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THE ROLE OF MONETARY AND MACROPRUDENTIAL POLICIES IN PURSUIT OF FINANCIAL STABILITY

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Abstract. *During the recent financial crisis, there have been significant real and fiscal implications that have renewed concerns of the regulatory agencies for financial stability. The stability of the financial system implies its resistance, which must be set up in advance and installed along the entire lifetime of financial institutions. The authors of this study have firstly presented the concept and conceptual questions of financial stability, and secondly, they have perceived the role of relevant policies in preserving financial stability. Special emphasis is given to the role of monetary and macroprudential policies and their conditionality in the realization of the same objective. Since the policy of preserving financial stability is a particularly sensitive area within the European Union (EU), this paper has summed up the current framework for financial stability, as well as the efforts towards the creation of the banking union.*

Key words: *crisis, financial stability, macroprudential policy, monetary policy, banking union*

INTRODUCTION

Due to the frequent banking crisis in the last decades of the past century, the issue of financial stability has become more than a popular topic. Bearing in mind that the stability of the financial system is seen as a precondition for the stability of the economic system, achieving and maintaining the stability of the financial system is set as an explicit goal of a growing number of central banks (CB). In order to be realized, this kind of objective requires to be clearly defined, and its significance and position in relation to the primary objective of the central bank, which is price stability, should be pointed out. In this respect, the first part of the paper deals with the concept and the basic conceptual issues

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related to financial stability. Along with the actualization of the issues of pursuing financial stability, in a growing number of countries, special bodies for macroprudential issues are being formed, in all of which, the role of the CB is crucial. The extent to which the field of monetary and macroprudential policies will overlap, largely depends on the achieved level of development of the macroprudential framework in a particular country. In this regard, the second part of the paper suggests possible approaches to the role of the monetary policy in maintaining financial stability. In the last part of the paper, the policy of maintaining financial stability is narrowed down to the EU, where special attention is paid to the analysis of the role of the European Central Bank (ECB) in preserving monetary and financial stability.

1. Financial Stability – the Term and Conceptual Issues

Along with the financial deregulation that marked the last decades of the past century, the incidence of financial crisis has suddenly increased. Among them, the banking crisis emerged as the dominant form of financial crisis. In 1995, there were even 13 systemic banking crisis. The real and fiscal implications of the crisis were the reason for setting financial stability as an increasingly important objective for the economic policy formulation. This can be confirmed by the fact that almost all central banks and several international financial institutions have begun to publish reports on financial stability and financial stability has become the responsibility of many institutions. Actualization of issues of preserving financial stability has been related to several trends and changes in financial systems over the last few decades.

Due to the deregulation of the financial regulations, the environment for intensive development of the financial sector was created, which was why the volume of financial transactions exceeded the volume of transactions in the real sector several times. The enormous growth in the financial services sector is evident on several grounds: its dominant share in the gross domestic product (GDP), the size of financial assets, the number of employees and average wages in this sector (Scharfstein & Greenwood, 2013). These changes are indicated by the term *financialization*, which basically means the separation of the real and the financial sector, whereas the financial sector becomes an end in itself. The consequences of financialization are the growing transfer of income from the real to financial sector, an increasing income inequality and the growing influence of financial incentive used to manage companies. In such circumstances, the prices of certain financial assets are determined on the basis of monitoring the prices of other financial assets, without any connection to the current situation and trends in the real sector of the economy. This kind of the financial sector growth is encouraged by a number of financial innovations, and above all, by the rapid development of financial institutions in the shadow banking. This sector includes financial institutions that, similarly to banks, perform maturity transformation of the banking resources, but they cannot mobilize the insured deposits and do not have the same system of protection that applies to banks. Structured investment vehicles, money market funds and the Government-sponsored entities like Fannie Mae and Freddie Mac can be included here. These institutions, during the recent financial crisis allowed loans to a wide circle of beneficiaries at much more favorable terms than those offered by the banks (Palley, 2007). Although it was designed to improve the standard of living, this kind of model that offered mortgage loans led to the over-indebtedness of households, bearing in mind the fact that the most common users of housing loans were entities with low and middle income (low and average salaries). In addition, the participation of the shadow banking sector in the credit intermediation burdened this procedure with a larger number of stages and made it impossible for participants to adequately assess the counterparty risk. As this sector did not enjoy the benefits of the Safety net, during the recent financial crisis, it became the subject of assault and it generated a significant risk to financial stability.

The development of the new financial activities and institutions, internationalization and homogenization of financial activities led to the formation of financial conglomerates, which united banks and non-banking institutions (Jovanić, 2006). The more important relationship of institutions within and between financial systems, as well as a significant number of mergers and acquisitions in the financial sector, left the creators of the economic and financial policies without adequate instruments and tools to preserve global financial stability.

In finance, not every efficiency drop needs to be followed by an immediate intervention. On the other hand, it is most certainly desirable in situations when the inefficiency of the market represents a threat to financial stability. However, the concept of an adequate framework for financial stability does not aim to prevent all possible risks in business, and there are several reasons why this is so. First, it is unrealistic to expect that all financial institutions will be able to manage the risks they face in their operations. Second, it is not desirable to create and enforce mechanisms that are too protective, considering that those mechanisms suppress innovation of institutions. In this sense, achieving and maintaining financial stability needs to be harmonized with other, perhaps even more important goals, such as economic efficiency. This means that finance should not be an end in itself, but also should support the efficient allocation of resources in the real sector of the economy. For this reason, policymakers need to establish a balance between stability and efficiency of the financial system. Looking at the characteristics of the US financial system which is a market-oriented, it is pointed out that the efficiency of the financial system is achieved at the expense of financial stability, which was confirmed during the latest financial crisis. In this sense, it is important to identify potential threats to financial stability at an early stage.

Setting up the concept of an adequate framework for maintaining and strengthening financial stability requires defining relevant concepts, such as financial systems, financial stability and systemic risk. In the broadest sense, the financial system is composed of three separate, but closely related components: financial institutions, financial markets and financial infrastructure. The financial system is considered stable if it enhances (rather than worsens) economic performance and is resistant to internal and external shocks (Schinasi, 2004). There are several important implications of defining financial stability in this way. Firstly, the assessment of the performance of the financial system shows the extent to which the financial system facilitates the allocation of economic resources, savings and investment processes, and ultimately economic growth. However, this is a two-way relationship, meaning that the real sector of the economy can have a positive or negative impact on the financial system, which has to be taken into consideration when designing a framework for evaluating and improving financial stability. Secondly, it should be noted that the disorder and instability in any of the components of the financial system do not pose a threat to financial stability, unless it leads to negative implications for the real sector of the economy. From the point of view of financial stability, shutting down less efficient markets and financial institutions is even desirable. As in Schumpeter (1934) business cycles, where the adoption of new technologies has both its constructive and destructive implications, the specific situation of instability can be occasionally tolerated if that will contribute to the long-term efficiency of the financial system. Third, not only does financial stability exist when the financial system adequately performs its role in mobilizing and allocating financial surpluses, transforming and managing risks, but also when the payment system functions efficiently. This means that the money, both the central bank money, and its close substitutes, properly serves its purposes as a means of payment, billing unit and a value keeper. Since this part represents a vital part of monetary stability, the financial and monetary stability overlap to a large extent. Fourth, financial stability means the absence of the financial crisis and the ability of the financial system to manage the imbalances before they become a threat to financial stability. And last but not least, financial stability can be seen as a phenomenon in time - reflecting different status combinations of the constituent parts of the financial system. One of the implications of observing financial stability in this way is that maintaining financial stability does not necessarily require that every part of the financial system operates continuously with maximum performance. The Continuum Concept becomes relevant in the analysis of the financial system, because the uncertainty and risk are constantly present, dynamic (intertemporal and innovative) and they consist of many interconnected elements (infrastructure, institutions and markets).

Financial stability is a fundamental precondition for the development of any economy, and that is why regulatory agencies continuously monitor the risks that threaten financial stability. This includes a two-dimensional approach where risks are monitored both at the level of individual financial institutions and at the level of the overall financial system. This kind of approach is used so that the problems that individual institutions are facing can be avoided before they become problems for the whole system. Systemic risk is often defined as a risk of disruption in providing financial services that can seriously harm the real economy. In this sense, it is very important to define policies for its management on time. The policies for managing systemic risk must include both of its dimensions, structural and cyclical. The structural dimension of the systemic risk results from the external effects produced by the components of the financial system affecting financial stability. In this respect, the policies for managing this dimension of systemic risk include establishing higher capital requirements for systemically important financial institutions, introducing a stable margin system (*hair-cuts*) as well as mechanisms for strengthening the resilience of the market infrastructures (Caruana, 2010). The cyclical dimension of the systemic risk indicates the progressive accumulation of risk over time, whereby the stakeholders tend to over-invest in the beginning, whereas the down phase leads to strengthening of the uncertainty in the market, price drop of financial assets, the reduction of financial leverage, a sharp decrease in liquidity, and to financial crisis after all (Cardarelli, Elekdag, & Lall, 2009). Measures to manage the cyclical dimension of systemic risk are prudential in their nature, and involve the introduction of countercyclical and sectoral protective layers of capital, limitation of the leverage level, as well as the introduction of standards for liquidity risk management (Bank for International Settlements, 2010).

The recent financial crisis pointed out to the importance of having an adequate regulatory framework for preserving and strengthening the stability of financial institutions. Its basic goals are to prevent and resolve systemic problems, in a situation when prevention fails to yield results. This is the concept of financial safety net, which includes a number of institutions, rules and procedures that are activated to protect stability of the system of financial intermediation (Marinkovic, 2004, p. 14). Since the banks are the dominant financial institutions in most of the financial systems, this framework is largely adapted to them. The regulatory framework is set along the entire lifetime of financial institutions and includes both *ex ante* components - regulation and supervision, and *ex post* components - the lender of last resort, deposit insurance and the policy of restructuring and exiting of banks from the market. Though important in the different stages of the bank's operations, the stability of the banking sector can only be achieved by the synergetic effect of all components.

Ex ante components of the security infrastructure define policies for the efficient and stable functioning of the banking and overall financial system, whereas *ex post* components' role is to stop further expansion of the crisis and to intervene with the institutions threatened with bankruptcy. The deposit insurance system aims to maintain the confidence of depositors in times of crisis, while in the stable conditions generally takes over the duties of restructuring banking institutions. Deposit insurance becomes important once a bank is declared insolvent and its primary task is to protect the depositors first, while the lender of last resort becomes important at the moment when the bank has already exhausted all the previous sources of liquidity, and then its focus is primarily on the protection of banks. The abovementioned components are directed, as we can see, towards the realization of different, not entirely consistent objectives, and that is why there is an institutional division of responsibilities and the presence of numerous institutions: prudential authorities (regulators and supervisors), Deposit Insurance Agencies, the Agency for Restructuring, monetary and fiscal authorities. The Central Bank has a significant role in pursuing financial stability, which is perfectly consistent with its role in implementing the monetary policy. In this regard, in the following part of the paper, we will try to look at what is the role of monetary policy in maintaining financial stability, in terms of coordination, and not mutual exclusion of monetary and macroprudential policy.

2. DIFFERENT APPROACHES TO THE ROLE OF MONETARY POLICY IN MAINTAINING FINANCIAL STABILITY

There are several reasons why we can claim that CB has a natural and not assigned role in preserving financial stability. First, the emergence and development of central banks was mainly related to their role in preserving financial stability. The Federal Reserve System was the first one responsible for preserving financial stability, and it was only later when it became responsible for monetary stability as well. Being a supreme monetary financial authority, a regulator and a supervisor in most of the financial systems, the central bank has all the necessary competence and experience to have the lead role in achieving and maintaining financial stability. The central bank issues legal tender and supplies the banking sector with the necessary amount of liquid assets. In addition, it is responsible for the payment system and its efficient functioning. The introduction of a real-time gross payment helped preventing the spreading of bankruptcy from one institution to another through the payment system. Given that banks are the main channel for the transmission of monetary policy, stable and sound operation of banks is a necessary precondition for the effective implementation of monetary policy (Bank for International Settlements, 2003). Once financial instability occurs, monetary instability is likely to follow, which is another thing that goes in favor for the central bank to be responsible for both aspects of stability.

Monetary policy, although primarily aimed at the preservation of price stability, must consider the impact of its measures on financial stability. During the recent financial crisis, it was monetary policy that was used as the first anti-crisis instrument that used its expansionary course of action to increase the liquidity in the system. The policy of low interest rates and the implementation of a number of unconventional monetary policy measures had had assets of central banks increased many times, due to which, further financial stability had become directly conditioned by fiscal policy. However, a significant state support for the banking sector arranged during the recent financial crisis, raised the question of fiscal sustainability of many national economies, thus illuminating the relationship between financial sector stability and the level of public debt and budget deficit. Due to the lack of adequate macroprudential regime in a number of countries, both monetary and fiscal policy played a significant role in calming the financial crisis. Of course, monetary and fiscal policy should primarily be responsible for the basic objectives of their policies, which is the reason why macroprudential policy should be further improved.

Monetary and macroprudential policies are singled out as a countercyclical policies - the former is concerned with price stability, and the latter with the stability of the financial system. Microprudential policy is concerned with the stability of individual banks. It is necessary to bear in mind that sometimes it is very difficult to separate microprudential policy from macroprudential one, given that macroprudential policy is largely implemented by means of instruments of microprudential policy. The connection of those policies have caused the European Central Bank (ECB) to expand the field and deadline for monetary analysis, in order to adequately comprehend the implications of the financial system stability on price stability, which is set aside as a complementary measure to the use of macroprudential instruments aimed at limiting ups and downs on the credit market in recent decades. In this sense, the following question arises: "Is it necessary to expand the jurisdiction of the functions of monetary regulation, so that it can be responsible for pursuing and strengthening financial stability?". Three views have risen from this question: a) Modified Jackson Hole Consensus, b) Leaning against the wind vindicated c) Financial stability is price stability (Smets, 2013, p. 125).

Table 1. Potential views to the role of monetary policy in maintaining financial stability

	Modified Jackson Hole Consensus	Leaning against the wind windicated	Financial stability is price stability
Monetary policy	Framework largerly unchanged. Limited effects on credit and risk taking. Blunt instrument to deal with imbalances.	Financial stability as secondary objective: lengthening of horizon. Affects risk-taking. „Gets in all of the cracks“	Twin objectives on equal footing. Unblocks balance sheet impairments; avoids financial imbalances in upturns
Macro prudential policy	Granular and effective	Cannot fully address financial cycle; arbitrage	Indistinguishable from monetary policy
Interaction	Limited interaction and easy separation of objectives and instruments.	Financial fragility affects monetary transmission and price stability	Financial stability and price stability are intimately interlinked
Issues	Coordination? Lender of last resort?	Coordination? Overburden money policy?	Time inconsistency problems?
Models	Svensson; Collard, Dellas, Diba and Loisel (2012)	Borio; Woodford (2012)	Brunnermeier and Sannikov (2012)

Source: (Smets, 2013, p. 134)

The first view advocates the responsibility of monetary policy solely to price stability, while financial stability is the sole responsibility of macroprudential policy. The course of leading monetary policy will not lead to the formation of the boom and bust cycle, and a short-term interest rate is not a suitable instrument for managing these imbalances. The application of higher prudential requirements conditions banks to internalize the risk, and these effects cannot be achieved by the measures of monetary policy, that are focused on the loan volume, rather than on the loan structure. This approach does not assume a connection between interest rates and macroprudential policy instruments, and it is not rare for these policies to move in completely opposite directions during the business cycle: on the one hand, the introduction of additional prudential requirements, and on the other, the reduction of interest rates in order to avoid the effects of prudential policy on the loan volume.

The second view does not support a narrow focus of monetary policy, noting that it is the focus of a number of central banks to preserve price stability in the short term the one that has prevented their aggressive engagement in preserving financial stability. Given that the banking sector is the main channel for the transmission of monetary policy, its stability has important implications for price stability. In order to comprehend the impact of financial imbalances in the implementation of monetary policy, the CB must expand its scope of action. Representatives of this approach point out that monetary policy can significantly contribute to the maintenance of financial stability with its tools and instruments, without compromising the price stability. The coordination of monetary and macroprudential policies in the field of preserving financial stability is quite justified, given that both have an impact on real economic variables. In addition, the fact that monetary policy can take over the macroprudential role at a certain point is justified by the fact that the monetary policy decisions are more frequent than those of macroprudential policy (Galati & Moessner, 2011).

The third view advocates equal treatment of price and financial stability, emphasizing that they are so closely connected that it is practically impossible to distinguish between them. The task of the monetary policy is to support the sector in crisis with its standard and non-standard tools and instruments, as it did in the case of the price of mortgage instruments during the recent crisis, by buying mortgage securities, and thus helped overindebted household sector. This approach, therefore, advocates the important role of monetary policy in the field of preserving financial stability, especially in the case when the fiscal policy measures do not achieve the desired effects.

The abovementioned views clearly have different implications for the institutional set-up for the monetary and financial stability policy, although each of them highlights the interrelatedness of monetary and financial stability. To what extent monetary policy should take an active role in the field of preserving financial stability largely depends on the extent to which it can manage the growing instability in the system by using its standard tools and instruments, as well as to what extent it can channel the risk that financial institutions take by using short-term interest rates. It should be borne in mind that the impact of monetary policy is not sector-oriented but it affects all financial institutions, even those that operate in the shadow banking, and that are difficult to comprehend with measures of supervision and regulatory activities. However, in a situation where an excessive growth of credit activity is linked to a specific market or institution, regulatory and supervisory measures are considered adequate. In such conditions, the standard instrumentation of monetary policy does not work, causing the central bank to introduce a number of non-standard monetary policy instruments. In fact, numerous non-standard monetary policy measures (changes in the policy of mandatory reserves or adjusting the value of the collateral in the system in operations conducted by the central bank) can be characterized as macroprudential policy instruments. In this case, the question is whether CB should use non-standard measures to lean against boom periods (Smets, 2013, p. 140)

Assigning macroprudential mandate to the central bank, in addition to its primary responsibility for price stability, is justifiable. This ensures better coordination and exchange of information necessary for the preservation of price and financial stability. Then, the central bank has the expertise in macroeconomic affairs and supervision of financial institutions and other segments of the financial system. Finally, as a lender of last resort, it grants loans for liquidity to banks, thus reducing the likelihood of the outbreak of the crisis. However, this kind of engagement of the central bank may quite distance it from its primary objective, which is the pursuit of price stability, because it has to take the role of a distributor and the role of a quasi-fiscal actor. This draws its political responsibility and ultimately it may compromise its independence. As an additional problem, dynamic (time) inconsistency is highlighted, given that the central bank can be easily found in the position to put a larger quantum resources into the system than necessary to preserve the long-term price stability. Such risks can be controlled by the division of goals, instruments and responsibilities of macroprudential and monetary policy, which is especially important if both of these roles are performed by the same institution, i.e.the central bank. In order to solve the problem of time inconsistency, the central bank, being a part of monetary regulation must take care primarily of price stability, while pursuing financial stability remains the primary responsibility of macroprudential, and not monetary policy.

There are numerous ways in which the central bank fulfills its macroprudential role. In some countries (e.g. The United Kingdom), the central bank has a clear mandate for macroprudential and microprudential policies. In other countries, the central bank has a significant share in the structure of the committee vote on macroprudential issues (as in the case of the European Systemic Risk Board, ESRB). In the US, the Federal Reserve System is one of the 10 authorities that have the right to vote in the Financial Stability Oversight Council (FSOC), and are responsible for the regulation of systemic banking and nonbanking financial institutions. The role of macroprudential policy in preserving and strengthening financial stability largely depends on the effectiveness of its instruments, and it should be taken into consideration that there is no widely accepted list of macroprudential instruments. On the contrary, they are adapted to the specific intermediate target, which may be stopping excessive credit growth and leverage, maturity mismatches, direct and indirect exposures, etc. These instruments proved to be very useful in combating the cyclicality of the financial system during the recent financial crisis. However, the lack of international coordination of these measures can be the basis for regulatory arbitrage, thus reducing their effectiveness in combating systemic risk significantly. This problem is particularly acute in the area of European Monetary Union (EMU), given the supranational monetary policy and national policy of financial stability.

3. THE ROLE OF MONETARY AND MACROPRUDENTIAL POLICIES IN PRESERVING FINANCIAL STABILITY IN THE EUROPEAN UNION

On the territory of the European Union, the division of responsibilities over the basic functions of CB was carried out so that ECB took over responsibility for the implementation of monetary policy in the Eurozone countries, while the functions of supervision and the lender of last resort remained under the jurisdiction of the national central banks and supervisory authority. The ECB is in total control of the function of monetary regulation within which it defines and implements monetary policy, taking care of price stability within the EMU. However, the ECB does not have official jurisdiction in matters of regulation and supervision, and it is included here only indirectly, through the European System of Central Banks, as much as the central bank of a particular national economy is at the same time a regulator as well. Despite possible limitations and the lack of direct involvement of the ECB in the field of regulation and supervision of credit institutions, its role in this segment cannot be ignored, especially when it comes to its macroprudential role. Macroprudential role of the ECB is even more relevant in the context of monetary union, where its duty is to express the differences between the financial systems of comparable countries which have the same level of economic development (Božina & Štajfer, 2009). Within a monetary union, macroprudential policy is defined at the national level and the national central banks have the ability to define macroprudential policy instruments tailored to the specific sources of instability in the financial system. That is how they act countercyclically by using macroprudential policies, given that the monetary policy is within the competence of the ECB and that they have no ability to influence interest rates (Galati & Moessner, 2011).

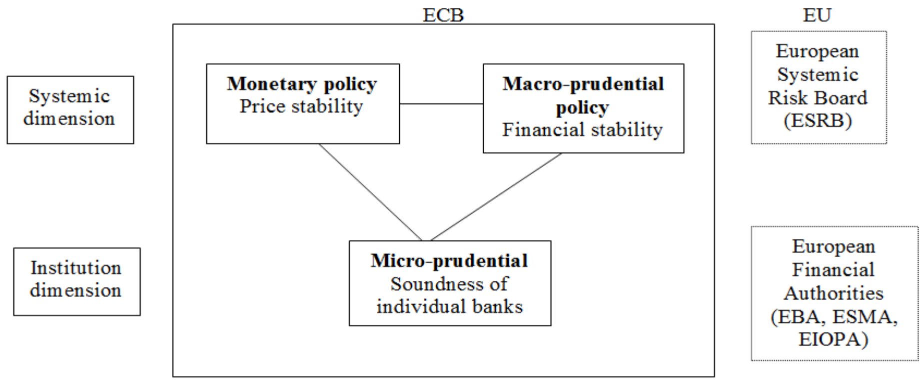

Fig. 1 The new institutional framework of the European Monetary Union
Source: (Smets, 2013, p. 122)

As we can see in the figure, monetary and macroprudential policies are used as countercyclical policies, whereby monetary policy is focused on price stability and macroprudential policy on financial stability. On the other hand, microprudential policy takes care of the stability of the individual financial institutions, i.e.banks. It is necessary to examine how monetary and macroprudential policy co-operate since they have different objectives and use different instruments. In the previous section, we have pointed out to a significant relationship these objectives have, which is the reason why the ECB in its monetary strategy opted out for a broader approach and perceiving the impact of financial stability on price stability. In this way, it has made a balance between its business area and macro and micro prudential policies.

The ECB has a limited capacity in the field of preserving financial stability given the limited fiscal mandate, which prevents it from stepping forward as the lender of last resort for credit institutions. This is a significant difference compared to the Fed and the Central Bank of England, which have the capacity to come forward in the role of the lender of last resort. Moreover, the Fed has the final say in the supervision over the other regulatory bodies, which is not the case in the Eurosystem, where the national central banks decide in case of bankruptcy of an institution. The lack of uniform measures, and procedures that supervisors in the EU apply, caused the convergence of supervisory practices. In order to achieve a higher level of integration and coordination between national supervisory authorities, the European Commission in late 2008 organized a group of experts (de Larosière group) under the direction of Jacques Larosière, whose task was to build new infrastructure functions of supervision of the financial services sector (The de Larosière Group , 2009).

The reform divided supervision in two levels: supervision at the macro level, assigned to the European Systemic Risk Board (*European Systemic Risk Board, ESRB*) and supervision at the micro level, assigned to the European System of Financial Supervisors (*European System of Financial Supervision*, *ESFS*), consisting of national supervisors and three new European supervisory authorities: (*European supervisory Authorities*, *ESAs*) banking (*the European Banking Authority, EBA*); securities and markets (*the European Securities and Markets Authority, ESMA*) and insurance companies and pension funds (*the European Insurance and Occupational Pensions Authority*, *EIOPA*).

European Systemic Risk Board has been established in order to coordinate macroprudential policies, as a supranational consultative body whose main task is to send ESFS early signals about the possible existence of systemic risk and the need for the intensive supervision. The way micro-supervision is organized is that every financial services sector is regulated by a separate body. There are national regulators for all three sectors separately at the bottom of the European supervisory infrastructure. As it can be noted, here we have a vertical model of supervision where each sector is regulated by a separate body.

With the new institutional framework, the ECB has taken a key role in the European Systemic Risk board - as a macro-supervisor, whereas micro-supervision has remained within the competence of national supervisors of the Member States. In addition, an authority for macroprudential issues at the national level has been formed at the central bank or at the supervisory authority. In this way, a jurisdiction in macroprudential policies has been divided between those newly formed authorities and ECB. In such macroprudential framework, the ECB has the right to define more severe requirements for macroprudential instruments in comparison to those already defined by national supervisors (Freystatter, 2015). This role of the ECB in the macroprudential sphere is partly limited. Namely, it only refers to macroprudential instruments that have been already defined at the national level, and which are at the same time part of the ECB; its power is asymmetrical, given that there is no possibility to prescribe more lenient requirements, and a problem of coordination can occur, considering that ECB shares its responsibility with national authorities.

The new institutional framework of the macroprudential policy in the Eurozone cannot be fully identified with leaning-against-the-wind approach. National macroprudential authorities are the first ones responsible for maintaining financial stability, and they are trying to use monetary policy as little as possible for the purposes of preserving financial stability. However, underdevelopment and lack of experience in using macroprudential instruments have caused that monetary policy does take its stake in preserving financial stability. The financial crisis in the Eurozone has clearly shown that in countries that share single currency, there is a need to centralize the rules governing banks, especially due to the extreme relationship of countries and their banking systems. Banking Union emerged as a possible solution to this problem. In June 2012 there was an initiative for the establishment of a banking union, which would centralize supervision (*the Single Supervisory Mechanism, SSM*), restructuring policy (*the Single Resolution Mechanism, SRM*) and deposit insurance (*the European Deposit Insurance Scheme, EDIS*). The first two pillars of the banking union, SSM and the SRM have already been established, and the proposal for the third pillar was accepted for consideration in November 2015.

Banking Union is based on the Single Rule Book to ensure equal conditions for business institutions and the functioning of the regulatory authorities, avoid national regulatory authorities being bias, as well as problems of coordination and cooperation, and at the same time, preventing the spillover of problems from one country to another (Gaspar & Schinas, 2010). Also, this helps preventing the problems that occur in the banking sector to affect the public finances of the national economy, given that with the new approaches, socialization of bank losses is forbidden. Banking Union is required for the EMU member countries, (19 countries currently), while other non-EMU countries can join the banking union if they wish. Of course, this implies that all three pillars of the Banking Union must be fully accepted.

CONCLUSION

Financial stability is a precondition for the development of any economy, causing regulatory authorities to monitor the risks that threaten financial stability on an ongoing basis. This includes a two-dimensional approach in which risks are monitored, both at the level of individual financial institutions and at the level of the overall financial system. The Central Bank has a significant role in preserving financial stability, which is perfectly consistent with its role in implementing the monetary policy. In this sense, the question is: what is the role of the monetary policy in maintaining financial stability? During the recent financial crisis, due to the absence or insufficient development of macroprudential frameworks in many countries, monetary and fiscal policies took an important role in mitigating the financial crisis. However, this kind of engagement of the central bank may quite distance it from its primary objective, which is the pursuit of price stability, because it has to take the role of a distributor and the role of a quasi-fiscal actor. This affects its political responsibility and ultimately may compromise its independence. As an additional problem, time inconsistency can be highlighted, given that the central bank may get itself in a position to put a larger quantum of resources into the system than it is necessary in order to preserve the long-term price stability. Such risks can be controlled by the division of goals, instruments and responsibilities of macroprudential and monetary policies, which is especially important if both of these roles are performed by the same institution, the central bank in this case. In order to solve the problem of time inconsistency, being a part of monetary regulation, Central Bank must take care of price stability first, whereas, maintaining the financial stability is a primary responsibility of macroprudential, and not monetary policy.

Defining the relationship between monetary and macroprudential policy is particularly specific to the area of EMU, given that monetary policy is defined at supranational level, whereas macroprudential policy is defined at both supranational and national levels. With the new institutional framework, the ECB has taken a key role in the European Systemic Risk board - as a macro-supervisor, while national supervisors of the Member States have jurisdiction over micro-supervision. In addition, there is a formation of the body for macroprudential issues at the national level, either at the central bank or at the supervisory authority. In this way, the jurisdiction of macroprudential policy is divided between the established bodies and ECB. The primary responsibility for maintaining financial stability belongs to the national macroprudential authorities that are trying to use monetary policy as little as possible as a means of preserving financial stability. However, insufficient development and lack of experience in using macroprudential instruments have caused monetary policy to take its stake in preserving financial stability. The financial and debt crisis in the Eurozone has clearly shown that in countries that share the single currency, it is necessary to centralize the rules governing the operations of banks, especially due to the exceptional relationship among countries and their banking systems. For these reasons, in June 2012, an initiative for the establishment of a banking union was launched, within which two pillars have been formed so far - Single Supervisory Mechanism and Single Resolution Mechanism, while the third pillar - the European Deposit Insurance Scheme was accepted for consideration in November 2015.

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ULOGA MONETARNE I MAKROPRUDENCIJALNE POLITIKE U OČUVANJU FINANSIJSKE STABILNOSTI

Značajne realne i fiskalne implikacije nedavne finansijske krize obnovile su zabrinutost regulatornih organa za finansijsku stabilnost. Stabilnost finansijskog sistema podrazumeva njegovu otpornost koja mora biti unapred osmišljena i postavljena duž celog životnog veka finansijskih institucija. Autori su u radu najpre izložili pojam i konceptualna pitanja finansijske stabilnosti, a potom sagledali ulogu relevantnih politika za očuvanje finansijske stabilnosti. Poseban akcenat dat je ulozi monetarne i makroprudencijalne politike i njihovoj uslovljenosti u realizaciji istog cilja. S obzirom da je politika očuvanja finansijske stabilnosti posebno osetljivo područje unutar Evropske unije (EU), u radu je ukratko izložen trenutni okvir za očuvanje finansijske stabilnosti, kao i napori ka stvaranju bankarske unije.

Ključne reči: *kriza, finansijska stabilnost, makroprudencijalna politika, monetarna politika, bankarska unija*