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# CENTRAL BANK MONITORING – DECEMBER

Monetary Department  
Monetary Policy and Fiscal Analyses Division

2017

## IN THIS ISSUE

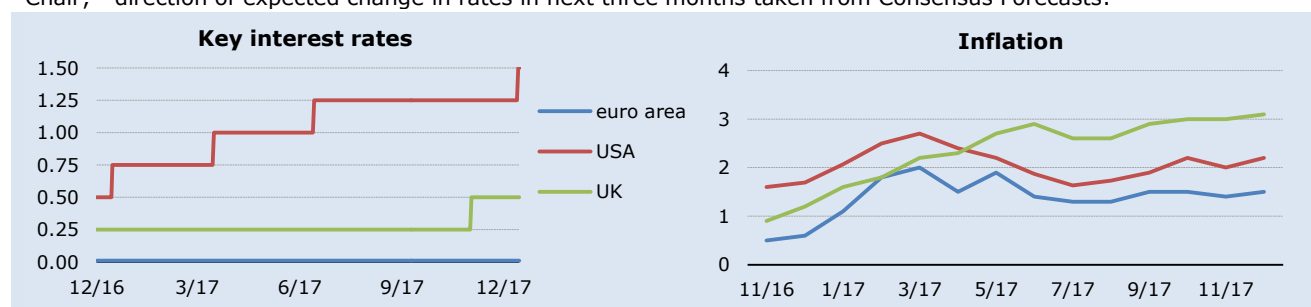
*Most of the central banks under review, including the ECB, are keeping their interest rates at low levels, and several are also continuing their unconventional monetary policy programmes, although the ECB, for example, has reduced its monthly asset purchases. A major exception is the US Fed, which, as expected, is continuing to raise its key interest rate and, according to outlooks, will maintain this trend next year. The UK has also seen its first rate hike in ten years. By contrast, the Hungarian central bank's new instruments are aimed at lowering yields at the longer end of the yield curve. Spotlight focuses this time on the countercyclical capital buffer. In our Selected speech, outgoing Fed Chair Janet Yellen sums up US monetary policy over the last ten years.*

## 1. LATEST MONETARY POLICY DEVELOPMENTS AT SELECTED CENTRAL BANKS

### Key central banks of the Euro-Atlantic area

	Euro area (ECB)	USA (Fed)	United Kingdom (BoE)
<b>Inflation target</b>	<2% <sup>1</sup>	2% <sup>2</sup>	2%
<b>MP meetings (rate changes)</b>	26 Oct (0.00) 14 Dec (0.00)	19–20 Sep (0.00) 31 Oct–1 Nov (0.00) 12–13 Dec (0.25)	14 Sep (0.00) 2 Nov (0.25) 14 Dec (0.00)
<b>Current basic rate</b>	0.00%; -0.40% <sup>3</sup>	1.25–1.50%	0.50%
<b>Latest inflation</b>	1.5% (Nov 2017) <sup>4</sup>	2.2% (Nov 2017)	3.1% (Nov 2017)
<b>Expected MP meetings</b>	25 Jan 8 Mar	30–31 Jan 20–21 Mar	8 Feb 22 Mar
<b>Other expected events</b>	8 Mar: publication of ECB staff projections	Jan 2018: publication of Beige Book, Feb 2018: publication of Monetary Policy Report	8 Feb: publication of Inflation Report
<b>Expected rate movements<sup>1</sup></b>	→	↑	↑

<sup>1</sup> ECB definition of price stability “below but close to 2%”; <sup>2</sup> January 2012 definition of inflation target; <sup>3</sup> deposit rate; <sup>4</sup> flash estimate; <sup>5</sup> meeting associated with summary of FOMC economic forecasts and press conference given by FOMC Chair; <sup>6</sup> direction of expected change in rates in next three months taken from Consensus Forecasts.



The **ECB** kept its policy rates unchanged and expects them to remain at their present levels for an extended period of time. It announced (in October) and confirmed (in December) the long-awaited extension and adjustment of its asset purchase programme. The programme was extended by at least nine months. The monthly asset purchases will be reduced to EUR 30 billion as from January 2018. In an accompanying statement, the ECB again did not rule out further extending or increasing the programme if necessary. Compared to its previous forecast, the ECB expects higher GDP growth of 2.4% in 2017, 2.3% in 2018 and 1.9% in 2019. The inflation outlook has also been revised up, mainly reflecting higher oil and food prices. It foresees inflation at 1.5% in 2017, 1.4% in 2018 and 1.5% in 2019.

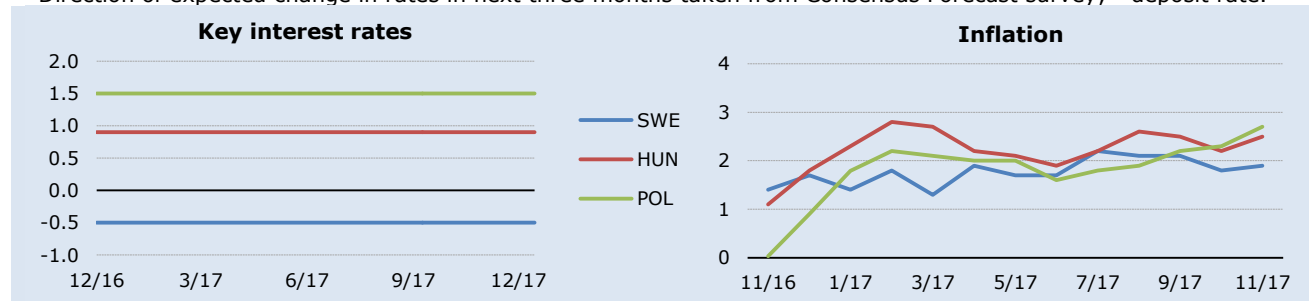
In December, the **Fed** raised its key interest rate for the third time this year, by 0.25 pp to 1.25%–1.50%. The rate increase had been expected by the markets. The median projection of the FOMC members for this year – 1.4% – was also fulfilled. According to the [median of the FOMC members' projections](#), three policy rate hikes of 0.25 pp to 2.1% can be expected in 2018. In the longer run, the FOMC expects rates to stand at 3.1% in 2020. The labour market remains strong and the unemployment outlook for the next three years is 4%. According to the FOMC, gradual growth in economic activity can be expected (2.5% in 2018 and 2.0% in 2019). Inflation will stay at 1.5% this year and stabilise around 2% in the medium term.

The **BoE** increased its key interest rate by 0.25 pp to 0.50% in November. At the December meeting, it left rates unchanged and maintained the stock of government and corporate bond purchases at GBP 435 billion and GBP 10 billion respectively. Inflation reached 3.1% in November. The BoE expects the pass-through of the past depreciation of sterling to consumer prices to diminish. This will result in inflation declining gradually towards the 2% target over the following three years. In November, the BoE increased its countercyclical capital buffer rate from 0.5% to 1% (see *Spotlight* for details).

### Selected central banks of inflation-targeting EU countries

	Sweden (Riksbank)	Hungary (MNB)	Poland (NBP)
<b>Inflation target</b>	2%	3%	2.5%
<b>MP meetings (rate changes)</b>	25 Oct (0.00)	19 Sep (0.00); (-0.10) <sup>2</sup> 24 Oct (0.00) 21 Nov (0.00)	3–4 Oct (0.00) 7–8 Nov (0.00) 4–5 Dec (0.00)
<b>Current basic rate</b>	-0.50%; -1.25% <sup>2</sup>	0.9%; -0.15% <sup>2</sup>	1.50%
<b>Latest inflation</b>	1.9% (Nov 2017)	2.5% (Nov 2017)	2.7% (Nov 2017)
<b>Expected MP meetings</b>	19 Dec 13 Feb	19 Dec 30 Jan 27 Feb	9–10 Jan 6–7 Feb 6–7 Mar
<b>Other expected events</b>	20 Dec: publication of Monetary Policy Report	19 Dec: publication of Inflation Report	12 Mar: publication of Inflation Report
<b>Expected rate movements<sup>1</sup></b>	→	↑	↑

<sup>1</sup> Direction of expected change in rates in next three months taken from Consensus Forecast survey; <sup>2</sup> deposit rate.



The **Riksbank** left its policy rate unchanged at -0.5% in October and, like at the previous meeting, does not expect to raise it until the middle of 2018. Government bond purchases will continue until the end of 2017 and may be extended at the December meeting. The Executive Board decided to extend the mandate enabling the Swedish central bank to intervene quickly on the foreign exchange market. CPI inflation stood at 1.8% in October. GDP growth accelerated slightly to 2.9% in Q3, mainly on the back of fixed investment growth. In its October forecast, the Riksbank kept its CPI inflation outlook for 2017 at 1.8% and lowered its CPI inflation outlook slightly to 1.9% (from 2%). For 2018, it expects CPI inflation of 1.9% and CPI inflation of 1.8%. The Riksbank lowered its GDP growth forecast for this year from 3.2% to 2.9% and expects 2.9% for next year.

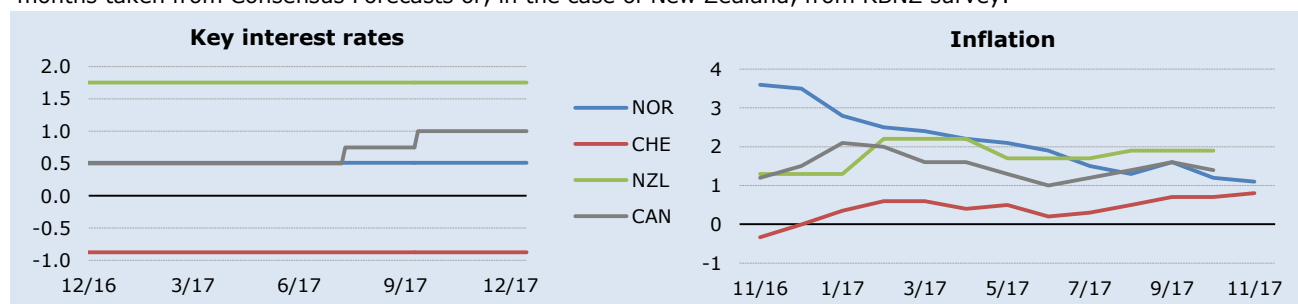
The **MNB** maintained its base rate at 0.9% and lowered its deposit rate by 10 bp to -0.15%. According to preliminary estimates, the Hungarian economy again grew at a solid annual pace of 3.6% in Q3, thanks mainly to services and industry. In the years ahead, the MNB expects the economy to grow by 3%–4%. Employment was at historical highs in Q3 and the unemployment rate is continuing to fall. With effect from January 2018, the MNB introduced an IRS facility with five- and ten-year maturities and allocated HUF 300 billion to it in Q1. This will enable banks to swap a variable interest rate for a fixed one offered by the MNB at longer maturities in tenders (details have yet to be published). In addition, the MNB decided to launch a programme aimed at purchasing mortgage bonds with maturities of three years or more. Both measures are intended to lower yields at the longer end of the yield curve.

The **NBP** left its interest rate unchanged at 1.5% in the past period. Annual GDP growth accelerated further to 4.9% in Q3, again driven primarily by consumer demand, supported by wage growth and consumer optimism, and by investment growth. Inflation rose to 2.5% in November due to higher food and energy price growth. However, core inflation remains low. According to the NBP's November forecast, the economy will grow by 3.8%–4.6% in 2017 and 2.8%–4.5% in 2018. The NBP expects inflation of 1.9%–2% in 2017 and 1.6%–2.9% in 2018. From 1 January 2018, the NBP will remunerate the required reserve at a rate of 0.5%.

## Other selected inflation-targeting countries

	Norway (NB)	Switzerland (SNB)	New Zealand (RBNZ)	Canada (BoC)
<b>Inflation target</b>	2.5%	0–2%	2%	2%
<b>MP meetings (rate changes)</b>	21 Sep (0.00) 26 Oct (0.00) 14 Dec (0.00)	14 Sep (0.00) 14 Dec (0.00)	28 Sep (0.00) 9 Nov (0.00)	25 Oct (0.00) 6 Dec (0.00)
<b>Current basic rate</b>	0.50% -0.50 reserve rate <sup>1</sup>	from -1.25% to -0.25%; <sup>2</sup> -0.75% <sup>3</sup>	1.75%	1.00%
<b>Latest inflation</b>	1.1% (Nov 2017)	0.8% (Nov 2017)	1.9% (2017 Q3)	1.4% (Oct 2017)
<b>Expected MP meetings</b>	25 Jan 15 Mar	15 Mar	8 Feb 22 Mar	17 Jan 7 Mar
<b>Other expected events</b>	15 Mar: publication of Monetary Policy Report	20 Dec: publication of Monetary Policy Report	8 Feb: publication of Monetary Policy Statement	17 Jan: publication of Monetary Policy Report
<b>Expected rate movements<sup>1</sup></b>	→	↑	↑	↑

<sup>1</sup> Only on reserves exceeding the quota; <sup>2</sup> chart displays centre of band; <sup>3</sup> negative deposit rate on banks' account balances held at the SNB, graded according to balance amounts; <sup>4</sup> direction of expected change in rates in next three months taken from Consensus Forecasts or, in the case of New Zealand, from RBNZ survey.



The **NB** left its interest rate at 0.50% and expects it to be stable until autumn 2018 and then rise gradually. Capacity utilisation in the Norwegian economy will continue to increase, but the output gap will close slightly earlier than the NB previously expected. The NB still expects growth in the housing market and related investment to slow. Fiscal policy will probably be less expansionary than it has been in recent years. Inflation is currently low and will remain below 2.5% in the coming years. The Ministry of Finance, acting on advice from the NB, kept the countercyclical capital buffer rate for banks unchanged at 2%, effective 31 December 2017.

The **SNB** is maintaining the target range for its monetary policy rate (3M LIBOR) in negative territory (at between -1.25% and -0.25%). The rate on banks' account balances with the SNB also remains unchanged at -0.75%. The SNB is still communicating its willingness to intervene in the foreign exchange market as necessary. Despite a slight depreciation of the franc against the US dollar and the euro, the SNB considers the franc to be overvalued. The bank expects GDP growth of around 2% in 2018. It anticipates inflation of 0.5% in 2017. It has slightly increased its forecast for 2018 from 0.4% to 0.7%, and for 2019 it expects 1.1%.

The **RBNZ** left its official rate at 1.75%. According to the RBNZ, monetary policy will remain accommodative for a considerable period. GDP growth in 2017 Q2 was unchanged at 2.5%. The GDP outlook remains positive, supported by accommodative monetary policy, fiscal stimulus and favourable terms of trade. Inflation was 1.9% in Q3. It is expected to decline temporarily in early 2018, but will be at the target level for the rest of 2018. House price inflation is moderate, partly due to a tightening in credit conditions by the RBNZ.

The **BoC** left its key interest rate at 1%. According to the new BoC outlook, the Canadian economy will grow at a faster pace this year (3.1%, as against 2.8% in the previous outlook) and by 2.1% in 2018. The output gap is approximately closed and is estimated to be between -0.5% and 0.5%. Inflation rose to 1.4% in October and will average the same level in 2017. The BoC expects it to return to the 2% inflation target in late 2018. Core inflation measures range between 1.5% and 1.7%.

## 2. NEWS OVER THE LAST THREE MONTHS

### Fed specifies start of balance sheet cuts

At its September meeting, the FOMC specified the start date for the Fed's balance sheet cuts (for more, see the [September](#) and [June](#) CBM). The balance sheet normalisation process began in October. The initial monthly caps on the amount of bonds that will not be reinvested after maturing remain as set by the [Addendum](#) to its September 2014 Policy Normalization Principles and Plans, i.e. USD 6 billion per month for Treasury securities and USD 4 billion per month for MBS.

### ECB develops new overnight benchmark rate

The ECB will develop and administer a new euro unsecured overnight interest rate benchmark before 2020. The rate will complement existing benchmarks produced by the private sector (EURIBOR and EONIA) and will serve as a backstop reference rate. The interest rate will be based entirely on transactions in euro that are reported by banks in accordance with the ECB's money market statistical reporting (MMSR).

### Jerome Powell nominated as next Fed chair

US President Donald Trump announced the nomination of Jerome H. Powell, a Fed governor since 2012, to be Chairman of the Board of Governors of the Federal Reserve System. If confirmed by the US Senate, Powell will replace Janet Yellen, whose four-year term as Fed chief ends in February 2018. Yellen is the first woman to chair the Fed, but will also be the first US central bank chief not to be renominated to a second term since 1979. Janet Yellen then [announced](#) she would leave the central bank once her term as chair ends and would therefore finish her term as governor long before it formally ends in 2024. Powell backed Yellen's direction on monetary policy and it is widely expected that the Fed under his leadership will continue with its current careful monetary policy.

There will be more changes at the Fed next year, as in early November Federal Reserve Bank of New York President William Dudley [announced](#) his resignation for the middle of next year, well before his term ends in January 2019. The New York Fed chief is an important position, as he or she by tradition serves as the vice-chairman of the policy-setting Federal Open Market Committee and has a permanent vote on its decisions.

### Riksbank renews mandates for governor and first deputy governor

The General Council of the Riksbank has unanimously decided to extend Stefan Ingves' mandate as governor of the Riksbank by five years and First Deputy Governor Kerstin af Jochnick's mandate by six years. Stefan Ingves has already served two six-year terms as governor.

### Norges Bank comments on changes to NB law

The Norges Bank (NB) submitted a [consultation response](#) (and its governor commented in a [speech](#)) on a proposal for a new NB law submitted by an advisory commission of the Norwegian Ministry of Finance (see the [September CBM](#)). The NB supports most of the commission's proposals, such as a more precise mandate in the legislation and a broadening of its macroprudential responsibilities to include responsibility for setting banks' countercyclical capital buffer. As for separate management of the Government Pension Fund Global (GPF), the NB suggests a closer examination but admits that the separation may be necessary in context of the future GPF investment strategy. If the GPF remains with the NB, the bank agrees with the creation of an independent committee for monetary policy. If the GPF is separated from the NB, the bank does not see any reason for creating such a committee, as it views its current decision-making structure as adequate.

## Changes in RBNZ management and proposed dual mandate

The five-year mandate of RBNZ Governor Graham Wheeler, who did not seek a second term, ended in September 2017. On his departure, Deputy Governor Grant Spencer became acting head of the RBNZ for six months (for this and other related changes see [here](#)). The appointment of an acting governor should give the new Labour government, formed at the end of October, more time to decide on the appointment of a permanent governor, expected in March 2018. Acting Governor Spencer has also twice [co-signed](#) an agreement on monetary policy targets, first with the outgoing finance minister in September and then with new Finance Minister Grant Robertson in November. Both agreements confirmed the current price stability target (an inflation target of 2% with a 1%–3% band).

Finance Minister Robertson also published [Terms of Reference for the Review of the Reserve Bank Act](#). The most serious proposal of the review is a widening of the RBNZ's mandate to include full employment in addition to price stability. It also proposes instituting a committee to decide on monetary policy; at present, the RBNZ governor is the single decision maker. As an outcome of this review, a draft new RBNZ Act should be introduced in advance of the appointment of the next RBNZ governor.

## [RBNZ to ease macroprudential policy in field of property market lending](#)

The RBNZ decided to undertake a modest easing of the macroprudential conditions in the field of property market lending as from January 2018. Over the past six months, the RBNZ has seen pressures in the housing market moderate due, among other things, to the tightening of loan-to-value restrictions (LVRs) in October 2016 (see the [September 2016 CBM](#)). From January 2018, no more than 5% of bank lending to residential property investors can be at LVRs of more than 65% (currently 60%) and no more than 15% of lending (currently 10%) to owner-occupiers can be at LVRs of more than 80%. The RBNZ will monitor the impact of these changes and will only make further LVR adjustments if financial stability risks remain contained.

## Bank of England modernises website

Bank of England in December modernised the design, slightly improved the structure and edited content of its [website](#). The site is also adapted to the needs of mobile devices. Beginning with the November Inflation Report, BoE also began publishing a [visual summary](#) of its most important data and information on a separate website. The visually attractive design, fully customized for mobile devices, provides the most interesting and essential information in a nutshell.



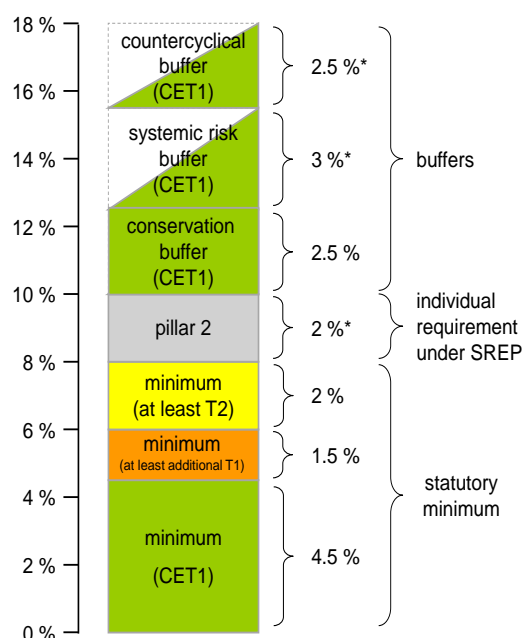
### 3. SPOTLIGHT: RAINY DAY FUNDS?

*This article looks at the countercyclical capital buffer, one of the macroprudential instruments requiring financial institutions to create, in good times, a capital buffer for bad times. The countries traditionally monitored in CBM are surveyed to illustrate the various ways in which the buffer rate is set. The article also describes why the countercyclical capital buffer was introduced, how it works and how it can be loosened.*

Financial crises are costly in terms of economic activity in both the short and medium term. The huge negative impacts of financial crises have necessitated the introduction of a series of new measures designed to avert such situations or at least to mitigate their consequences (such as GDP contraction, increased unemployment and losses incurred by financial institutions and covered by state budgets). Two main streams of global regulatory change have emerged in the wake of the most recent financial crisis: a need to enhance banks' resilience to shocks and a need to safeguard their ability to absorb losses and recapitalise from their own resources, i.e. without using state or taxpayers' funds. These two main streams have shaped the macroprudential policy framework at both national and supranational/international level. Specific instruments are being created within this framework to mitigate systemic risks and reduce the frequency and depth of financial crises. These instruments differ in terms of what problems in the financial system they are targeted at and how they are applied.

In December 2010, the Basel Committee on Banking Supervision (BCBS, operating under the Bank for International Settlements, BIS) issued a [Global regulatory framework for more resilient banks and banking systems](#), abbreviated as Basel III. The framework sets out detailed global regulatory rules for capital adequacy and bank liquidity, including a countercyclical capital buffer (CCyB), and applies to the BIS member states, including the EU countries<sup>1</sup> (each EU country assesses the need to introduce the CCyB at national level). In order to set the CCyB, all the countries monitored in CBM have adopted a single approach based on the recommendations of the BCBS and (for EU countries) the European Systemic Risk Board (ESRB).

In line with the above recommendations, further capital requirements (known as buffers) are being added to the existing basic minimum requirement applicable to all banks (Pillar 1, totalling 8%)<sup>2</sup> and the 2% Pillar 2 requirement. They comprise a capital conservation buffer (CCB), a countercyclical buffer and a systemic risk buffer (SRB). In simplified terms, these buffers are calculated on the basis of banks' total risk exposures (risk-weighted assets). The rule is that banks must comply with the minimum capital requirement (the minimum capital ratio) in both the upward and downward phases of the financial cycle. For each of the other buffers, the compliance duty depends on its specific target. Overall, banks may hold buffers of between 8% and about 18%



Note: The capital quality requirement is given in parentheses. \* denotes the possibility of a higher-than-stated value. SREP: Supervisory Review and Evaluation Process.

Source: CNB Financial Stability Department.

<sup>1</sup> The key documents for EU countries are the Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR).

<sup>2</sup> The basic minimum capital requirement (the ratio of capital to risk-weighted assets) is referred to as the (minimum) capital ratio and indicates banks' ability to absorb risk.

depending on their importance in the domestic financial system and on the position of the economy in the financial cycle. Naturally, banks are subject to no ceiling on the amount of capital they can hold, but they do run into constraints as regards their efficiency, or their performance relative to the risks they undertake.

### **Why was the CCyB introduced and how does it work?**

The CCyB is intended to protect the banking sector against risks arising from its behaviour over the financial cycle. In the spirit of the new regulation, banks should, in the upward phase of the financial cycle (characterised by rapid credit growth), create a sufficient buffer to cover losses caused by the economy moving into the downward phase. As soon as risks materialise, the buffer should be released and banks should be able to use the reduced capital requirement to keep supplying credit to the sound part of the economy. In addition, as the buffer is formed, growth in loans, especially those with a riskier profile, may be contained, and that, in turn, will be reflected in the capital requirements. However, this phenomenon is merely a possible side-effect of creating the buffer, not the primary purpose of the tool. As a rule, the competent authority announces the CCyB rate on a quarterly basis and banks usually have 12 months to incorporate the new rate into their business plans.<sup>3</sup> The buffer is thus phased in gradually and institutions can adjust to it.

### **How is the CCyB rate set?**

The starting point for setting the CCyB rate is to determine the deviation of the credit-to-GDP ratio from its long-term trend (the "credit-to-GDP gap"). Under the relevant ESRB Recommendation,<sup>4</sup> total credit means the value of all loans provided to the domestic private sector (non-financial corporations, households and non-profit institutions serving households) plus holdings of bonds issued by the domestic private non-financial sector. The long-term trend is calculated using the longest available time series and, in accordance with the ESRB Recommendation, the Hodrick-Prescott filter with a smoothing parameter ( $\lambda$ ) of 400,000. The gap is used to derive the benchmark CCyB buffer rate, which lies in the range of 0–2.5%,<sup>5</sup> although a rate exceeding 2.5% is allowed by national law in all the countries we monitor. This methodology may not suit all countries, especially those that have experienced structural breaks. Each country therefore has room to adjust the methodology or expand the range of approaches used. The credit-to-GDP gaps in selected economies are plotted in Chart 1.

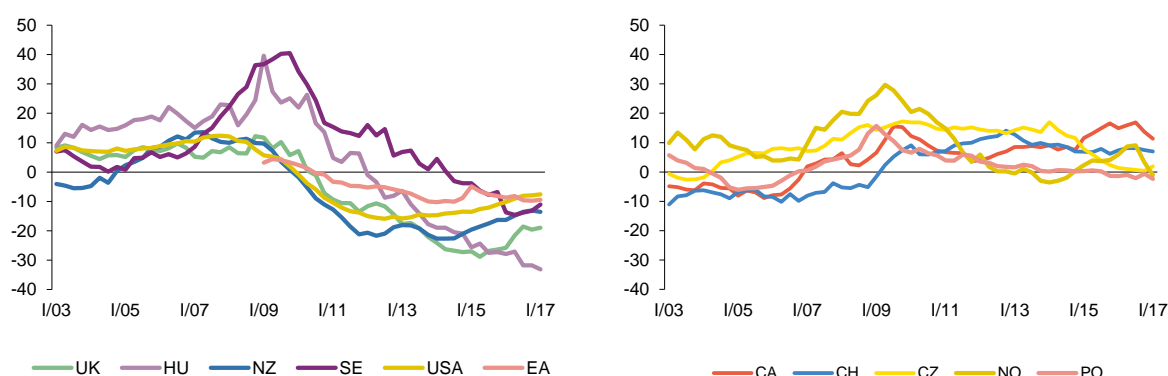
The resulting CCyB rate for each financial institution is computed as a weighted average of the CCyB rates in countries where the bank's exposures are located.<sup>6</sup> The aggregate buffer rate is thus determined not only by the size of the domestic benchmark CCyB buffer rate multiplied by the institution's total domestic risk exposure (risk-weighted assets), but also by the CCyB rates applied to the bank's relevant foreign exposures. For exposures in European Economic Area (EEA) countries, the rate is adopted if it is lower than 2.5%. If it is higher, banks may either accept it or opt for a rate of 2.5%. In the case of exposures in third countries, a rate of less than 2.5% may be either accepted or increased to 2.5%. If the rate is higher, the same rule applies as in the case of EEA countries. As well as the CCyB rate, EU member states are obliged to publish the credit-to-GDP gap and the corresponding calculated benchmark buffer rate on a quarterly basis. Other countries are not as strict.

<sup>3</sup> Switzerland sets its CCyB rate once a year and banks are given 3–12 months to adjust. The USA also sets the rate once a year. EU Member States, conversely, are obliged to set the CCyB rate every quarter.

<sup>4</sup> Recommendation of the European Systemic Risk Board of 18 June 2014 on guidance for setting countercyclical buffer rates (ESRB/2014/1).

<sup>5</sup> The benchmark buffer rate is non-zero if the gap is equal to or greater than 2 pp. The following formula is used for larger gaps of up to 10 pp: benchmark buffer rate =  $0.3125 \times (\text{gap}) - 0.625$ . Gaps exceeding 10 pp are assigned a benchmark buffer rate of 2.5%.

<sup>6</sup> The weights are the capital requirements for credit risk pertaining to private credit exposures subject to the countercyclical capital buffer (in particular corporate and retail exposures).

**Chart 1 Credit-to-GDP gaps**

Source: BIS calculations and data. Note: The left-hand chart shows countries with negative gaps and the right-hand chart countries with positive or near-zero gaps.

However, the credit-to-GDP gap is only an initial guide to setting the CCyB rate. If countries based their decisions solely on this gap, it is likely that only Canada and Switzerland would have set non-zero CCyB rates to date. However, Norway and Sweden have been applying non-zero CCyB rates since 2013 and 2014 respectively. These countries are experiencing sharp growth in household debt and rapidly rising property prices. Given the complexity of the financial system, it follows that the competent authorities also consider systemic risks and risks forming in other segments and markets. Most of these CCyB rate-setting authorities therefore use additional indicators and analyses to assess the condition of the financial system and to determine the position of the economy in the financial cycle. For instance, they measure loans in various ways, not only on an aggregate basis, but also for individual segments (households and non-financial corporations), and take into account credit growth as well as the credit-to-GDP ratio. Property price growth indicators and the price-to-income and price-to-GDP ratios are also used (see Table 1). It should be noted that risks often form in a hidden and non-linear way. They can link up and thus create domino effects and multiply. It would therefore be insufficient and – given the complexity of the entire issue – undesirable to set the CCyB rate mechanically on the basis of the credit-to-GDP gap alone. So, when setting the CCyB rate, the competent authority monitors a whole range of information, with expert judgement also playing a significant role.

**Table 1 Overview of CCyB rates and relevant indicators**

	Current rate (applicable since)	Announced rate (applicable from)	Decision-making authority	Indicators (other than the gap**)
<b>Euro area*</b>	Only Slovakia 0.50% (08/17)	Slovakia 1.25% (11/18)	National Bank of Slovakia	Wide set of credit indicators, differing from country to country
<b>USA</b>	0% (10/17)	-	Regulator/supervisor/Federal Reserve Board of Governors depending on institution	No fixed set, wide range of indicators
<b>UK</b>	0.5% (6/18)	1.0% (11/18)	Financial Policy Committee (FPC)	Credit growth, interest rate on mortgage loans and loans to non-financial corporations, banking sector indicators, market risk indicators, external imbalances
<b>Sweden</b>	2.0% (03/17)	-	Regulator/ supervisor	Wide set of credit indicators, e.g. property market indicators (price-to-income and price-to-rent ratios), household debt serviceability, capital ratio, leverage ratio, stock prices, external imbalances, etc.

<b>Norway</b>	1.5% (06/16)	2.0% (12/17)	Government (supervisor and central bank have advisory role)	Gap** expressed in segments, price-to-income ratio, commercial property price growth, bank financing indicator
<b>Poland</b>	0% (01/16)	-	Ministry of Finance; Financial Stability Committee on Macroprudential Supervision (FSC-M) makes recommendation	No fixed set mentioned, only indicators of cyclical systemic risks generally
<b>Hungary</b>	0% (01/16)	-	Magyar Nemzeti Bank	Own calculation of credit-to-GDP gap, potential overvaluation of property prices, growth in loans to firms and households, external imbalances, strength of banks' balance sheets, potential bad risk assessment; also risk map
<b>New Zealand</b>	-	-	RBNZ	No stable set, wide range of indicators
<b>Switzerland</b>	0% (02/17) 2% (01/14)***	-	Government (supervisor and central bank have advisory role)	Primarily credit-to-GDP gap
<b>Canada</b>	-	-	Bank of Canada and/or regulator/supervisor	No fixed set, wide range of indicators

Source: ESRB, BIS, individual central banks.

Note: \* different in individual countries; of the EA countries, only Slovakia has a non-zero CCyB rate. \*\* credit-to GDP gap. \*\*\* applies solely to mortgage loans financing residential property located in Switzerland; as this is a [specific sectoral requirement](#), mandatory reciprocity as foreseen in Basel III does not apply to it.

### Could the equilibrium CCyB rate be non-zero?

The Bank of England's Financial Policy Committee (FPC) intends to set a non-zero CCyB before the level of risks becomes elevated. The FPC recommends maintaining the rate in the region of 1% in normal times when systemic risks are judged to be neither subdued nor elevated. In this context, one can therefore reflect on whether the equilibrium CCyB rate is zero or whether it is higher and, if so, what it might be. The equilibrium CCyB rate in the UK seems to be 1%. The rate currently applied in the UK is 0.5%. This rate was set (temporarily) at 0.5% in the past, but was lowered to zero due to Brexit-related uncertainty and later increased back to 0.5%. The FPC decided in November to raise the CCyB rate by another 0.5% to 1% with effect from 28 November 2018.

### How can CCyB policy be loosened?

The CCyB rate can be reduced either gradually or to zero in one go. For example, the Hungarian central bank (despite applying a zero CCyB rate) has put in place a procedure defining conditions for loosening CCyB policy. It will reduce the rate to zero in one step if a financial crisis occurs. It will make such a decision if the rapid-reaction stress indicator (REPSI) exceeds a threshold value. However, it is prepared to reduce the CCyB rate gradually if (i) the growth rate of the nominal credit aggregate declines for three consecutive quarters, (ii) the CCyB guide rate has not increased in any of the last four quarters, (iii) the REPSI level signals no systemic risk exceeding the usual degree.

The other banks we monitor have not made any binding commitment to the public specifying the action they would take to loosen CCyB policy. Nevertheless, in line with the definitions contained in the BCBS/ESRB methodology, they envisage such action being likely at times of increased financial stress and rising credit losses. Except for the above-mentioned annulment of the CCyB policy loosening in the UK in July 2016 due to Brexit-related risks, however, none of the economies has released a CCyB set in accordance with the BCBS/ESRB methodology.

**Conclusion**

The countercyclical capital buffer is a broad-based macroprudential policy tool. It is released after financial risks begin to materialise. So, despite being intrinsically forward-looking, it is not used primarily to avert problems in the financial sector. There is clearly a need for a sufficient and timely buffer to cover a satisfactory proportion of any future losses. While the buffer is being built up, it is not known when it will be used, nor can future losses be accurately quantified.

#### 4. SELECTED SPEECH: A CHALLENGING DECADE AND A QUESTION FOR THE FUTURE

*Outgoing Fed Chair Janet L. Yellen, in a [speech](#) given in Washington in October, described how Fed policy makers coped with the problems arising from the financial and economic crisis.*

Ten years ago, the Federal Open Market Committee (FOMC) confronted a key challenge: how to pursue its mandated goals of maximum employment and price stability once the main conventional policy tool, the federal funds rate, had been lowered to essentially zero. Addressing that problem led to a second challenge: how to scale back monetary policy accommodation in an orderly fashion once it was no longer needed.

Yellen is convinced that the Fed met the first challenge and has made good progress in meeting the second. The US economy is much stronger today than it would have been without the unconventional monetary policy tools deployed. Key tools were large-scale asset purchases and forward guidance about the future path of short-term interest rates. Given its inability to lower short-term interest rates after they reached near-zero in late 2008, the FOMC used these measures to apply downward pressure on longer-term interest rates. The goal of lowering longer-term interest rates was to help the US economy recover from the recession and stem the disinflationary forces that emerged from it. Some have suggested that the slow pace of the recovery proves that these unconventional policy tools were ineffective. However, one should recognise that the recovery could have been much slower in their absence. The evidence suggests that forward guidance and securities purchases – by substantially lowering borrowing costs – helped spur consumption and business spending, lower the unemployment rate and stave off disinflationary pressures. Other central banks also deployed unconventional policy tools in the years that followed the financial crisis and their experience also supports the notion that these tools have helped stimulate economic activity.

After the US economy began to recover, the Fed's focus shifted from providing additional monetary policy accommodation to scaling it back. A key question was how to reduce the degree of accommodation in the context of a vastly expanded Fed balance sheet. One possible approach was to start by reducing securities holdings while short-term interest rates remained at the lower bound. The FOMC, however, did not have any experience in calibrating the pace and composition of asset sales. And as the so-called taper tantrum of 2013 illustrated, even talk of prospective changes in the Fed's securities holdings can elicit unexpected abrupt changes in financial conditions. For that reason, the FOMC in September 2014 announced that changes in the Fed's securities holdings would play a secondary role in the normalisation strategy and the overall size of the Fed's securities holdings would stay at an elevated level until sometime after the FOMC had begun to raise short-term interest rates. The subsequent reduction of the size of the balance sheet would be gradual and predictable and would be done passively by not reinvesting all of the principal payments from the Fed's securities.

Another issue in the post-crisis environment was whether and how the FOMC would be able to influence short-term rates. Before the crisis, the FOMC could raise the federal funds rate by removing a small amount of reserves from the banking system. The post-crisis excess of reserves, however, precluded that. This problem was solved by the Congress granting the Fed the authority to pay interest on excess reserves. This allows the Fed to influence short-term interest rates regardless of the amount of excess reserves in the banking system.

Yellen believes that targeting the federal funds rate should be the Fed's primary tool. Still, the deployment of unconventional policy tools should be considered again if the federal funds rate reaches its lower bound and the economy still needs further monetary policy accommodation. Evidence suggests that the neutral level of short-term interest rates is lower than in previous decades. Unconventional policy tools will therefore probably be needed again, as a less severe economic downturn might drive short-term interest rates back to their effective lower bound.

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