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A Holistic Approach to ECB Monetary Policy and Prudential Supervision

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Matthias Goldmann: current legal framework of EMU does not require separation of monetary policy and financial supervision



When prudential supervision was put in the hands of the European Central Bank (ECB), it was the political understanding that the ECB should follow a policy of meticulous separation of monetary policy and financial supervision. However, the financial crisis showed that monetary policy and prudential supervision deeply affect each other and that an overly strict separation might generate systemic risk. As a consequence, the functional separation of monetary policy and financial supervision has been questioned and calls for a more holistic approach have become louder.

Such a holistic approach – the mutual consideration of financial stability concerns in the making of monetary policy, and of monetary policy concerns in prudential supervision – would not contradict the current legal framework of the Economic and Monetary Union. While the political process leading to the adoption of the EU Regulation on the Single Supervisory Mechanism (SSM) generated the impression that “Chinese Walls” would separate the monetary and supervisory prongs of the ECB, the legal shape taken by these walls turns out to be much more porous than expected.

However, the realization of a holistic approach might intensify – already existing – doubts of the democratic legitimation of the ECB under the framework of the ESCB, as it would increase its discretionary powers. Nevertheless, the independence of the ECB should be maintained. New solutions for the time inconsistency problem that would render the central bank’s independence moot are not available. Therefore, given the great importance of the autonomy of the European institutions for the European integration, instead of stripping the ECB of its independence, the democratic control over the ECB should be strengthened.

More on this topic: Matthias Goldmann: "Monetary Policy and Prudential Supervision (<http://safe-frankfurt.de/policy-center/policy-publications/policy-publ-detailsview/publicationname/monetary-policy-and-prudential-supervision-from-functional-separation-to-a-holistic-approach.html>) – From Functional Separation to a Holistic Approach?", SAFE Policy Letter No. 63. (<http://safe-frankfurt.de/policy-center/policy-publications/policy-publ-detailsview/publicationname/monetary-policy-and-prudential-supervision-from-functional-separation-to-a-holistic-approach.html>)

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