Reserve Bank Act Review – Perimeter of Macroprudential policy

Purpose

This note comments on the perimeter of macroprudential policy for the purpose of informing the scoping of Phase II of the Reserve Bank Act. It follows a request from the Independent Expert Advisory Panel in the third panel meeting for a one pager on the perimeter of macroprudential policy.

Information

"Macroprudential" policy is designed to address systemic aspects of risk in achieving the objectives of the regulator, which tend to relate to financial stability and often macroeconomic stability as well. A macroprudential perspective means one that is broader than the soundness of individual institutions, extending to the stability of the financial system as a whole. There are two aspects to considering of the perimeter of macroprudential policy, the conceptual and the practical. These aspects are interlinked.

Conceptual aspect: How is macroprudential policy defined?

Pinning down the definition is important because this has implications for the policy objectives of both macroprudential, and standard prudential policy. Communication in this regard is also important to ensure that there is an understanding about how prudential, macroprudential, and monetary policy are co-ordinated. Macroprudential policy is widely regarded as an emerging policy area and there is no international consensus regarding what should be considered as 'macroprudential,' or even whether it is a clearly distinct policy area. As an example of the spectrum of views:

- At one end, APRA considers 'macroprudential policy' to be a subset of wider financial stability policy, rather than a clearly distinct area. Financial policy considers systemic risks both across institutions and across the financial cycle. However, they have taken some prominent actions (such as the limit on investor loan growth since 2014) that most countries would classify as macroprudential.

- In New Zealand, 'macroprudential policy' is the consideration of time varying risks across the financial cycle, as set out in the MoU. Cross-sectional systemic risks, such as the risks that arise from the interconnectedness of financial institutions and from exposures to common risks, are addressed in the Reserve Bank's prudential policies, which have long had a systemic focus (in line with the Reserve Bank's objectives under section 68).

- The Bank of England considers 'macroprudential policy' to be policy that addresses sources of macroeconomic and financial risk that arise both due to variations in the financial cycle, as well as cross sectional aspects, which include the interconnectedness of institutions and institutions' exposures to the wider economy. They have three separate committees that make decisions relating to the financial system: the Financial Policy Committee (who sets restrictions such as LVRs and DTIs), Prudential Regulation Committee, and the Monetary Policy Committee. There are procedures and cross-membership to encourage coordination between them.

Practical aspect: What institutions are regulated and what tools are available

Currently in New Zealand, macroprudential regulation applies to registered banks; it does not apply to non-bank deposit takers or other financial institutions. In Australia, recent macroprudential actions have applied to authorised deposit taking institutions, and APRA is in the process of acquiring powers to extend them to other lenders if this is seen as necessary. The Bank of England applies macroprudential tools to a range of registered lenders. The literature on this topic often highlights the risks of leakage, which is when lending shifts to outside the regulatory perimeter. If leakage is material, an extension of the regulatory perimeter may be appropriate. The Reserve Bank notes that they have observed little leakage to the non-bank sector while administering loan-to-value ratio (LVR) restrictions.

There are a variety of options for macroprudential tools. Currently the New Zealand model has four tools, of which only LVRs have been actively used. Both APRA and the Bank of England also use serviceability tools, which are not part of the framework in New Zealand. As some macroprudential policies can have significant distributional consequences on the public, the considerations of broader stakeholders and the need for value judgements will be relevant in determining what tools are available to the regulator, and how they are implemented.