

# Policy Panel on Interactions between monetary and macroprudential policy

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# Two challenges for macroprudential policy

## Two challenges

- Low interest rates for long
- EMU: an incomplete architecture

# Monetary policy and risk taking

**Remark 2** *The policy rate affects bank risk taking incentives in two ways: directly through profits, and indirectly through debt:*

$$\frac{dx^*}{dr} = \frac{\partial x^*}{\partial r} + \frac{\partial x^*}{\partial d^*} \frac{\partial d^*}{\partial r}. \quad (3)$$

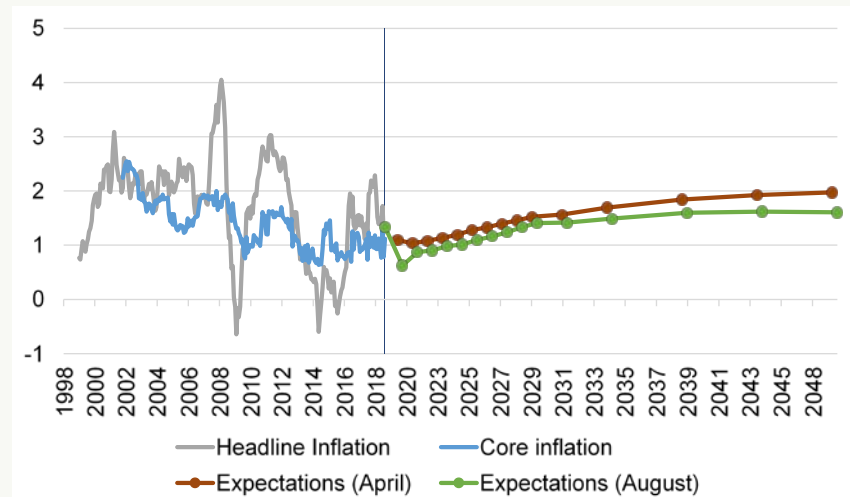
**Proposition 1** *We identify these effects as the two transmission channels:*

*Channel 1 - "Profit effect",  $\frac{\partial x^*}{\partial r} > 0$ : for given leverage, a higher  $r$  increases  $x^*$*

*Channel 2 - "Leverage effect",  $\frac{\partial x^*}{\partial d^*} \frac{\partial d^*}{\partial r} < 0$ : a higher  $r$  lowers  $d^*$ , and consequently also  $x^*$*

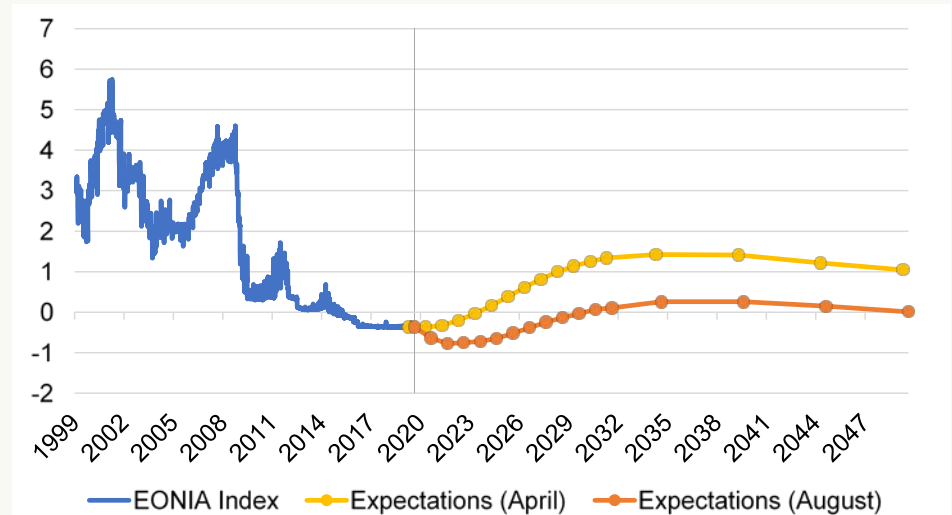
# Low interests for long

Figure 1: Euro-area inflation, core, headline and market expectations (year-on-year, %)



Source: Bruegel based on Bloomberg. Note: inflation expectations as of April and August 2019, derived from inflation zero-coupon swaps of different terms (1 year, 2 years, up to 30 years), which provide information on market expectations of average yearly inflation over the contract term. Expectations for 2020 inflation, for instance, are derived from expected inflation over the next year (2019), given by the 1-year swap, and expected inflation over the next two years (2019 and 2020), given by the 2 year swap. Expectations are related to the Eurostat Harmonised Indices of Consumer Price (HICP) excluding tobacco.

Figure 1: Short-term interest rates and market expectations (%)



Source: Bruegel based on Bloomberg. Note: Interest rate expectations as of April and August 2019, derived from EONIA zero-coupon swaps of different terms (1 year, 2 years, up to 30 years), which provide information on market expectations of the compounded overnight EONIA over the contract term. Expectations for 2020 interest rate, for instance, are derived through expected compounded EONIA over the next year (2019), given by the 1 year swap, and expected compounded EONIA over the next two years (2019 and 2020), given by the 2 year swap.

Source: Claeys, Demertzis and Papadia al 2019.

# EMU: an incomplete architecture

Tension between

policy coordination and shock accommodation

What is the role of macroprudential policy in managing this tension?

How should it be designed to do so?