BANK FOR INTERNATIONAL SETTLEMENTS

Macroprudential policy: making it work

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Bank for International Settlements

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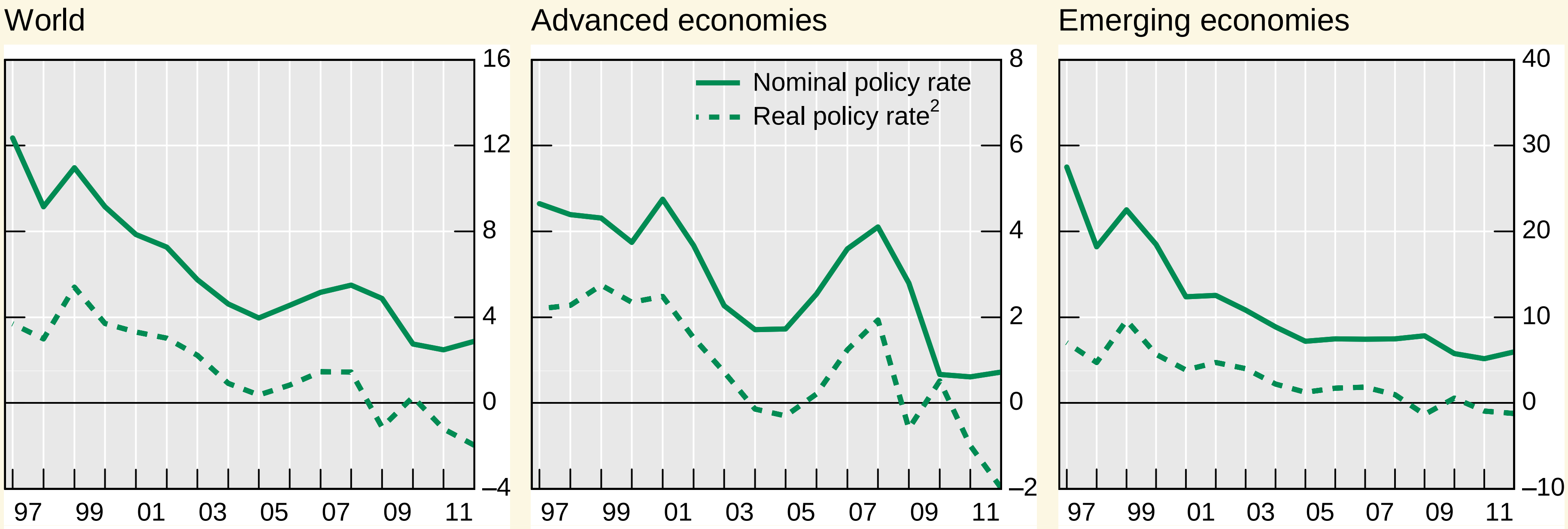
Eroding monetary policy buffers

Nominal and real policy rates[1]

In per cent



[1] Weighted average based on 2005 GDP and PPP exchange rates of 62 economies for world, major advanced economies or major emerging economies. [2] Nominal policy rates adjusted for consumer price inflation.

Sources: Bloomberg; CEIC; Datastream ; IMF.

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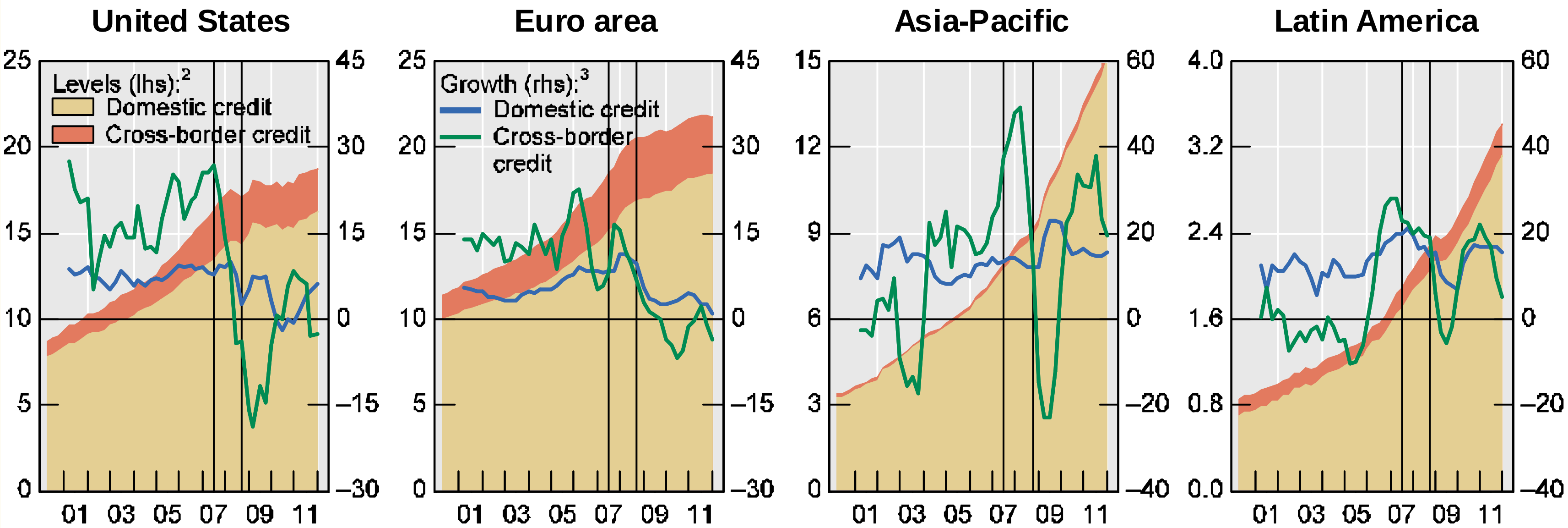
Global bank credit aggregates, by borrower region

At constant end-Q4 2011 exchange rates[1]

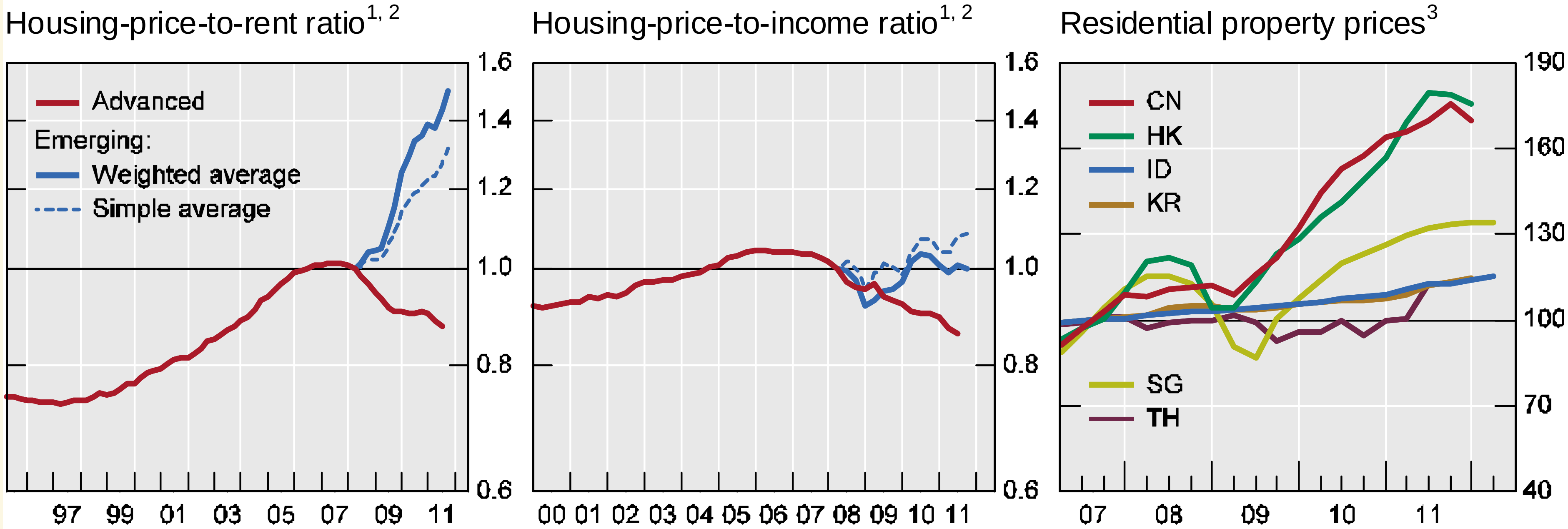


The vertical lines indicate end-Q2 2007 and end-Q3 2008.

[1] The shaded areas indicate total bank credit to non-bank borrowers (including governments) and are adjusted using various components of the BIS banking statistics to produce a breakdown by currency for both cross-border credit and domestic credit. [2] In trillions of US dollars. [3] In per cent.

Sources: IMF, *International Financial Statistics*; BIS international banking statistics; BIS calculations.

Housing market indicators



CN = China; HK = Hong Kong SAR; ID = Indonesia; KR = Korea; SG = Singapore; TH = Thailand.

[1] Advanced economies: euro area, Japan, United States, and United Kingdom. Emerging economies: China, Brazil, and Korea. The green and red dashed lines are historical trends of emerging countries and advanced countries, respectively. [2] Indices, Q1 2008 = 1; in log levels. [3] Indices, 2007 = 100.

Sources: Bank of Italy; IMF; national data; BIS calculations.

Lessons

- Financial stability requires
  - Symmetric monetary policy
  - Sustainable fiscal policy
  - Well-designed, rigorous regulatory policy
- Interest rates are not enough

Macroprudential instruments: tools and objectives

- Define macroprudential instruments narrowly

  Not an excuse to do whatever you want!

- Two complementary objectives
  - Structural: increase resilience
  - Time-varying: respond to cyclical build-up of risks

Tools: increasing resilience

- More and better capital
- Leverage ratio
- Liquidity requirements
- Provisioning and accounting rules
- Central clearing
- Margining practices
- Data collection

Tools: respond to risks

- Variable capital buffers
- Loan-to-value ratio
  or loan qualification requirements
- Reserve requirements

Policy design

- Prices vs quantities
- Borrowers vs lenders
- Assets vs liabilities
- Rules vs discretion

Governance: risks

- Reputations at risk
- Politicization of the central bank
  - Regulatory actions are political (most countries)
  - Coordination with political actors required
  - Taxpayers pay for mistakes
  - Objectives may conflict
- Management complexities, distraction risk

Governance: options

- Central bank does everything
- Complete separation:
  - new macro-prudential agency
  - separate micro-prudential regulators
- The middle road, requiring …
  - significantly better understanding of problems and therefore policy objectives
  - improved instruments
  - managing expectations
  - full transparency of decision-making

Conclusion

- Increase resilience everywhere
- Change incentives through prices
- Rules are always better
- Coordination is essential, but hard