The 14th Edition of the Seminar on Financial Stability Issues

Tackling new challenges on financial stability

Welcome address
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Dear Miss Buch,
Dear Mister Hilbers,
Distinguished audience,

Welcome to the fourteenth edition of the Seminar on Financial Stability Issues organized by the National Bank of Romania and the International Monetary Fund! The last time this seminar took place was in 2019, so we are returning after a three-edition hiatus due to the restrictions imposed by the pandemic. Until the onset of the COVID-19 crisis, the Seminar on Financial Stability Issues has been held annually, becoming a reference point and attracting experts from the region to discuss, exchange ideas, and gain a better understanding of current concerns about financial stability and macroprudential policy.

First and foremost, I would like to express our gratitude to the International Monetary Fund for their continuous support in the development of this partnership!

In the years since the last edition of the seminar, many notable events have taken place, with significant effects on the economic, financial, military, political, and social landscapes. Paraphrasing the current chairman of the Federal Reserve, Jerome Powell, regarding the multitude of shocks to which the world's economies have been exposed in recent years, we can say that a *new normal* is emerging, one that looks quite different from the normalcy we were accustomed to.

Indeed, if we look at the period from the end of World War II to the present day, we do not encounter another succession of two events such as those that occurred starting with the spring of 2020.

A pandemic is an event that typically occurs once in a century, and Russia's unprovoked invasion of Ukraine represents the most significant threat to security in Europe since World War II.

Both events had strong reverberations worldwide. In light of the aforementioned, this year's theme of the Financial Stability Seminar is "*Tackling New Challenges on Financial Stability*."

In December 2015, then Federal Reserve Chair and current U.S. Secretary of the Treasury, Janet Yellen, declared, "I think it's a myth that expansions die of old age... So the fact that this has been quite a long expansion doesn’t lead me to believe that... Its days are numbered."

This statement came amid uninterrupted economic growth in the United States since June 2009, which in the end was the longest period of economic expansion in history. Specifically, the U.S. economy grew for 128 consecutive months, from June 2009 to February 2020, the longest in its history.

Throughout this period, prosperity was felt both in mature and emerging economies. Asked about Janet Yellen's statement on the longevity of economic expansions, former Federal Reserve Chair Ben Bernanke joked: "I like to say they get murdered instead."

It seems he was about to be proven right, as the COVID-19 pandemic, an entirely exogenous phenomenon to the real economy, caused economic contractions in both advanced and emerging economies.

Measures adopted by governments worldwide successfully mitigated the negative effects of the pandemic. However, two years after the pandemic began, the war in Ukraine erupted, and the economic effects did not take long to manifest. The main effects of the war in Ukraine were reflected in the global increase in risk aversion and, especially, in rising inflation. Furthermore, the sharp increase in interest rates immediately followed the inflation surge.

The ECB’s chief, Christine Lagarde, commented in March 2023 on ensuring the macroeconomic equilibria: “price stability goes with financial stability, and they are both present and come together – but there is no trade-off”.

Inflation and the normalization of interest rates levels are occurring at a time when the global debt level is high and following an upward trend. It is particularly complicated to bring back to a stabilizing trajectory a rising public debt during periods of high inflation and therefore high interest rates, because of the many interrelations between the behaviors of different categories of agents within an emerging market open economy.

At the same time, in the case of private debt, the effects of inflation and high interest rates also lead to an accumulation of effects which decrease the resilience of debtors.

The complex nexus between high inflation and interest rates on one hand, and the elevated level of global debt on the other, is emerging at a time when international geopolitical tensions are leading to an increased risk of fragmentation.

In a recent study, the IMF highlighted that the materialization of the fragmentation risk would result in a significant increase in the investors’ risk aversion, thereby pressuring governments worldwide to reduce the level of public debt. This scenario would be particularly challenging, especially for the emerging economies with twin deficits, as is the case of Romania.

Rising interest rates inherently increase credit risk. However, as the SVB collapse has reminded us, the liquidity risk is also crucial to preserve financial stability.

Moreover, the financial systems are now facing challenges that have not been encountered in the past.

The accelerated process of digitalization and the use of modern technologies such as artificial intelligence and machine learning bring new perspectives for conducting business, along with higher incidences of cyber risks.

Digitalization increased the interest of central banks to study and test possible ways to adopt digital currencies, at some point in the future, within a framework with very well considered conditions. This potential development may bring advantages but also may introduce significant challenges from the perspective of monetary policy, financial stability, and the functioning of the banking system as a whole.

Last but not least, climate change agenda has major implications for the financial systems. These consequences refer to both physical and transitional risks. Here, at the National Bank of Romania, we have started to focus on such topics for a while, and during our NBR-IMF seminar in 2019, our colleagues from the Financial Stability Department presented the results of a stress-test exercise on how the transition to a green economy would affect credit risk in the banking sector.

Many countries have run similar exercises and the European Banking Authority is currently preparing a project to assess the potential consequences at the EU banking sector level.

On this note, which highlights the continuity of our debates and preoccupations, please allow me to wish you fruitful debates in this seminar!