



Banc Ceannais na hÉireann  
Central Bank of Ireland

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Eurosystem

# ECB, monetary policy and financial supervision

Introductory remarks by Stefan Gerlach

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# Introduction

- *Is the separation of the ECB's monetary policy and financial supervisory functions adequate?*
- Take a step back:
  - Central banks original supervisors.
  - Monetary policy & financial supervision arranged in different ways across the world -- no one-size fits all.
  - Shifts over time -- a decade ago tendency to separate these function but recently focus on co-locating them.
  - Arguments go both ways -- suggesting that complete separation or combination not desirable.

# Some arguments for separation

- *Conflict of interest* commonly voiced concern:
  - Banks benefit from low short-term interest rates, leading to a potential risk of too expansionary monetary policy.
  - If **banking system** and monetary transmission mechanism affected, then a more expansionary policy may be warranted.
  - If an **individual bank** is affected, ECB less likely to relax monetary policy than an NCB would have been.

- Concerns reflect an earlier age of central banking:
  - No independence; unclear objectives; limited transparency.
  - Banks "large" relative to the central bank.
  
- History suggests that CBs have at times been insufficiently concerned about banking system:
  - US in the 1930s.
  - Japan in the 1990s?
  
- *Reputation risks:*
  - Credibility of CB's monetary policy could be harmed by regulatory mistakes.
  - Seems unlikely. Examples?

- *Decision-making capacity:*
  - Setting monetary policy and conducting financial supervision are more than full-time undertakings and entail different professional skills.
  - May be sensible to have different decision makers (but not necessarily different institutions responsible).

# Some arguments for co-location

- Supervisory information are important for central banks' conduct of monetary policy:
  - Better understanding of financial conditions & the health of the banking system -- and of the monetary transmission mechanism -- improves monetary policy.
  - Helpful when functioning as LOLR and in crisis management -- explains perhaps why there is now greater support for co-locating these activities.
  - Central banks' expertise in judging macro economic conditions, which are important determinants of risks banks run, may improve supervision.

# Conclusions

- Many ways of organising relationship between monetary policy and financial supervision.
- These activities are conducted separately within the ECB.
- Little risk that the ECB's monetary policy becomes captured by supervisory concerns, given the set-up of the monetary policy function.