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Monetary Policy and Macroprudential Policy:  
Rivals or Teammates?  

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Abstract

This paper sheds some light on situations in which monetary and macroprudential policies may interact (and potentially get into conflict) and contributes to the discussion about the coordination of those policies. Using data for the Czech Republic and five euro area countries we show that monetary tightening has a negative impact on the credit-to-GDP ratio and the non-risk-weighted bank capital ratio (i.e. a positive impact on bank leverage), while these effects have strengthened considerably since mid-2011. This supports the view that accommodative monetary policy contributes to a build-up of financial vulnerabilities, i.e. it boosts the credit cycle. On the other hand, the effect of the higher bank capital ratio is associated with some degree of uncertainty. For these and other reasons, coordination of the two policies is necessary to avoid an undesirable policy mix preventing effective achievement of the main objectives in the two policy areas.

Keywords:  
Bayesian estimation, financial stability, macroprudential policy, monetary policy, time-varying panel VAR model

1. Introduction

Monetary policy based on inflation targeting has proved to be effective in combating inflation since it was first introduced in the 1990s. Following the economic and financial crisis of 2008–2013, however, many monetary economists and central bankers have started to ask whether the main postulates of this form of monetary policy should be revised and supplemented. It has been accepted that price stability alone is not enough for maintaining financial stability. In this context, there has been renewed discussion about whether the central bank should take risks to financial stability into account in setting its monetary policy tools even when the current forecast does not indicate any risks to price stability over the monetary policy horizon (??). A consensus on this issue has not been reached so far.

A consensus has emerged on the need to establish macroprudential policy as an essential addition to microprudential capital and liquidity regulations. At present, the monetary and macroprudential functions represent autonomous parts of central bank policies, with their own objectives and toolkits. The incorporation of macroprudential policy into the framework for the functioning of central banks has given rise to new questions regarding the form of coordination between macroprudential and monetary policy.
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