



## Macro-prudential Policy: Israel

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The background of the slide features a large, light blue watermark of the Bank of Israel logo. The logo consists of a menorah (candelabrum) with seven branches, set within a circular frame. The Hebrew text 'בנק ישראל' (Bank of Israel) is written in a circular path around the menorah. The text is semi-transparent and serves as a background for the main content.

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**IMF Conference, Rethinking Macro Policy II**

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# Macro-Prudential (MAP) Supervision

- Macro-prudential analysis studies the behavior of the financial system as a whole, with a focus on systemic interactions and systemic risk.
- Events following the Lehman Brothers bankruptcy are the archetype of the result of systemic risk.
- Macro-prudential supervision is directed at monitoring systemic risk, using available tools to reduce systemic risk when it reaches or is expected to reach levels that demand action, and if necessary, at dealing with the aftermath of systemic disturbances.

# Co-ordination of Monetary Policy and MAP in the Bank of Israel

- Bank supervision is located in the Bank of Israel
- Its legal framework is defined in a law separate from the Bank of Israel Law (2010)
- The Bank Supervisor reports to the Governor
- There is a Financial Stability Unit in the Research Department
- Once a quarter a special meeting of the members of the MPC is devoted to financial stability, with a report presented by the Financial Stability Unit, in collaboration with Supervision and Markets departments.
- When necessary, the Bank Supervisor briefs the MPC on any financial stability issues, including steps that are being considered or about to be implemented by the Supervisor.

# Coordinating MAP between Institutions

- Three separate regulators deal with different issues relevant to MAP: the Banking Supervision Department at BOI, the Capital Markets, Insurance and Savings division at the Ministry of Finance, and the Israel Securities Authority.
- An inter-institutional team (with representatives of the Bank of Israel, the Capital Markets, Insurance and Savings division at the Ministry of Finance and the Israel Securities Authority) work as a forum of professional cooperation regarding systemic risks of the financial system.
- Goals of the inter-institutional team:
  - To identify systemic risks in the financial system.
  - To discuss possible courses of actions, preventive and ex post in crises for dealing with systemic risk.
  - Exchanging essential knowledge among the authorities regarding the financial institutions, financial markets status and financial instruments.

# Coordinating MAP between institutions (contd.)

- The 2010 Law allows the Bank of Israel to act as LLR to non-bank financial institutions.
- The Bank of Israel is allowed to demand any information it needs from a financial institution.
- Discussions to establish a high-level FSC, anchored in law, are ongoing, with key issues being:
  - I. the relative roles of the Finance Minister and the Governor
  - II. The concern of the other supervisors that they will lose their independence
- Political solutions:
  - I. Different roles in normal times versus crisis
  - II. “Comply or explain”

# Working Program on MAP at the Bank of Israel

## Work in progress:

- Monitoring the stability of the banking and insurance sectors.
- Risk analysis of institutional investors' portfolios.
- Monitoring non-financial companies with a high potential of creating systemic risk.
- Implementing stress tests to assess the stability of financial institutions.
- Monitoring developments in real estate, the stock market and credit in order to detect the formation of bubbles.
- Development of indicators to assess financial stability (FSI, Radar Chart).

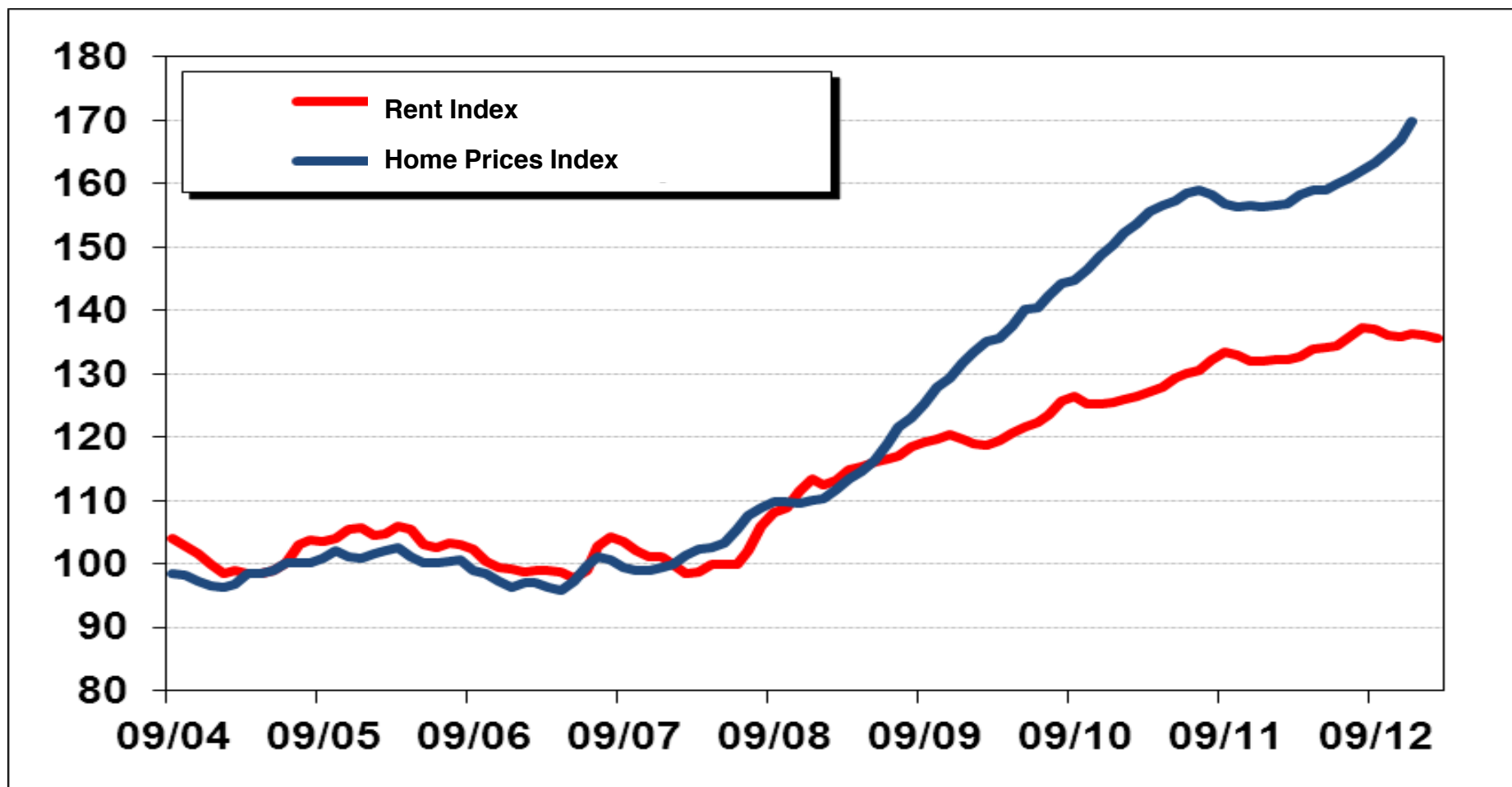
# Stress Tests

- “Balance-sheet tests” for the entire banking system – Macro Model; Satellite Model for credit risks; Extreme Macro Scenario for testing institutional balance-sheets.
- Contingent Claims Analysis - CCA – Analyze an extreme macro scenario regarding the probability of bankruptcy of banks, as estimated by the CCA model.
- Stress Tests for insurance companies (in cooperation with the Ministry of Finance).



# Implementation of MAP: Housing Market

Survey of Home Prices vis-à-vis Rent Index  
(January 2008 = 100)



# Housing Market: Prices and MAP measures

- **The dynamics of house prices.**
- **Evaluating whether a bubble exists in house prices:**
  - Direct observation (prices were rising at 16.2% per annum July 2009-July 2011).
  - Econometric estimation: Asset-pricing methodology for estimating the “fundamental price”.
- **Measures to deal with house price increases:**
  - **July 2010:** Requirement for banks to make additional provisions for housing loans with high loan-to-value ratios.
  - **October 2010:** Requirement for a higher capital provision for floating-interest loans granted with a high loan-to-value (LTV) ratio.
  - **May 2011:** Limiting the adjustable-interest-rate component of housing loans to 1/3 of the total loan .
  - **November 2012:** Limiting LTV ratio in housing loans: up to 75% for first-home buyers, up to 50% for investors, up to 70% for those upgrading their homes.
  - **February 2013:** Change of the risk weights for capital charge, and increase in the allowance for credit losses in respect of housing loans.

# Key Question: MAP, Institutional Design and CBI

- Question posed by the organizers: “If central banks are in charge of monetary policy, financial supervision, and macroprudential policies, should we rethink central bank independence?”
- **Answer: Yes.**
  - CBI in the case of interest rate setting (classical (of the last 20 years) role of the central bank) is essential.
  - the implementation of MAP (e.g. housing market) may have important allocative effects with important socio-economic consequences.
  - therefore the government needs to take a more active role in such decisions
- But co-ordination between MAP and monetary policy is necessary (the invalid quasi – Smith theorem); hence desirable to place at least bank supervision in central bank.
- Best solution so far: 2 committees, e.g. Bank of England:
  - MPC, as is
  - MAPC (FSC), with greater role for government

**Thank you**