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PRESS RELEASE

The transmission mechanism of new and traditional instruments of monetary and macroprudential policy
(Article in the December 2016 Economic Review)

On 13 and 14 October 2016, the National Bank of Belgium (NBB) held its ninth academic conference on the theme ‘The transmission mechanism of new and traditional instruments of monetary and macroprudential policy’.

The financial crisis and the resulting economic recession created new challenges for monetary policy and proved the need for a macroprudential policy to guarantee financial stability. The current economic environment of low inflation and zero interest rates also illustrates the limitations of the traditional monetary policy instruments. This situation implies that new instruments need to be implemented to achieve both monetary and macroprudential policy objectives.

From the monetary policy perspective, these new instruments are related to the composition and size of the central bank balance sheet – policies of credit and quantitative easing – and to forward guidance about future policy intentions. How do these measures encourage financial institutions to relax their credit supply policies and how do lower future borrowing costs convince firms and households to expand their investment plans? From the macroprudential perspective, the new countercyclical capital buffers, liquidity and leverage ratios, and specific target instruments – such as loan-to-value and debt-to-income restrictions – offer new ways to control the credit and financial cycle. Recent policy discussions have revealed a lot of unanswered questions about the transmission channels of these new instruments.

Many contributions at the conference attempted to quantify these transmission channels for both monetary and prudential instruments. Changes in prudential capital requirements are found to have steeply diverging effects depending on the characteristics of individual banks. The institutions at greatest risk are effectively also the most restrained by these measures, while any undesirable costs arising from lending restrictions were found to be limited. This shows that such measures can be efficiently used to enhance the financial stability and resilience of financial institutions, without sparking major macroeconomic spill-over effects. These same observations also apply to the effects of unconventional monetary policy incentives. Here too, the relevant instruments manage to reach the financial institutions that most need the additional funding. There are few signs that such capital injections are encouraging excessive risk behaviour, even at less robust institutions. A more rigorous regulatory framework may have helped to ensure this stability.

Communication
National Bank of Belgium Ltd.
boulevard de Berlaimont 14
1000 Brussels
phone + 32 2 221 46 28
www.nbb.be
Company’s number:
0203.201.340 – RLP Brussels