EUROPEAN CENTRAL BANK

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Governing Council statement on macroprudential policies

2 November 2022

The Governing Council of the European Central Bank (ECB) is releasing the following statement following the meeting of its Macroprudential Forum Steering Committee on 28 September 2022:

In many countries participating in European banking supervision, macro-financial vulnerabilities have increased in recent years and over the course of the coronavirus (COVID-19) pandemic. While the build-up of vulnerabilities has been particularly pronounced in some residential real estate markets, it has also occurred more broadly on the back of robust credit growth and increasing indebtedness in the non-financial private sector in some countries. Against this background, the Governing Council acknowledges and endorses the warning on vulnerabilities in the Union financial system issued by the European Systemic Risk Board on 22 September 2022.

To address medium-term risks stemming from the identified vulnerabilities, several macroprudential authorities have already gradually tightened capital-based and/or borrower-based macroprudential measures. Some of these measures were put in place in late 2021 or in 2022, after the pandemic slowdown had started to ease. Currently, ten countries participating in European banking supervision have announced or implemented a positive rate for the countercyclical capital buffer, seven countries have announced or implemented a positive rate for the (sectoral) systemic risk buffer, and 15 countries have applied some form of borrower-based measures.

The outbreak of war in Ukraine has made the macro-financial situation more challenging, compounding existing vulnerabilities and increasing the likelihood of risk materialisation in the near term. Thus far, both financial and non-financial sectors in Europe have proved to be resilient to increasing geopolitical tensions and economic uncertainty, and both households and firms have retained sound access to bank credit. Nevertheless, weaker economic growth, higher inflation and tighter financing conditions weigh on the debt servicing capacity of non-financial corporations and households, although there are mitigating factors such as corporate cash buffers, household savings, and thus far resilient labour market conditions. At the same time, further geopolitical or economic shocks may trigger or aggravate risk materialisation.

In this challenging macro-financial environment, macroprudential capital buffers help to preserve and strengthen resilience in the banking sector. Regulatory advances and an active use of prudential policies since the Global Financial Crisis have resulted in stronger bank balance sheets and capital positions. While the sector is generally well-positioned to withstand economic adversity, some national authorities and the ECB are exploring whether an increase of macroprudential capital buffers in some countries with still robust macroeconomic conditions and macro-financial imbalances is still warranted to preserve resilience and ensure that banks are able to withstand systemic risks, should they materialise at a later point in time. While an early activation of buffers has benefits, an increase in buffer rates can be beneficial also late in the economic or financial cycle, provided that procyclical effects are avoided. This would serve to shield against vulnerabilities that have accumulated in the past and address risks that may be associated with a reversal of the credit cycle. It would also give authorities greater leeway to make capital available for use when needed by releasing these buffers if and when adverse developments materialise. In turn, this would boost the capacity of banks to absorb losses while continuing to provide key financial services to the real economy when needed the most.[1]

At the same time, the macroprudential policy response should consider the current near-term headwinds to economic growth, to avoid that an increase in capital buffers results in an excessive tightening of credit conditions at the current juncture. In most countries, the existing capital headroom above regulatory requirements, coupled with the ability for banks to retain profits, mitigates the risk of procyclical consequences (i.e. tighter lending conditions) arising from an increase of macroprudential capital buffers. Nevertheless, possible macroprudential policy responses need to take into account the highly volatile and uncertain course of the energy crisis in Europe and should be properly tailored to the specific conditions in each country.

Finally, financial stability risks in the non-bank financial sector should also be addressed from a systemic risk perspective. This requires tackling identified vulnerabilities and increasing the resilience of non-bank financial institutions and market-based finance. While this is beyond the scope of European banking supervision, it nevertheless stands as a critical issue for banks' management of counterparty risk and is very relevant from an overall financial stability perspective.

1 Evidence from the pandemic indicates that a release of buffers like the countercyclical capital buffer when adverse developments materialise can mitigate the potentially procyclical behaviour of the banking system in periods of economic distress (for further details and discussion, see e.g. the special feature entitled "Bank capital buffers and lending in the euro area during the pandemic", *Financial Stability Review*, ECB, November 2021).

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For specific terminology please refer to the ECB glossary (available in English only).