Centralna banka Bosne i Hercegovine

How should monetary, fiscal and financial policies be coordinated?

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The views and opinions expressed in this presentation are those of the author, and do not necessarily reflect the position of the CBBH.

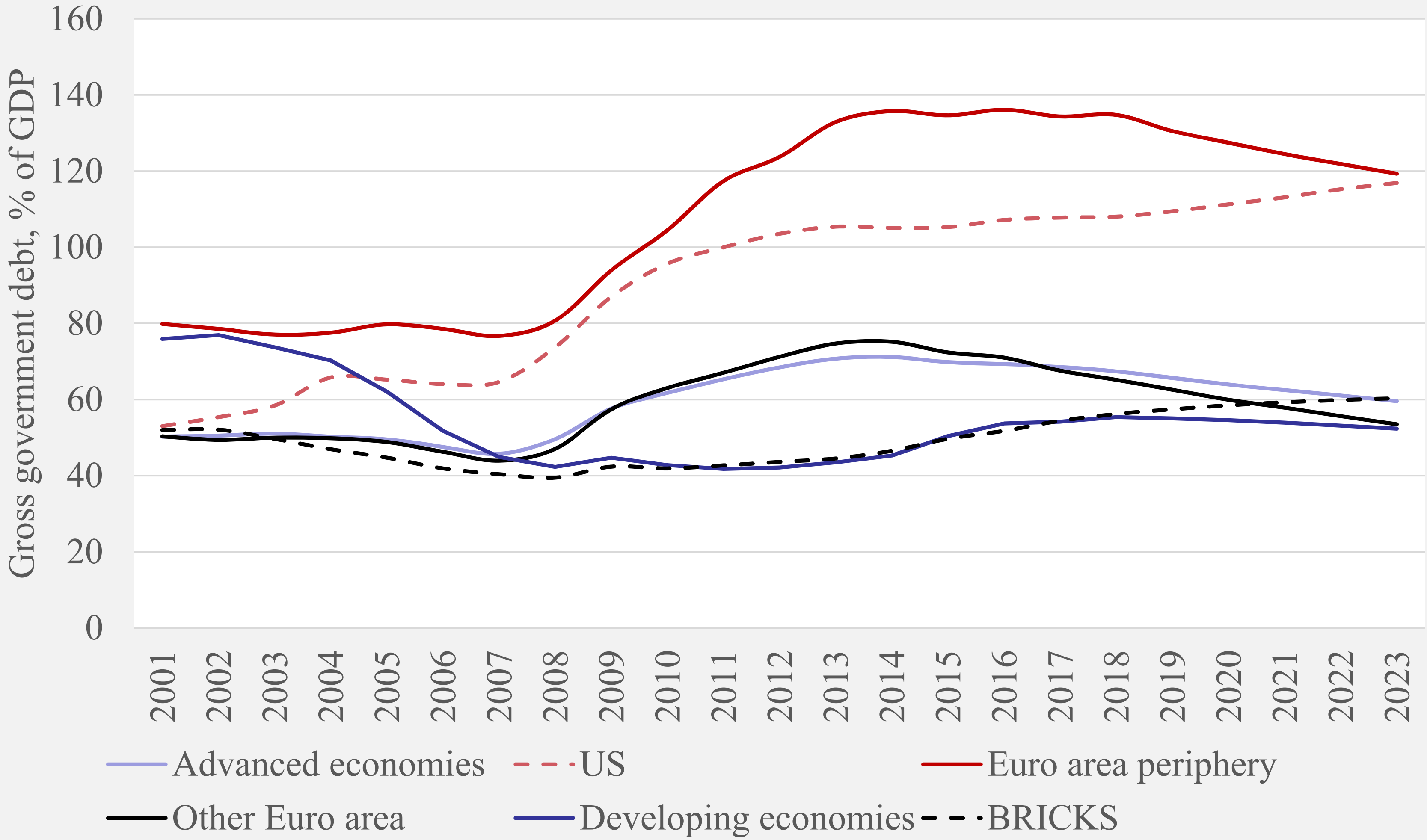
What are the tools at disposal to respond to large shocks?

- Fiscal side
  - ➢ Tax cuts
  - ➢ Increased government spending
- MP tools
  - ➢ Conventional (reducing interest rates)
  - ➢ Unconventional (expanding the central bank‘s balance sheet)
- FS tools
  - ➢ Microprudential (LTV and DTI ratios, stress tests)
  - ➢ Macroprudential (the countercyclical capital buffers)

Carvalho and Castro (2016)

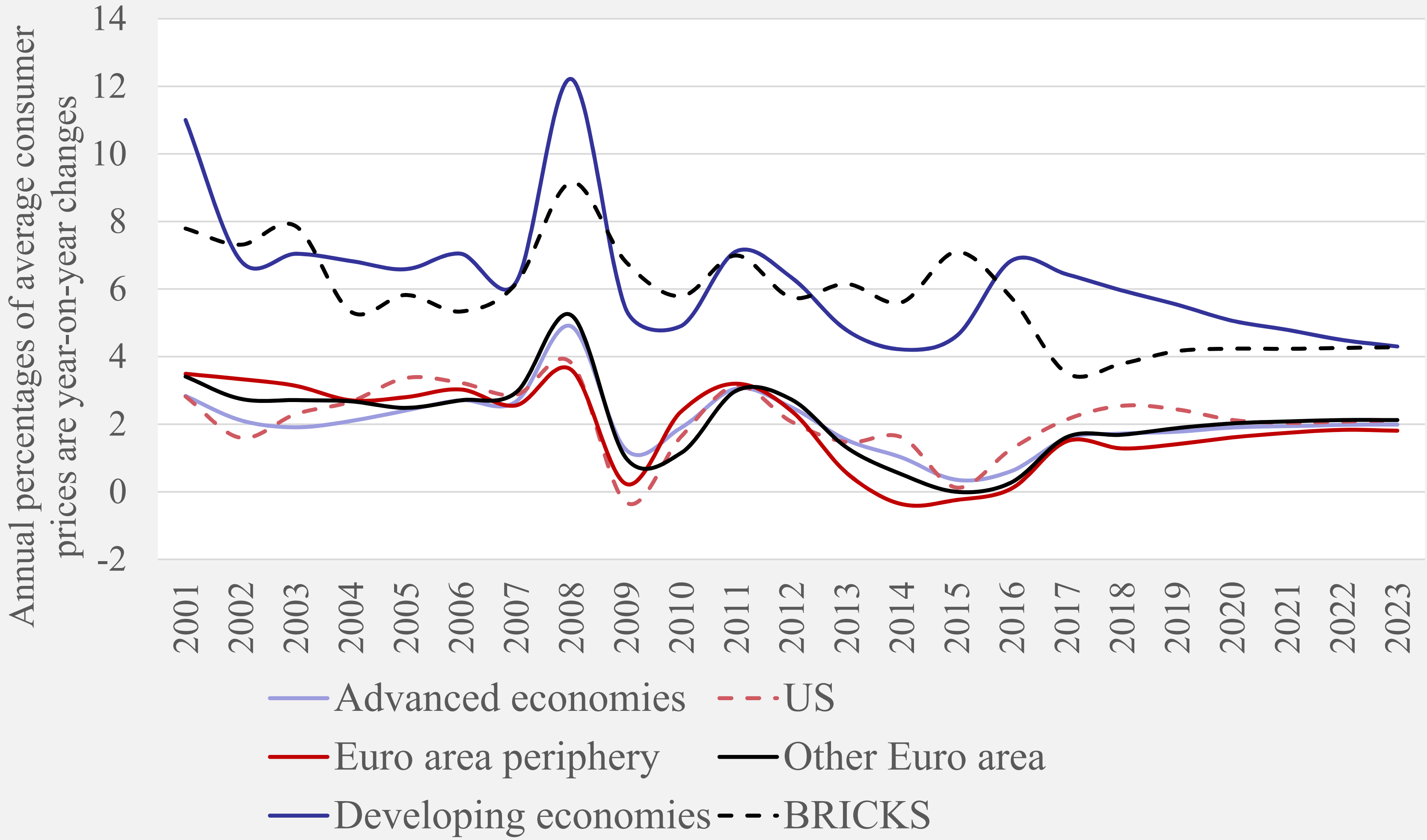
- The optimal combination is comprised of a fiscal policy that is anticyclical in the business cycle and slightly procyclical in the credit cycle (with the former dominating), a very aggressive countercyclical response of the CCyB to the financial cycle and a monetary policy that strongly reacts to inflation and business cycle.
- The gains from implementing a fiscal policy that reacts to both the fiscal and financial cycles are minor if macropru policy is not allowed to countercyclically react to the financial cycle.
- Finally, the optimal fiscal response will depend on the specific source of the shock given its particular influence on credit dynamics.

Fiscal capacity is reduced in some developed countries



Source; IMF WEO; April 2018.
Euro area periphery: PT, ES, IT, GR.

Monetary policy cushion is relatively small by historical standards



Source; IMF WEO; April 2018.

Euro area periphery: PT, ES, IT, GR. Venezuela is excluded from the sample.

Space for financial stability response is there, but underutilized

- Microprudential tools do not alter the post-stress level of capital
- The CCyB are currently non-zero only in a handful of countries:
  - Hong Kong (SAR) 1.875% (2.5% as of 01/19)
  - Sweden 2%
  - Norway 2%
  - U.K. 0.5% (1% as of 28/11/18)

  Rosengreen also mentions Iceland and Slovakia at 1.25%, and Czech Republic with 1% in June 2018, the latter aiming 1.25% towards the end of the year. Also, Lithuania had CCyB at 0.5% with implementation date as of the end of 2018.

Thank you for your attention.