



WORLD BANK GROUP

Using Macroprudential Instruments: Issues and Challenges

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Macroprudential Policy

Approach

- Promote the stability of the financial system – not of individual institutions
- Address risks to and within the financial system
- Address evolution of risk over time
- Address distribution of risks across the system

Objectives

- Main objective: Promote financial stability
- Sub-objectives:
 - Promote the resilience of the financial system
 - Address build-up of risks

Macroprudential Instruments: A sample menu

Time Dimension

- LTV
- Limits on net open positions/ foreign currency mismatch
- Reserve requirements
- Limits on maturity mismatch
- DTI
- Dynamic provisioning
- Countercyclical Capital buffer/ requirements
- Limits on credit growth
- Limits on foreign currency lending

Cross Section Dimension

- Capital surcharge for systemic institutions
- Exchange trading & Central counterparty clearing
- LCR
- NSFR
- Leverage
- Limits on inter-bank exposures
- Limits on exposures to unregulated segment

USING MACROPRUDENTIAL INSTRUMENTS - CHALLENGES

Using MPPI – Challenges

- Timing
 - Confidence in measures of systemic risk
 - Mandate & decision making process
 - Scope
 - Binding, comply or explain, recommendatory
 - Consensus Vs Majority
 - Rules based vs discretionary vs constrained discretion
- Instrument choice
 - Limited tools and experience
 - Understanding of transmission channels
 - Institution vs product orientation
 - Single vs multiple, broad vs targeted ...
 - Interplay with other policy instruments

Using MPPI – Challenges ⁽²⁾

- Calibration options
 - Quick and significant step
 - Gradual and measured steps
- Consequences & implications
 - Migration of risk to less or unregulated segments
 - Leakages & Spillover
- Communication
 - Ex-ante evidence of costs and benefits
 - Ex-ante and ex-post evidence of effectiveness

How MPPIs may be used

○ Uncertainty about measurement of systemic risk; lack of adequate evidence; limited understanding of the transmission channels; leakages etc.

○ Greater reliance on simultaneous use of multiple policy instruments

○ Greater reliance on expert judgment and discretion

○ Adoption of instruments targeting specific sectors

○ Measured steps along with periodical impact evaluation

○ Greater reliance on communication

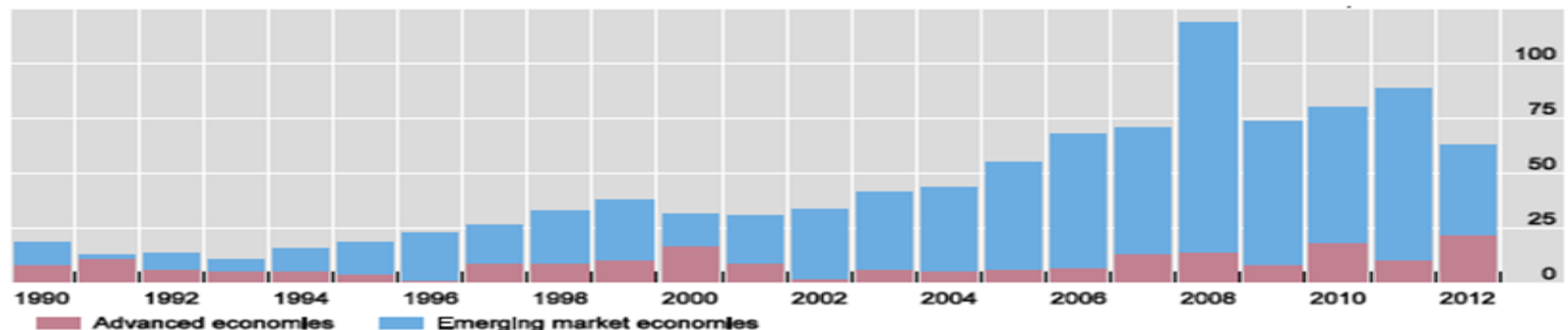
○ Early action ?

How Macroprudential Instruments (MPPI) were used

Interestingly, it was in the more advanced economies that the macroprudential dimension was most neglected in the run-up to the crisis. Emerging market economies have generally been more aware of the need to think about the financial system as a whole, and policymakers there have shown greater willingness to take action against a build-up of imbalances and risks. (Jaime Caruana, GM, BIS)

Number of macroprudential policy actions

Graph 1

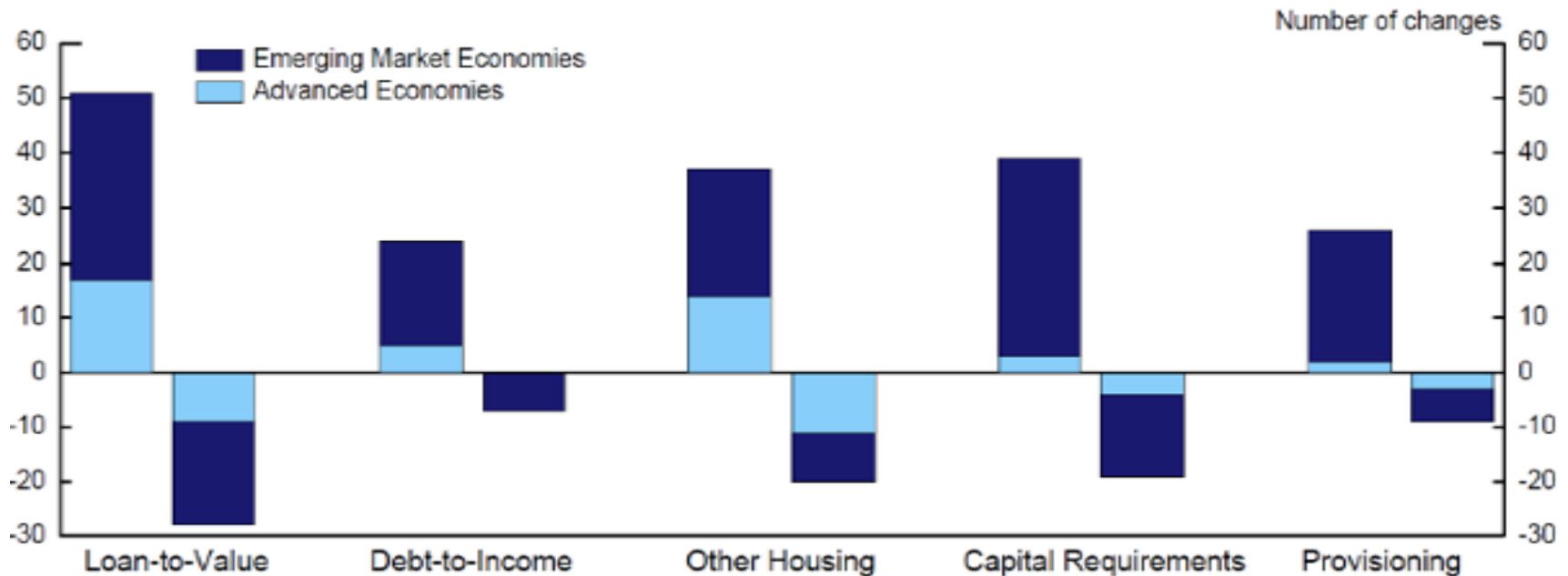


¹ The sample covers 1,034 macroprudential policy actions adopted in 64 countries (29 advanced and 35 emerging market economies). The database has been constructed using information in K Kuttner and I Shim, "Can non-interest rate policies stabilise housing markets? Evidence from a panel of 57 economies", *BIS Working Paper Series*, no 433, November 2013; and C Lim, I Krznar, F Lipinsky, A Otani, and X Wu, "The macroprudential framework: policy responsiveness and institutional arrangements", *IMF Working Paper*, no 166, 2013.

Sources: IMF; BIS.

How MPPI were used (2)

Use of various MPPI, 2000-Q1 to 2013-Q4



Source: US Federal Reserve

USING MACROPRUDENTIAL INSTRUMENTS – ISSUES FOR DISCUSSION

ISSUE: Interplay with microprudential supervision

- Is the macroprudential authority also the microprudential authority for systemic institutions?
- Potential conflicts during recession
- Pillar II buffers – can these be a macroprudential policy option?
- Minimum capital requirements – need for clarity on hierarchy of buffers for microprudential supervision

ISSUE: Relevance of fiscal policies

- Can complement in addressing sectoral developments – through fees, taxes, subsidies, and tax-reliefs
- Can play a role in strengthening financial market infrastructures
- Can play a role in promoting economic activity
- Can eliminate distortions/ conflicts:
 - Treatment of debt over equity
 - Treatment of provisions for NPAs

ISSUE: Cross-border Spillovers & Leakages

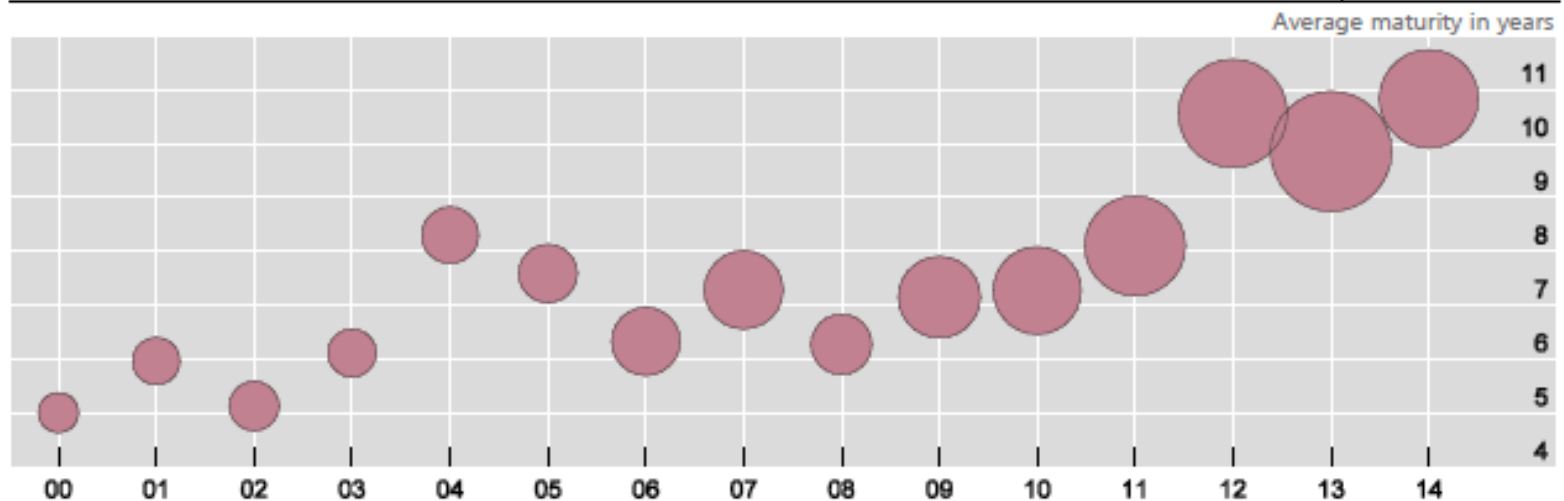
- Leakages weaken effectiveness of MPP
- Leakages can be addressed by coordination & reciprocity
 - Is there a need for a global repository of MPP actions?
 - What are the options for EMEs dominated by foreign bank branches?
 - What are the options for jurisdictions with active market intermediation?
- Spillovers can arise from MPP or other policy actions
- Spillovers can be positive or negative
- How can EMEs address negative spillovers?

ISSUE: EME perspective

- Ever increasing global integration
- Adoption of expansionary monetary policies in major jurisdictions
- Significant issuance of EME non-bank/ non-financial debt
- Impending adjustments of national monetary policies
- Have EMEs initiated appropriate policies during the easing phase?
- Are EMEs equipped to respond adequately during the reversal phase?
- Are MPP instruments appropriate & adequate?

EME Debt Issuance

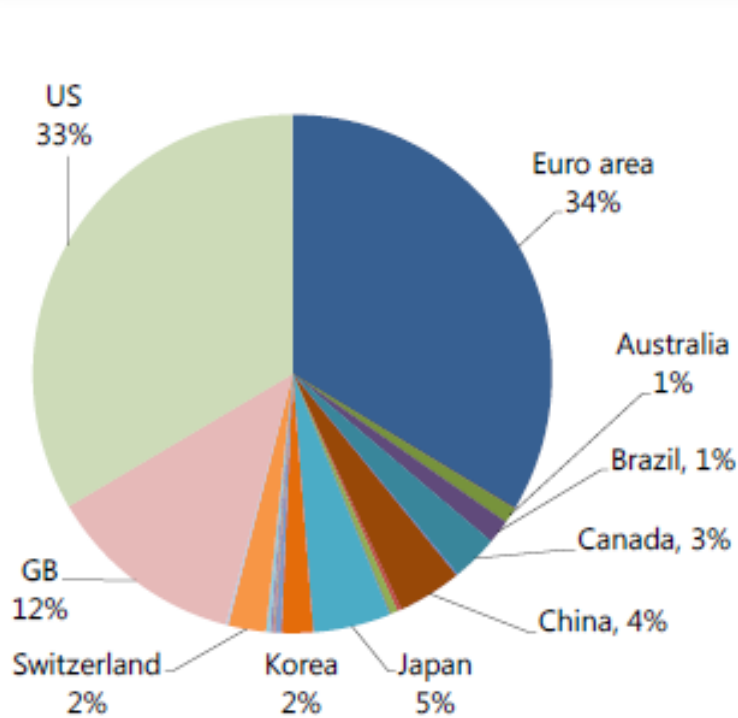
Annual gross issuance and weighted average maturity of EME non-bank international debt securities



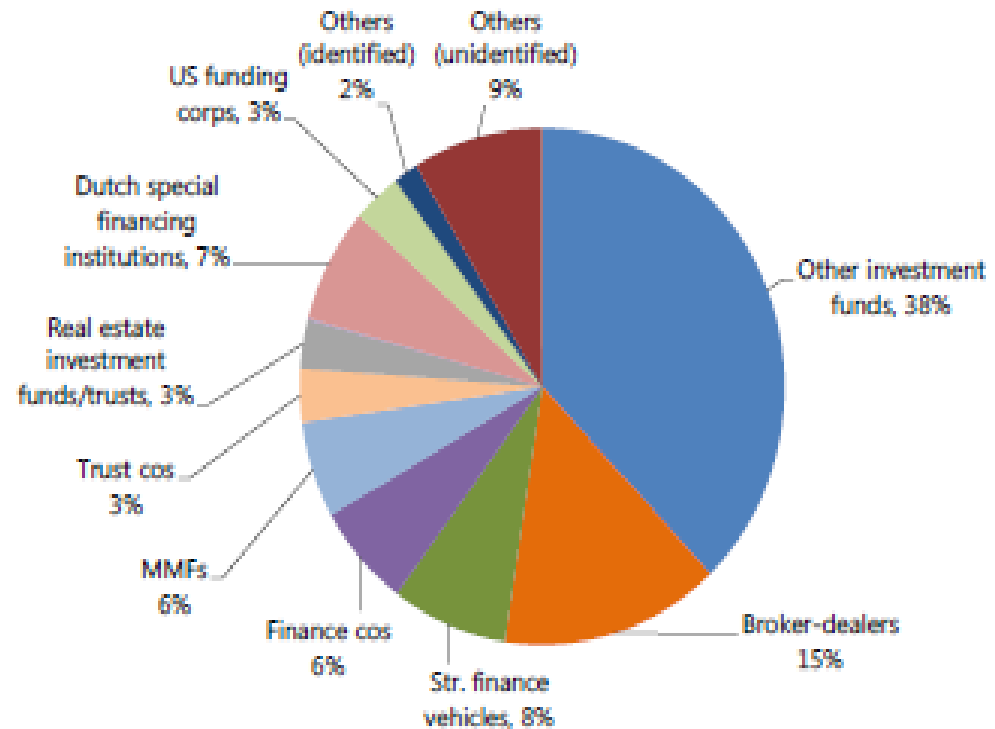
Sum of non-financial corporations and non-bank financial corporations. The size of the bubbles reflects the relative volume of gross issuance in each year. Data for 2014 as of end-September. Source: BIS international debt securities database.

Shadow Banks

By Jurisdiction



By Type



Source: FSB

ISSUE: Instruments for Shadow Banks

- Clarity about constitution of SB
- Regulation and supervision of SB
 - Is it necessary?
 - When?
 - Should it be the same as for banks or should it be calibrated?
 - Effectiveness of a tiered approach to MPP
- Can MPPI address potential or identified risks from SBs?
 - Leakages
 - Interconnections with banking system
 - Common exposures and concentrations

ISSUE: Others

- MPP and sovereign exposures
 - Are they risk free?
 - Can banks assume unlimited exposures on sovereigns?
 - Does domestic sovereign deserve a different treatment from foreign sovereign?
 - Does this deserve a micro or a macro instrument?
- MPP instruments and cyclicality
 - Can MPPI claim ability to tame the cycle?
 - Can MPPI be the right choice during recession?
- MPPI Toolkit for jurisdictions with special features
 - Small and open
 - Commodity driven
 - Dollarised or Euroised
 - Predominantly off-shore



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Thank You

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