Macro-Prudential Policies: Asian Perspectives
Shanghai, China, October 18, 2010

Session I: The Macro-Prudential Framework

The opening session focused on the objectives of macro-prudential oversight and how these could be integrated with more traditional regulatory and macroeconomic policies, particularly monetary policy. At the outset, the participants recognized the considerable challenges faced in defining the nature and scope of macro-prudential policies, the appropriate tools to be used, and who should be responsible for deploying them. While these difficulties call for a measured approach and some humility, it was agreed that they should not paralyze policymakers into inaction and preclude careful experimentation. In particular, the recent crisis had revealed severe information and data gaps and new elements that needed to be integrated into the assessment of countries' vulnerabilities. The process would no doubt take time but it needed to start now, otherwise there was a danger of losing focus as the memory of the crisis fades.

Overall, the session issued a clarion call for developing a clearer framework for defining macro-prudential policies and how they could be conducted. Participants agreed that while the concept of systemic risks to financial stability was not new, it has nevertheless taken a long time for policymakers to accept that macro-prudential oversight was important. This reflected conceptual difficulties faced by: (1) *supervisors*, in making the leap from bottom-up to systemic approaches, and (2) *macroeconomic policymakers*, in integrating the financial sector into their policy frameworks.

Strategically, it was felt that reaching some agreement on the objectives was key. Clear objectives could in turn help better define the appropriate perimeter of macro-prudential regulation, as well as the instruments and institutional arrangements needed. In this context, objectives championed by the Fund received broad support, notably removing procylicality in credit and financial cycles; focusing on system-wide financial linkages and those between the financial system and the real economy; mitigating cross-border spillovers; and improving the supervision, regulation, and resolution of systemically important financial institutions, including those that operate in multiple jurisdictions.

In terms of policy instruments needed to achieve such objectives, many participants felt that we needed to look beyond existing tool-kits. The new Basel-III proposals, while useful, were widely viewed as incremental rather than adding the new dimension needed for adequate macro-prudential regulation of the financial sector. At the same time, it was recognized that policy tools can have spillover effects and should therefore not be pigeon-holed as serving exclusively monetary, micro-supervision or macro-prudential purposes—for instance, interest rates can affect asset prices, credit creation, capital flows, as well as risk perceptions.

Instead, a combination of tools could be better suited to address systemic risks to financial stability—in Singapore, for instance, a combination of loan-to-value ratios, transaction taxes and supply-side policies had helped the authorities to ensure a stable and sustainable property market.

Equally, there was agreement that regulations are only part of the solution and that more emphasis on effective supervision was also called for. In this context, the need to insist on better and more complete disclosure by large financial institutions on their exposures and linkages was also deemed important. On the other hand, there was a shared view that the risks of over-regulating financial sectors and creating overly-complex new frameworks in the false pursuit of immutable financial stability needed to be guarded against. In emerging markets, where the financial systems are incomplete, for instance, a strict rules-based approach to implementing counter-cyclical capital buffers was viewed by some as having an adverse impact on needed investments in productive capacity, without having sufficient effect on property market dynamics."

On the question of who should be given primary responsibility for macro-prudential policies, there was broad agreement that they need to be nested into the broader macroeconomic framework, with monetary policy ultimately at the heart of the matter. In particular, any perceived conflict between price stability and financial stability was rejected as false—indeed, there was some support for monetary policy responding more symmetrically to asset prices and the financial cycle. Therefore, the value of divorcing the two functions entirely was questionable. Instead, ensuring a single agency (such as the central bank) or at least very close cooperation between multiple concerned agencies was deemed desirable. The Reserve Bank of New Zealand, for instance, has dual mandates covering both price and financial stability.

If central banks are charged with this responsibility, however, their mandates and operational frameworks would need to be recast and they would need to attract the best human capital from a variety of fields, including both macroeconomics and the financial sector. In this context, a key challenge would be to preserve monetary policy credibility and independence while ensuring some form of accountability. Overall, it was acknowledged that there was no one-size-fits all approach and that countries would benefit from sharing their experiences with diverse strategies and institutional arrangements, including financial stability oversight committees. In the United States, for example, almost all the regulators and the Treasury have been assigned new powers to safeguard financial stability. Indeed, the Federal Reserve has been cautious about taking on new responsibilities and providing any firm guarantees of being able to deliver on what are still relatively nebulous concepts of macro-prudential stability, particularly since it is wary of losing the credibility it has built up over many decades.

During the discussions, participants acknowledged that for macro-prudential policies to be successful and prevent regulatory arbitrage, they would need an effective multilateral context. Here, institutions such as the BIS, the FSB, the G-20, and the IMF could help identify systemic cross-border risks to macroeconomic and financial stability. Some participants also felt that these bodies could help lay down the basic principles for developing global macro-prudential policies, which could then be tailored to individual country circumstances. In addition, participants concurred that international cooperation would be needed to make progress on several unfinished aspects of the financial stability and reform agenda, particularly with regard to supervision and resolution mechanisms, including a cross-border coordination framework.