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# News release

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## Macroprudential policy – Addressing the things we don't know

In a co-authored paper published jointly today by the Group of 30 and the Bank of England, Alastair Clark – External Member of the Financial Policy Committee and Senior Adviser for Financial Stability at HM Treasury – and Sir Andrew Large – Former Deputy Governor of the Bank of England – identify and discuss some of the more difficult and contentious issues relating to macroprudential policy.

While the recent emphasis on macroprudential policy reflects the inadequacies of traditional approaches to macroeconomic policy and financial regulation revealed by the financial crisis, the paper points out that there is as yet no clear consensus on the scope or precise targets of macroprudential policy. The paper identifies, however, two key elements: monitoring, analysing and seeking to mitigate emerging "conjunctural" risks (e.g., an excessive build-up of leverage or debt); and enhancing the resilience of the financial system in the face of these risks.

At the same time, the paper recognises the need for balance with other policy objectives: "A regulatory regime which requires, for example, excessive levels of capital may ensure systemic stability but at the same time may unnecessarily inhibit the growth and risk-handling capacity of the economy." The challenge, Clark and Large say, is to capture such trade-offs without losing the focus on systemic stability.

The authors highlight the overlaps with fiscal, monetary and other policies and the difficulty of identifying a distinct set of macroprudential instruments. Indeed they suggest that the designation "macroprudential instrument" may be unhelpful; rather there are instruments which are relevant to macroprudential objectives but often to other objectives as well. These overlaps complicate the decision-making process.

They also consider which indicators best identify potential sources of systemic vulnerability, for example, unsustainable trends in financial aggregates over time and unstable patterns of financial exposures as well as structural weaknesses. When determining which data are more useful for macroprudential analysis, they emphasise the need first to define a clear objective and call for a balance between the collection of "ideal" data and the costs (for financial firms) of producing it and the costs (for the authorities) of analysing it. In the background they note the question of whether or how any macroprudential policy framework should be reflected in statute. The authors believe that such statutory backing can be helpful, particularly in signalling the importance of this area of policy, but suggest a “gradualist approach” focussing first on those aspects about which there is already a reasonable level of confidence.

Should the finance ministry, the central bank or the regulators take the lead on macroprudential matters? The paper argues that this is bound to be influenced by national circumstances but that in “peacetime” there is a good case for the function to be anchored at the central bank. In contrast, however, the authors suggest that in a crisis the finance ministry should be in overall charge, partly because, in a crisis, there is likely to be a key question about whether and if so how fiscal resources should be used but also because the response to any significant financial disruption could involve difficult political judgements. Central banks and regulators are nevertheless likely to have a dominant role in the operational response to a crisis, subject to the finance ministry’s ultimate power of decision. Such arrangements imply the need for a process to switch from peacetime to crisis; the macroprudential authority might have responsibility for triggering this transition.

Finally, the authors consider the constraints on developing a national as opposed to an international approach to macroprudential policy and the challenges in achieving convergence between the two. They argue that, given fiscal capacity and legal frameworks are predominantly national, there are limits on how far international bodies can assume an operational role in crisis management. However, the authors emphasise the valuable part international authorities like the IMF and FSB can play in setting standards for macroprudential policy frameworks. The paper concludes that the highly interconnected nature of the financial system means that it will be increasingly important for national authorities to coordinate their actions.

**Key Resources**

**Macroprudential policy – Addressing the things we don’t know – Occasional Paper**