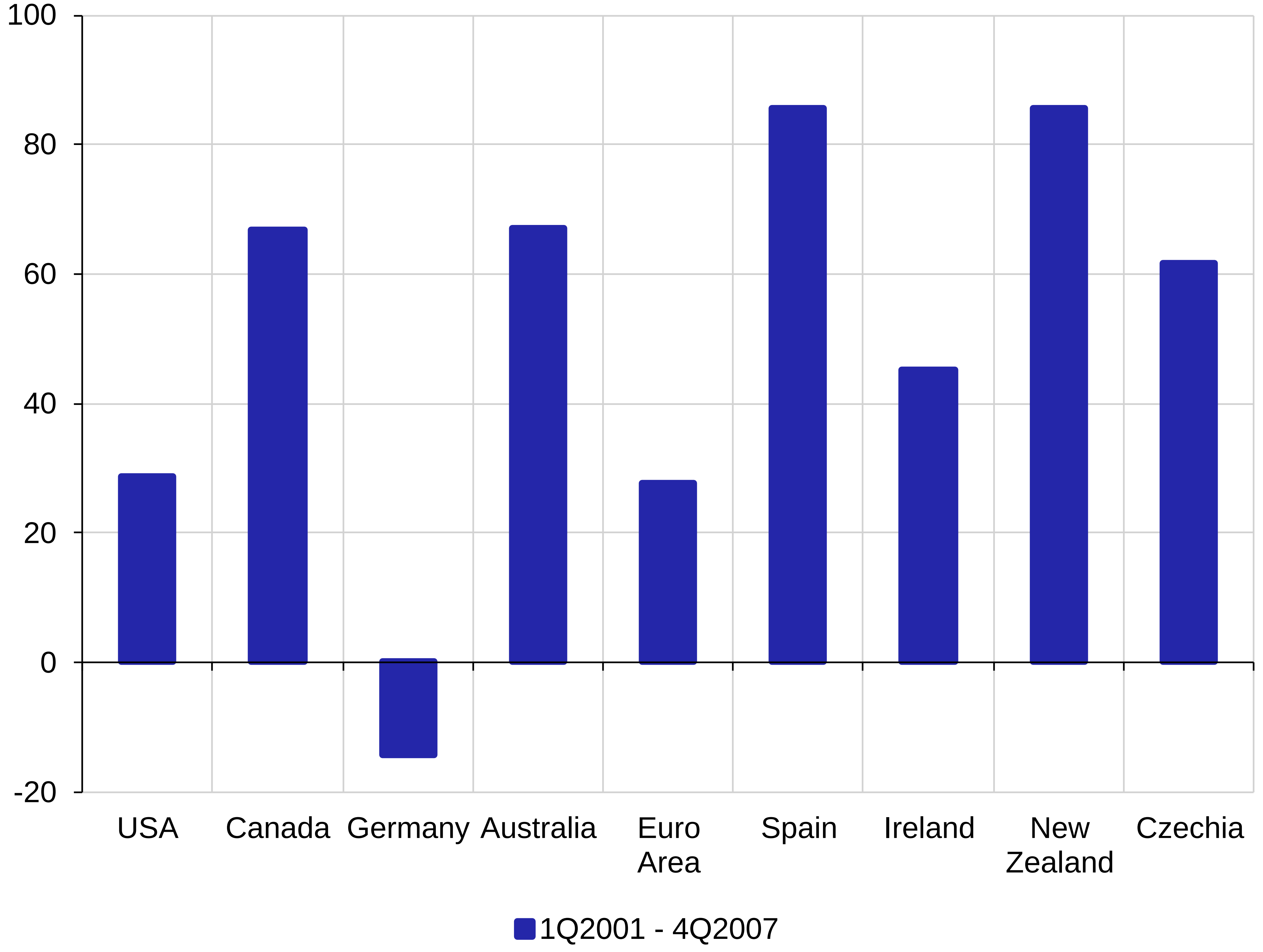
Commercial property prices
Index, 2017=100, nominal, source: BIS



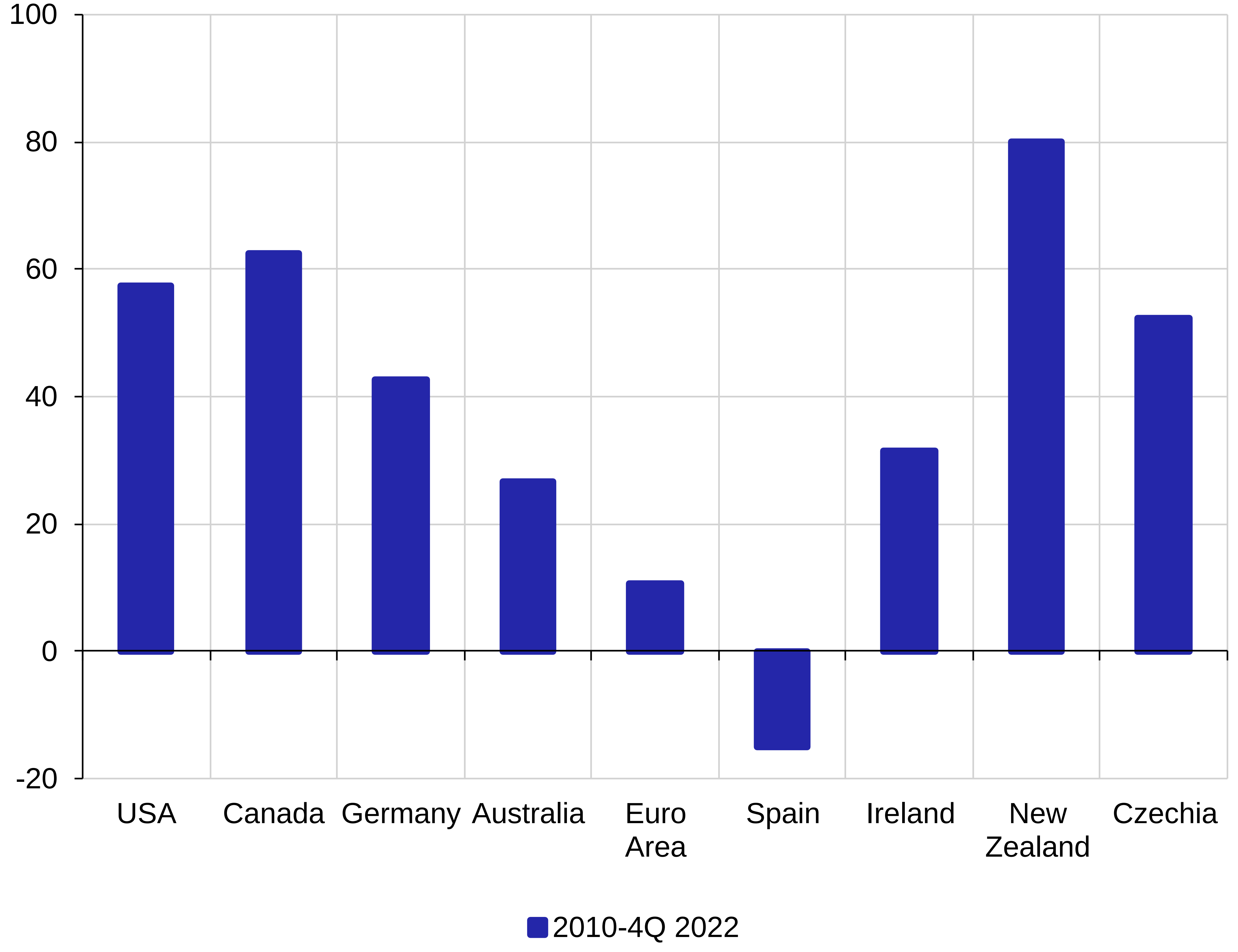
Cycles in property prices (2)

- …do we need some kind of “Basel reforms” for monetary policy frameworks (inflation-forecast targeting in particular) too?

Residential property prices
real, cummulative change during the period, source: BIS, CNB



Residential property prices
real, cummulative change over the period, source: BIS, CNB



What do we need to do to perform better in the future?

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- Co-ordinate monetary and financial policies more closely (Malovaná and Frait, 2016)
- Factor our experience from the Great Macrofinancial Volatility into the inflation-targeting framework and how we apply it (Frait, 2023)
- Extend the macroprudential approach beyond the banking sector
- More luck!

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Thank you for your attention

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