Before 2008 it was commonly known that achieving price stability also ensures financial stability. Yet, the global financial crisis revised this understanding and showed that price stability is a necessary but not a sufficient condition to maintain financial stability.

It is clearly visible that central banks, after the global financial crisis are more actively involved in safeguarding financial stability (especially by conducting macroprudential policy). However, the issue of involving monetary policy in reducing financial imbalances still raises some concerns. Several studies also point out that monetary policy, on the contrary, may even strengthen financial imbalances. Examples include cases when: (1) in the real economy, inflation is below the inflation target and the financial system is experiencing excessive credit growth; (2) in the real economy, inflation exceeds the target and at the same time the credit growth reaches values below the equilibrium level. Against this background, the first objective of the project is to analyze monetary policy stance towards financial imbalances.

Significant in this context is the discussion of the proponents of taking into account factors related to the financial stability in the conduct of monetary policy, against the opponents of such approach. It seems that the global financial crisis and high costs associated with it have confirmed the validity of monetary policy involvement in maintaining financial stability. But both supporters and opponents have strong arguments. The main argument of the opponents is that the central bank has a direct impact only on the short-term interest rate and financial stability is considered rather in the long-term. Moreover, financial instability is affected by global imbalances, on which the central bank has limited influence. Supporters, on the other hand, point out that maintaining low interest rates over a longer period can cause an excessive increase in asset prices and contribute to the likelihood of a financial crisis (for example by intensifying the credit boom).

After the global financial crisis, it is expected that monetary policy instruments are used to strengthen financial stability. An example may include the Central Bank of Hungary (MNB), which is involved in reducing of systemic risk of loans in foreign currency (especially in the Swiss franc). Therefore, the second objective of the project is to check whether, after the global financial crisis, it is justified to include a variable reflecting financial stability to the central bank's monetary policy reaction function (apart from deviation of inflation from the target and output gap)?

The first stage of the project is comparison of author’s own financial imbalances index with monetary policy stance. In the next step it was checked whether monetary policy modelling requires inclusion of financial variables.

Proposed research project can confirm the existence of important challenge for central banking, i.e. the possibility of conflict between the price stability and financial stability. Future inclusion of potential conflict in the decision-making rules of both policies can affect the effectiveness of the instruments used by central banks, which in turn will determine the economic development and stability of the financial system.