

Frank Elderson: Family ties - ten years of monetary policy and banking supervision under one European roof

Dinner speech by Mr Frank Elderson, Member of the Executive Board of the European Central Bank and Vice-Chair of the Supervisory Board of the European Central Bank, at the 2024 Annual ECB Banking Supervision Research Conference, Frankfurt am Main, 11 June 2024.

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Like many events this year, the Annual ECB Banking Supervision Research Conference is celebrating the tenth anniversary of European banking supervision under the Single Supervisory Mechanism (SSM). Ten years of the SSM also means ten years of monetary policy and banking supervision living under the same roof. It means ten years of ECB Banking Supervision existing alongside the ECB's central banking arm and benefiting from the same shared services that are critical for effective monetary policy and banking supervision. And one could also say ten years of close family ties between the experts working in monetary policy and banking supervision, both here in Frankfurt and across Europe in the European System of Central Banks and the Single Supervisory Mechanism.

And like all families, ours is unique.

One distinctive institutional feature of European banking supervision is the separation principle that applies between the ECB's monetary policy and supervisory tasks. The former targets price stability and the latter strives to keep banks safe and sound. Under this set-up, the ECB has a Governing Council, which takes monetary policy decisions, and a separate and independent Supervisory Board. The Supervisory Board proposes draft supervisory decisions to the ECB's Governing Council, which can adopt or reject these decisions, but not modify them. The separation principle ensures that each function is carried out in accordance with its specific objectives and prevents potential conflicts of interest.

The Governing Council is chaired by Christine Lagarde and the Supervisory Board by Claudia Buch. In addition, the Supervisory Board has a Vice-Chair who is chosen from among the members of the ECB's Executive Board. I currently hold this role. And this comes with the great privilege of being the one person who participates in all the key decision-making bodies of our unique ECB family, for both monetary policy and banking supervision.

In my remarks this evening, I will explain how our decade-old ECB family is about more than just sharing an institution, a roof and a Vice-Chair. Though pursuing different objectives, our monetary policy and banking supervision functions have several of the same characteristics: their focus on stability, a commitment to their respective mandates, their attitude towards risks, and the challenges they will face in the years and decades to come.

The origins and achievements of European banking supervision

Our common ties can be traced back to the origins of European banking supervision.

The SSM was born out of crisis. In the years leading up to the establishment of European banking supervision, the euro area economy was struggling to recover from the great financial crisis and the euro area debt crisis. Financial crises and financial fragilities led to de-risking and deleveraging, which had negative repercussions on economic growth and the inflation outlook. Back then, weaknesses in the banking sector hindered the transmission of our accommodative monetary policy into similarly favourable financing conditions for companies and citizens. These obstructions to the transmission mechanism made it much more difficult for the ECB to maintain price stability.

Ultimately, the persistent weaknesses in the European banking sector led governments to establish the banking union. In addition to European banking supervision through the SSM, with a central role for the ECB, the banking union would include a Single Resolution Mechanism and a European deposit insurance scheme, although this third pillar is yet to be implemented. One of European banking supervision's achievements has been the strong culture of cooperation within our pan-European joint supervisory teams, who use a harmonised supervisory methodology that ensures the same standards are applied across all supervised banks. This has helped to significantly reduce risks in the European banking sector and increase the resilience of European banks.

The efforts of European banking supervision have paid off. This became clear during the pandemic, which was the first major crisis since the creation of the banking union. Instead of being sources or amplifiers of shocks like in previous crises, banks proved to be resilient to the pandemic shock. In fact, they were able to help dampen it by extending credit to citizens and companies that had experienced a sudden loss of income. Unlike during the crises that predated the banking union, banks were no longer part of the problem, but part of the solution. Of course, it should be kept in mind that they were able to do so in a context of massive fiscal support to citizens and companies and accommodative monetary policy.

Sound banks and effective monetary policy transmission

So where do we stand now? Let me start with the positives, but I must stress that these are no reason to be complacent.

On the banking supervision side, we see that European banks still have robust fundamentals, including sound capital positions and liquidity buffers. Levels of non-performing loans are relatively low, although they have started to increase recently. Thanks to their generally sound starting position, banks have been able to smoothly navigate the adverse macro-financial conditions seen since the end of the pandemic, such as increasing interest rates, geopolitical shocks and the banking sector turmoil in March 2023.

Meanwhile, on the monetary policy side, we have explicitly recognised the importance of safe and sound banks for our price stability mandate since July 2021, when we concluded our strategy review. Specifically, we acknowledge that financial stability is a precondition for price stability. Moreover, monitoring the transmission mechanism of

monetary policy – including how banks pass on our policy decisions – is a key consideration when calibrating our monetary policy. We made this very clear in our communication since we started to tighten monetary policy. In addition to the inflation outlook and the dynamics of underlying inflation, assessing the strength of monetary policy transmission is a key element of our reaction function. The safety and soundness of banks has not only made them resilient to the unprecedented increase in policy rates, which went from -0.5% in July 2022 to 4.0% in September 2023. It has also enabled them to pass on our policy rate increases in an effective and orderly fashion, ensuring that broader financing conditions evolved in line with our monetary policy intentions. Having said that, pass-through would have even been stronger had there been tougher competition for deposits in Member States.

From last September up to last week, a period when we kept policy rates on hold, we saw a continued strong and effective transmission of monetary policy. By keeping broader financing conditions restrictive, monetary policy has made a major contribution to bringing inflation back down from high levels. That is why, at last week's meeting of the ECB's Governing Council, we considered it appropriate to moderate the degree of monetary policy restriction by lowering our key interest rates by 25 basis points.

Banks have proven resilient, and inflation is continuing its downward trend. You might therefore expect both sides of the ECB family to be generally content with the progress made in the pursuit of their objectives in the recent tumultuous years. But we are also a family that doesn't easily declare victory, is always on the alert, and we warn of complacency in view of looming risks and lingering fragilities that may affect price stability and the safety and soundness of banks in the future. This is ingrained in our family DNA for all our tasks and responsibilities.

Such caution is particularly called for in today's macro-financial environment, which has been very much in flux in recent years amid changes in the economic outlook, geopolitical shocks, and challenges related to global heating, nature degradation and digitalisation. We expect this period of elevated uncertainty to continue, bringing challenges for both banking supervision and monetary policy. Indeed, the risks and trends identified in our monetary policy strategy and our supervisory priorities for the years ahead are very similar.

Common challenges ahead

So what will these challenges in the macro-financial environment imply for our tasks?

First, our objectives will become even more important. Price stability and sound banks provide an anchor that makes an economy – and therefore a society – more resilient to shocks. The more frequent and intensive the shocks, the more vital a secure anchor. For it is in choppy, not calm, waters when a ship truly benefits from its anchor.

At the same time, the types of shock hitting the economy and the financial system will become more complex to assess. But an accurate assessment is crucial to gauging the potential risk to price stability or to the soundness of banks, as well as the appropriate policy response.

Take the example of the ongoing and worsening climate and nature crises. We know that manifestations of physical risk – like floods, fires, droughts and extreme weather events – are on the rise. Governments are acting to support the green transition, while pursuing climate adaptation measures is becoming ever more important. A relevant question is whether climate and nature shocks can be fully captured by the traditional categorisation of demand, supply and financial shocks used in most macroeconomic models. In that vein, my fellow ECB Executive Board member Isabel Schnabel has suggested thinking about the impact of climate change on inflation in terms of "climateflation", "fossilflation" and "greenflation".¹ Even if such concepts can be mapped analytically into the more traditional type of shocks, we need to learn more about the exact mechanisms before being able to draw the appropriate conclusions for monetary policy.

Something similar applies on the banking supervision side. The Basel Committee on Banking Supervision has established that climate-related risks translate into the traditional types of risk that banks consider², covering credit risk, liquidity risk, market risk and operational risk, including litigation risk.³ However, here too, the exact mechanisms of mapping actual hazards to risks needs to be analysed further to fully capture climate and nature-related factors in quantifiable regulatory and supervisory requirements.

These are vitally important questions as global heating, nature degradation and transition and adaptation policies have a profound impact on the economy and the financial system. As Supervisory Board Chair Claudia Buch underlined in her opening address, research has an important role to play in supporting monetary policy and supervision in respect of these and other major challenges like the impact of geopolitical risks and the digital transition.⁴

Some of these themes will feature at this conference tomorrow. And on the monetary policy side, we recently established a new research network known as Challenges for Monetary Policy Transmission in a Changing World (ChaMP). The ChaMP network seeks to revisit our knowledge of monetary transmission channels in the context of unprecedented shocks and structural changes.⁵ Through conferences such as this one, initiatives like the ChaMP network, and many other interactions with the research community, we seek your inspiration, ideas and insights to address the challenges facing monetary policy and banking supervision in the future.

Conclusion

Let me wrap up.

Ten years ago, we at the ECB saw our family grow with the establishment of the SSM.

Ten years on, European banking supervision has made great strides in making banks more robust and resilient. This has helped strengthen the European economy in general while also enhancing the effectiveness of monetary policy.

In the next ten years, the two strands of our family will continue to pursue their respective objectives, no matter what challenges may emerge. They will do so under one roof, in line with the separation principle and united in their commitment.

Thank you for your attention.

¹ Schnabel, I. (2022), "[A new age of energy inflation: climateflation, fossilflation and greenflation](#)", speech at a panel on "Monetary Policy and Climate Change" at The ECB and its Watchers XXII Conference, 17 March.

² Basel Committee on Banking Supervision (2021), [Climate-related risk drivers and their transmission channels](#), BIS, April.

³ On litigation risk, see Elderson, F. (2023), "[Come hell or high water: addressing the risks of climate and environment-related litigation for the banking sector](#)", keynote speech at the ECB Legal Conference, 4 September.

⁴ Buch, C. (2024), "[Current challenges in supervision – new challenges for researchers](#)", keynote speech at the 2024 Annual ECB Banking Supervision Research Conference, 11 June.

⁵ The ChaMP network recently held its inaugural conference. See [Inaugural conference of the ChaMP Research Network – Challenges for Monetary Policy Transmission in a Changing World \("ChaMP"\)](#).