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Thank you very much. Jean-Claude asked me to add a macroeconomic perspective to this topic, specifically, to talk about macroprudential policy. I will say a few words about four issues. Firstly, what is macroprudential policy in contrast with microprudential policy (regulation and supervision)? Secondly, what is the role of central banks, or why is the role of central banks so prominent in building up macroprudential policies and macroprudential bodies? Then, why is macroprudential policy so important within currency unions? We all have in mind the situation in the European Union, particularly in the eurozone. Finally, I will make a short comment on an alternative approach to macroprudential policy, which goes beyond what is usually accepted as one.

Financial stability was always a part of the mandate of central banks, even if it was not as prominent as fighting inflation. Even if that policy existed in many countries, it did not gain in importance, essentially because the intellectual atmosphere was the following: what was really needed was microprudential regulation and supervision – it was thought that the market would take care of the rest. In recent years, it has been proved that a country might have healthy financial institutions, but if all of these institutions go in the same direction, it may bring about a disaster. One of the lessons that we drew from the recent crisis is that even if financial institutions, one by one, look healthy – and they do look healthy in times of prosperity – it does not mean that the whole system is not in danger. You need to have instruments to be applied to pre-empt the crisis.

What are the instruments of macroprudential policy? They are, in principle, the same as instruments of microprudential policy, but they are used with other motivations. The motivation is “macro” – it is systemic or macroeconomic, it does not relate to the size of what is regulated. If we deal with e.g. Deutsche Bank, it is still microprudential regulation, but if we deal with Latvia, it is macro-perspective, because we deal with several institutions, even if they are very small when compared to the size of the big bank. The instruments are capital ratios – which are very well known, leverage ratios, debt-to-income ratio, etc. The list is very long.

That constitutes the first part of my introduction. The second remark is about the prominent role of the central bank in macroprudential policy. In many countries, central banks are responsible for microprudential regulation and supervision. In these cases, the situation is quite simple. They can use prudential instruments from the point of view of macroeconomic considerations. When supervision and the central bank are separate institutions, there is no direct institutional channel between the two. Then, there is the question of how macroeconomic policy pursued by the central bank can be reinforced. In many cases, I would even say in most cases, when macroprudential bodies are being set up, central banks play a leading role – as they do in the eurozone, with the ECB. Even if the two functions are carefully separated, they are still under the same broad “roof”. Why is that? Let me resort to a very simple explanation. Central banks use interest rates and management of money circulation to regulate the credit. We know this can be flexible, but operates with long time lags. As we know and remember from the pre-crisis statements of Alan Greenspan, piercing the credit bubble would be very costly and risky. It would require a very large increase in interest rates to be effective. There is always a temptation; if we use macroprudential instruments or prudential instruments, we can limit the volume of credit in a more direct way. When increasing the mandatory loan-to-value limit, we limit just the amount of credit. That’s it. We do not use interest rate. As such, it is direct. Macroprudential instruments are of the same family. Even if there might be conflicts between the two.

Why they are so important in the eurozone or in the currency unions? I do not intend to say that macroprudential instruments are not important in countries like Korea or Canada, but if you have countries that have different characteristics and still have the same monetary policy and the level of interest rates, some of them will inherently develop a tendency to accumulate credit bubbles – let us think of Ireland and Spain. What is more, if you look at the countries that were not part of the eurozone, but had a unilateral commitment to peg their currencies to the euro – all currency fixers, as we call them – such as the Baltic States in central and eastern Europe, needed robust prudential instruments to counter accumulation of credit bubbles. However, in my opinion, the national sovereignty over macroprudential instruments is needed most within currency unions – like within the eurozone. We have the ESRB, in which we have the pleasure to work together. This is a wonderful institution that coordinates and harmonises the use of macroprudential instruments in the EU.

Now, let us turn to the fourth issue – an alternative approach to macroprudential policy. Conventionally, it focuses entirely on the financial sector and how to avoid relatively improbable but potentially devastating outcomes – so-called tail risks. Another approach would be to go beyond the financial sector and consider the situation in the whole economy. In this case it is to keep the economy to its potential output trajectory, to minimize output gaps. This is more ambitious and probably more difficult than the first approach, but there are some recent historical examples that show that the second approach is not totally senseless and is worth considering. For example, Spain has always had an assertive regulator and supervisor. They resorted to innovative instruments, like dynamic provisioning, which some countries are now considering to implement in their economies. But still, unfortunately for the Spanish regulator, the bubble developed somewhere else, outside of the financial sector: in the real estate sector. Of course, this cannot be not totally separated from the financial sector. However, if you take a narrower view – on the financial sector only, you can overlook these equilibriums that are unfolding somewhere else. There are also other approaches that are worth considering, but I will stop here and we might discuss them later.