10 Years after the Global Financial Crisis: Macroprudential Measures

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Governor Isărescu,
Deputy Governor Voinea,
Ladies and Gentlemen, Distinguished Guests,

It is my honor to be here as the Executive Director for Romania and 14 other countries at the International Monetary Fund. I am happy to see many familiar faces from our Constituency, including the distinguished speakers from Belgium, Georgia, Moldova, the Netherlands, Ukraine and of course Romania.

Let me start by thanking the National Bank of Romania for hosting this interesting seminar in collaboration with the IMF. Today and tomorrow, we will have the opportunity to discuss macroprudential policy, a relatively new field that took shape after the Global Financial Crisis. For the central bankers and macroprudential supervisors among us, or members of the supervisory community in general, this conference is an opportunity to learn more about the Fund's latest thinking on macroprudential policy. The participants from the IMF will hear from national authorities directly how they use macroprudential policies to stem financial stability risks.

I would like to do three things this morning:

- First, put macroprudential policy in a historic perspective;
- Second, review some of the current challenges; and
- Third, look at the interaction of macroprudential policy with other policies.

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1. From Jakarta (1998) to Bali (2018)

As illustrated in a myriad of articles, documentaries, seminars and conferences, it has been ten years since the start of the Global Financial Crisis. "A Decade after the Global Financial Crisis" was also the topic of the Fund's latest Global Financial Stability Report, which was discussed by Governors and Ministers during our Annual Meetings in Bali, Indonesia, a few weeks ago.

While I was in Bali, I thought of an event that took place in the same country, but in a different city, namely Jakarta, about 20 years ago. As a result of the Asian Crisis, on January 15, 1998, President Suharto of Indonesia personally signed the Letter of Intent of the IMF program with Indonesia. The grim image of President Suharto signing the Letter of Intent, with then Managing Director Camdessus hovering over him, has haunted the Fund for many years. The photo taken a few weeks ago in Bali of the smiling faces of President Widodo and Managing Director Lagarde could not be a bigger contrast.

The causes of the Asian Crisis were manifold. At the same time, the lessons learned from that crisis ignited a process of rethinking the Fund's relationship with its membership as well as the Fund's activities and toolkit. Weaknesses in the financial sector were a key contributor to the Asian Crisis. This led the Fund to strengthen its financial surveillance in 1999 by instituting what we know now as the Financial Sector Assessment Program or FSAP. The idea was that increased financial sector surveillance would prevent the buildup of financial vulnerabilities that could lead to capital account crises.

But the road from Jakarta in 1998 to Bali in 2018 has been a rocky one, and not only for the Fund. The year 2008 marked the start of the Global Financial Crisis. In response, supervisors and regulators aimed at making the banks more resilient, by increasing capital ratios and instituting liquidity requirements, as well as several other new prudential measures. But supervisors and regulators also realized that more was needed than ensuring the stability of individual financial institutions. The stability of the broader financial sector needed safeguarding, which led to what we know today as macroprudential policy.

2. Current challenges – developing the macroprudential toolkit

That brings me to my second point, addressing the current challenges. The messages from our latest Global Financial Stability Report are clear: financial stability risks have increased over the past few months; globally, monetary accommodation still results in easy financing conditions; and total debt of households, firms and governments surpasses the levels of 10 years ago.

Against this background of elevated financial sector vulnerabilities, a key priority is to further develop the macroprudential toolkit.

The housing market is a good example of how macroprudential policies can be useful. Many countries have developed borrowing- and lending-side measures to address risks in the housing market, including loan-to-value caps and debt-to-income or debt-service-to-income caps on the borrowing side, and countercyclical capital buffers and systemic risk buffers on the lending side. The Fund's Regional Economic Outlook for Europe, which was published last week, documents the increasing use of such measures in Europe. For the housing market, the evidence in the Regional Economic Outlook illustrates that these policies help limit the share of high-risk mortgages in the economy.

Of course, toolkits are only useful when they are used, and this in a timely and effective way. Independent processes and effective governance procedures are required to deploy macroprudential tools. For example: while all countries implemented the countercyclical capital buffer, only eight out of 44 countries surveyed in the Regional Economic Outlook apply a non-zero buffer.

It is also important to realize that macroprudential policies are, by design, often limited in scope. This means that macroprudential policies targeting the banking sector can be circumvented, for example, by non-bank financing. The Regional Economic Outlook suggests there is evidence that this happens in Europe.

The October Global Financial Stability Report illustrates how the coverage of macroprudential policies differs considerably across sectors. While the macroprudential toolkit for the banking sector is fairly well-developed, coverage is more limited in other sectors. This is why the Fund advises to further develop the macroprudential toolkit in those areas with already high and still rising vulnerabilities. The focus should be on corporate sector vulnerabilities, household sector vulnerabilities and the non-bank financial sector.

3. Interaction with other policy areas

My third point is about the interaction of macroprudential policy with other policies like microprudential policy, tax policy, and monetary policy. Clearly, macroprudential policy does not operate in isolation.

While microprudential policies target the stability of individual institutions, and macroprudential policy focuses on the stability of the entire financial sector, both are interrelated, as the stability of the system depends on the stability of its constituent parts.

Tax policies may also impact risks to the financial system. When faced with a potential bubble in the residential real estate market, removing tax credits for mortgage loan interest payments could be as or even more effective than macroprudential measures.

The relationship between macroprudential policy and monetary policy is a complicated one. The primary objective of the European Central Bank's monetary policy is to maintain price stability. The ECB aims at inflation rates of below, but close to, 2% over the medium term. With inflation rates in the Euro Area remaining stubbornly low, the monetary policy stance has remained accommodative. At the same time, accommodative monetary policy stances around the world have led to a build-up of leverage in the global economy, resulting in important risks to financial stability.

This leads to the question whether monetary policy in the Euro Area should remain accommodative to bring inflation rates closer to 2%, or, become less accommodative to address financial sector vulnerabilities, and whether macroprudential policy is sufficiently effective as an alternative to monetary policy to suppress risks to financial stability if monetary policy were to remain accommodative.

Jeremy Stein, a Professor at Harvard and a former member of the Board of Governors of the U.S. Federal Reserve, has expressed doubts about the effectiveness of using only macroprudential policy to deal with financial stability risks, arguing that monetary policy "*gets in all the cracks*".

The Fund's Financial Counsellor and Director of the Monetary and Capital Markets Department Tobias Adrian argues that there is a trade-off between short-term and long-term growth. According to his research, accommodative monetary policy intends to stimulate growth in the short-term. However, through the build-up of financial vulnerabilities, monetary accommodation may negatively affect medium-term growth, which in turn impacts inflation rates. In other words, from the perspective of the central bank's inflation target, it would be optimal to consider the effect of current policies on the build-up of risks to financial stability.

As I mentioned earlier, the road from Jakarta in 1998 to Bali in 2018 was a rocky one. Important lessons were learned from the Asian Crisis and the Global Financial Crisis, but many questions remain, especially on macroprudential policy. This leaves us with plenty of issues to discuss today and tomorrow. Looking at the impressive line-up of speakers, I look very much forward to the debates.

I would like to thank the National Bank of Romania again for their generous hospitality in this beautiful region, or in Romanian:

Vreau să mulţumesc domnului Guvernator Isărescu şi Băncii Naţionale a României pentru organizarea, împreună cu Fondul Monetar Internaţional, a acestui Seminar de Stabilitate Financiară. Este o dovadă a colaborării strânse a României cu Fondul Monetar Internaţional şi Constituenţa noastră. Mă bucur să mă aflu la Sinaia ca participant la seminar şi sunt convins că această inițiativă a Băncii Naţionale a României va avea un succes deosebit.

I wish you all interesting discussions and a pleasant stay here in Sinaia.

Thank you.