THE MACROPRUDENTIAL POLICY STRATEGY IN THE LIGHT OF THE LATEST GLOBAL FINANCIAL CRISIS

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Abstract: *In a domestic and international environment marked by a high degree of uncertainty, only a coherent mix of macroeconomic, structural and macro-prudential policies can sustain the lasting growth path and to ensure price stability and financial stability. The purpose of our paper is to analyze the macro-prudential policy strategy in the light of the latest global financial crisis, In order to ensure an adequate management of the imbalances to financial stability; an adequate macroprudential policy configuration is of prime importance. We highlight the particularities of macroprudential arrangements for safeguarding financial stability at European, and respectively national level. In order to reinforce financial system stability, the National Bank of Romania decided to pursue, aside from the EU-recommended intermediate macroprudential policy objectives, two other objectives: increase in financial intermediation and an improvement of financial inclusion. Our analysis shows that the banking system in Romania has an appropriate level of capitalisation, as highlighted by the Common Equity Tier 1 capital ratio which shows higher values than the combined buffer requirement applicable in 2016. The rest of the paper is organized as follows. Section 1 briefly surveys the major contributions of the literature review. Section 2 and 3 explain the particularities of macroprudential arrangements for safeguarding financial stability at European versus national level, while section 4 brings the main conclusions.*
Keywords: *monetary policy, financial stability, risks, central banks*

1. LITERATURE REVIEW

Ensuring and maintaining macrostability has become a key objective and a new design of financial stability policy is one of the key elements of reforms to achieve this objective. The implementation of macro-prudential policy is underway, in particular, on the role of central banks. The role of monetary authorities was reviewed, following the events triggered in 2007.

Therefore, the academic literature converge towards the idea that the central banks should be involved in formulating and implementing financial stability policy, given that such a policy is effective and not inconsistent with the monetary policy responsibilities. We invoke a number of reasons why the central bank should have a prominent role in the financial stability policy:

- financial instability can affect the macroeconomic environment, with remarkable consequences on economic activity, price stability and the monetary transmission mechanism;
- central banks represent lender of last resorts;
- performance of the functions in monetary policy provides to central banks a superior understanding of the macroeconomic environment, the financial market

infrastructure and institutions - essential for the performance of macro-prudential functions.

Therefore, the central bank can play an important role in macro-prudential policy because has expertise in systems analysis from a global financial perspective and has incentives to mitigate systemic risk ex ante. On the other hand, the increasing degree of financial innovation, especially on the instruments of credit risk transfer and upward trend of derivatives market, led to increasing complexity of monetary policy and raise challenges regarding its impact on the real economy (Anton, 2009), which motivates a suitable macroprudential policy configuration. Lastly, the central bank involvement in macro-prudential policy would ensure effective coordination between monetary policy and financial stability policies in a manner that preserve their autonomy (Weidmann, 2011). Also, Vinals (2010) considers that central banks can bring expertise, information and strong incentives to increase the effectiveness of macro-prudential policy.

The expertise of monetary authorities in the analysis of systemic risk is useful in calibrating macro-prudential policy. Central banks have a strong interest in design and implementation of effective macro-prudential tools, whether or not they are directly responsible. The reasons supporting this statement are (Vinals, 2010):

- ineffective macroprudential tools put additional pressure on monetary policy responsibility to avoid financial imbalances;
- ineffective macroprudential tools increase the likelihood of LOLR function in order to avoid a system-wide financial collapse, an aspect which can affect the successful implementation of monetary policy;
- ineffective application of macroprudential instruments is likely to affect the monetary policy transmission mechanism, both in normal times and in times of stress.

Also, Nier (2009) highlight three reasons why central banks want to implement effective macro-prudential policy:

- upward trend of financial excesses may generate substantial cost for macroeconomic policy objectives of a central bank, including price stability and the economic growth;.
- if prudential instruments are not applied effectively, the burden of monetary policy in combating the accumulation of financial imbalances increases;
- a greater frequency of financial excesses may compromise the effectiveness of monetary policy.

Once established the importance of central bank on financial stability policy, the post crisis dominant view in academic literature is that should be conferred to the monetary authority the financial stability objective associated with a clear mandate. The report "Rethinking Central Banking" published by Committe on International Economic Policy and Reform in late 2011 recommends to the central banks the followings:

- Central banks need to look beyond traditional interest-low inflation and adopt an explicit goal of financial stability. Macroprudential tools should be used alongside monetary policy to achieve this objective.

- increasing independence and credibility of central banks by recognizing and addressing tensions between inflation targeting and competing objectives.

Despite strong arguments in favour of a central bank's dual mandate, we find in literature and a series of contradictory arguments. We made a summary of them in the following table.

Table 1. Pros and cons of dual mandate (price stability and that financial stability) of central banks

Pro arguments	***Counter arguments***
✓ central bank's expertise in analyzing financial systems from a global perspective; ✓ central bank has incentives to mitigate systemic risk ex ante, because the financial instability affects macroeconomic environment, with remarkable consequences on prices and on monetary policy transmission mechanism; ✓ dual mandate would ensure effective coordination between monetary policy and financial stability policy in a manner that preserve their autonomy (Weidmann, 2011); ✓ an explicit mandate confer institutional power to issue macro-level regulations and to monitor their implications; ✓ The central banks participates, through its representatives, in the procedures of various structures and working groups of European bodies, and those international financial institutions have a countercyclical role during crises by providing financial assistance (Anton, 2013)	✓ it is difficult to determine the right time for a proactive response of monetary policy and also makes it difficult for monetary authority to increase interest rates in the absence of inflationary pressures over short term; ✓ it is difficult to calibrate the size of a proactive monetary policy reactions and trying to respond to financial imbalances could exacerbate economic volatility (Hunter, Kaufman and Pomerleano, 2005); ✓ there is a risk to overload central bank objectives and a risk of losing credibility, if a goal is missed; ✓ there is a challenge drived from rarity, non-liniaritatea unpredictable nature of financial crises. It is particularly difficult to predict the circumstances in which financial stability policy actions may be required in order to prevent imbalances (Caruana, 2010);

(Source: summary based on literature review)

We subscribe to the necessity to assign the mandate to safeguard financial stability to the central banks in the light of the arguments set out above, but also because if there are two structures of governance would appear a several incompatibilities:

- two institutions would be involved in liquidity management- central bank, in normal times, and the authority on financial stability in times of stress and it could be forced to operate as lender of last resort;
- authority on financial stability would act only in special cases it is possible to lose macroeconomic expertise;
- a new governance structure in time of crisis would generate further innovations and new regulations at the microeconomic level, and this structure will be exceeded by innovations in the field (Croitoru, 2013);

- quiet periods means inaction of financial stability authority and the economic agents might speculate this aspect, assuming excessive risk.

2. MACROPRUDENTIAL ARRANGEMENTS FOR SAFEGUARDING FINANCIAL STABILITY -PARTICULARITIES AT EUROPEAN LEVEL

Creating an appropriate framework for conducting macro-prudential policies in EU Member- whose necessity was revealed unequivocally by the global financial crisis- is a process carried out in accordance with Recommendation of European Systemic Risk Board (ESRB) of 22 December 2011. Each country has opted for a specific institutional framework, whose features depend, largely, on national supervision of financial markets.

In 13 countries (Belgium, Cyprus, the Czech Republic, Estonia, Greece, Hungary, Ireland, Latvia, Lithuania, Malta, Portugal, Slovakia, UK), the central bank has been designated as national macro-prudential authority. The choice is based mainly on the dominant role of the banking sector in the national financial system, which makes the central bank to hold the relevant expertise and the ability to translate quickly into practice the adopted measures. Such an institutional arrangement presents however the disadvantage that any error - whether real or only perceived by the public as such - in co-ordination of macro-prudential policies can have a negative impact on the credibility of the monetary policy.

On the other hand, in the following 13 countries: Austria, Bulgaria, Croatia, Denmark, France, Germany, Italy, Luxembourg, the Netherlands, Poland, Slovenia, Spain and Romania were established committees which should function as interinstitutional cooperation structures, bringing together representatives of the central bank, the national financial supervisory authority and the government. The main advantage is pooling of expertise of all financial market supervisors and the government, while the preponderant representation of central bank is likely to ensure the pro-active attitude of macroprudential policy. There are two EU countries (Finland and Sweden) where macroprudential mandate was assigned to national financial supervisory authorities, because their prerogatives have a broad enrollment, including the supervision of credit institutions.

Regardless of the chosen macro-prudential governance at national level, it is essential to be clearly defined, coherent, transparent and functional, with appropriate mechanisms for efficient cooperation of all authorities in order to ensure financial stability.

In the context of the single European market, financial stability can only be ensured by implementing correlated macroprudential measures. Effectiveness of macroprudential measures and achieving its objectives can be significantly affected by regulatory arbitrage. Although the EU financial sector is characterized by a high degree of integration, not all categories of macroprudential policy requires recognition by the Member States. Thus, the EU legislative framework provides more degrees of cross-border recognition on macroprudential measures, as follows: mandatory recognition, mandatory recognition to a certain threshold and voluntary recognition (reciprocal) by the ESRB involvement.

Table 2 European framework for recognition of macro-prudential measures

Macroprudential measure	***The legal framework***	***Mandatory recognition of prudential measures in National legislation, according to the European framework***
Countercyclical capital buffer	art. 130, 135-140 CRD IV	Mandatory (up to level 2.5 percent)
A higher level of requirements for credit risk related to institutions using the standard approach	art. 124 CRR	Mandatory
A higher level of LGD for institutions using internal ratings	art. 164 CRR	Mandatory
Measures at national level	art. 458 CRR	voluntary
the systemic risk buffer	art. 133-134 CRD IV	voluntary
Pillar II measures	art. 103 CRD IV	No mention
the buffer for other systemically important institutions	art. 131 CRD IV	No mention
LTV and DTI limits	national legislation	No mention
The loan / deposit ratio	national legislation	No mention

(Source: NBR Financial Stability Report, December 2016, p. 10)

3. THE PARTICULARITIES OF MACROPRUDENTIAL FRAMEWORK IN ROMANIA

In the years following the global financial crisis has become increasingly evident the need to adopt measures specifically designed to strengthen financial stability, increasingly the role of macro-prudential policy. At European level, the recommendations of the European Systemic Risk Board (ESRB) and new legislative package CRD IV / CRR (Capital Requirements Regulation and Directive) has been a defining element to create the macro-prudential policy. The literature on macroprudential policy does not provide a consensus on its objectives and instruments (Galati and Moessner, 2011). In Romania, an essential step in the process of finalizing the macroprudential policy framework was to define the macro-prudential strategy, which aims to link objectives, indicators and tools. In order to achieve the ultimate objective, to safeguard financial stability, NBR selected, in addition to intermediate objectives of macro-prudential policy recommended by EU - reduce and prevent excessive credit growth and indebtedness, reduce the maturity mismatches and prevent lack of market liquidity, limit direct and

indirect exposure concentrations, reduction of moral hazard and strengthening the resilience of financial infrastructures - two specific national targets - the sustainable growth of financial intermediation and financial inclusion improvement. From the perspective of operational macroprudential policies, the National Bank Romania introduced instruments such as debt service-to-income (DSTI) and loan-to-value (LTV) for lending to households since 2004.

Also, in line with the requirements of implementing in national legislation the European regulation (CRD IV / CRR), the National Committee for Financial Stability (CNSF) issued Recommendation CNSF. 1/26 November 2015 regarding the implementation of capital buffers and, respectively, Recommendation No. 3/18 December 2015 regarding implementation of systemic risk buffer in Romania, based on which National Bank of Romania introduced the following tools (NBR, 2015):

- the capital conservation buffer- defined as a reserve built up during economic upturns to improve the capacity to absorb losses during periods of crisis, its amount being 2.5 percent of the total risk exposure of the institution (level to be reached no later than 1 January 2019).
- the countercyclical capital buffer- built up during excessive growth period lending and can be released during contraction to absorb losses, aiming to increase the resilience of the banking sector to potential losses induced by excessive credit growth.
- the buffer for other systemically important institutions (O-SII buffer)- used as a reserve for mitigating systemic risk generated by the size of credit institutions, which may account for up to 2 percent of the total risk exposure.
- -he systemic risk buffer- intended to mitigate the structural risks which can be transmitted via the following channels: common exposures; the direct interconnectivity (through the interbank market) or indirect interconnectivity (information contagion informational) and concentration of the financial system.

Table 3. Capital buffers according to CRD IV and the national legislation

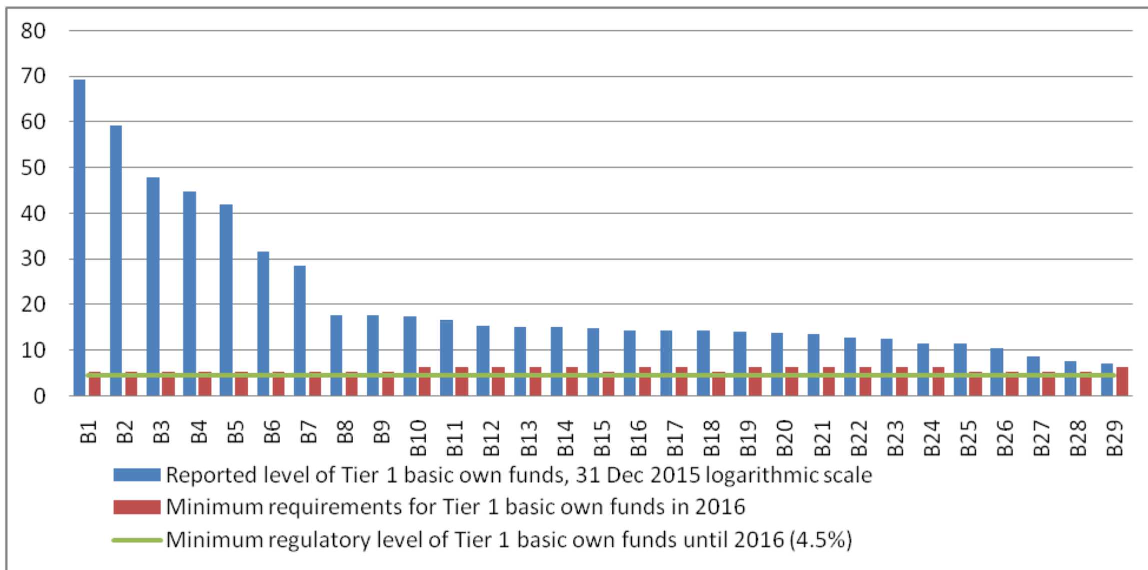
Buffer	***Level established in Romania***	***Deadline for implementation***
Capital conservation buffer	2.5 percent of total risk exposure amount of the institution by 2019	Gradual phasing-in, i.e. 0.625 percent per annum during 2016-2019. The first rate of 0.625 percent has been activated as of 1 January 2016
Countercyclical capital buffer	0 percent	The buffer has been applied since 1 January 2016
O-SII buffer	1 percent of total risk exposure amount of the institution, solely for systemically important banks	The buffer has been activated as of 1 January 2016

Systemic risk buffer	1 percent of total exposure amount to which it applies, solely for selected banks; it does not add to the O-SII buffer	The buffer has been activated as of 31 March 2016

(Source: NBR Financial Stability Report, April, 2016, p.85)

In accordance with the provisions of the CRD IV framework, capital buffers should consist of Common Equity Tier 1 capital. The banking system in Romania has an appropriate level of capitalization, as highlighted by the Common Equity Tier 1 capital ratio which shows higher values than the combined buffer requirement applicable in 2016 (see figure 1).

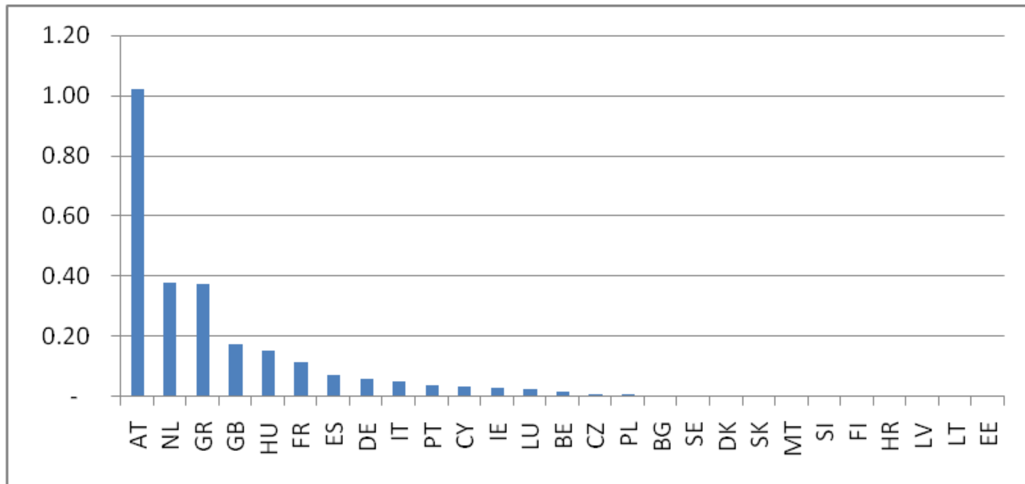
Figure 1 The level of Tier 1 basic own funds reported by banks (Dec 2015) and of capital requirements applicable in 2016 (logarithmic scale)



(Source: NBR data sets)

NBR is monitoring the situation changes in exposures of credit institutions. According to data available at 30 June 2016, the largest exposures of the Romanian banking sector against EU Member States are registered in Austria, Greece and the Netherlands, with share in total assets of between 0.22 and 0.39 percent (Figure 2)

Figure 2 Romanian banking system exposures to EU member states (share of total assets)



(Source: NBR data sets)

In the next period, central bank envisages to define the action plan, start the process of achieving the two new specific national targets and continue to develop the analytical framework to identify structural or cyclical systemic risks, by calibrating and introducing appropriate macro-prudential tools in order to increase the resilience of the financial sector, with benefits to financial stability. The objectives and instruments selected at national level will be reviewed and updated regularly, based on assessments and analyzes conducted by the NBR and the empirical experience acquired on the application of macroprudential tools at international level.

4. CONCLUSIONS

The post-crisis orientation emphasizes the need to reconcile potentially short run conflicting objectives, namely, price stability and financial stability. In addition to analyzing risks and vulnerabilities that could affect the soundness of financial system, it becomes increasingly evident the necessity to adopt specific measures designed to reinforce financial stability, defining a new role of macroprudential policy.

The institutional arrangements in the field of macroprudential supervision in the EU Member States differ, but the most important aspect for each national macroprudential governance framework is to be clearly defined, coherent, transparent and functional, in order to ensure the effective cooperation between all the authorities that can contribute to safeguarding financial stability. At European level, the recommendations of the ESRB and the new package CRD IV/CRR, were a defining element for macroprudential policies in the Member States. Recently, more and more European countries have been focused on operational stage of introducing various tools designed, primarily, to reduce excessive lending exposure in certain markets or risks associated to institutions that have acquired a systemic character.

In Romania, the central bank selected, in addition to intermediate objectives of macro-prudential policy recommended at EU level, two specific national objectives - sustainable growth of financial intermediation and financial inclusion improvement - in order to achieve the ultimate objective, to safeguard financial stability. International financial crisis has shown the need to create a new regulatory framework which provides to national authorities mechanisms to identify structural and cyclical risks, as well as with the macroprudential instruments necessary for mitigating such risks.

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