

IFC Workshop on “Combining micro and macro statistical data for financial stability analysis” Warsaw, 14–15 December 2015

Opening remarks by Turalay Kenç, IFC Chair and Deputy Governor, Central Bank of the Republic of Turkey

Micro and macro views on financial stability

Good morning, ladies and gentlemen

Welcome to the IFC Workshop on “Combining micro and macro statistical data for financial stability analysis”. On behalf of the Irving Fisher Committee on Central Bank Statistics (IFC), I would like to thank the Narodowy Bank Polski (Poland) for organising and hosting this event. There are almost 100 participants with us today from all over the world, and I would like to extend my appreciation to all of those – IFC Executives and members, distinguished guests, speakers and participants – who are contributing to this important workshop.

About the recent financial crisis

The Great Financial Crisis of 2007–09 revealed the insufficiency of a financial stability policy based solely on the combination of microprudential bank regulation and the limitation of the central bank’s role to price stability. Hence the first lesson of the crisis was the importance of a system-wide approach when thinking about regulation and supervision. This systemic orientation should focus on interconnectedness and spillovers, at any given point in time, and over time, because of the procyclicality of the financial system. In other words, the systemic focus of policymakers should be on the cross-sectional as well as the time dimension of the build-up of financial fragilities in the system.

Second lesson: the old-fashioned assumption that there are specific sectors specialised in lending to distinct borrowing sectors is not relevant anymore. Most financial institutions now act as both lenders and borrowers, and today’s financial architecture consists of a complex network of financial exposures and liabilities. This differs from the “classical banking system” traditionally based on the originate-to-hold model: in the current system it is the originate-to-distribute model, in which banks can resell loans via securitisation.

Third lesson: this new banking model has also spurred the growth of financial intermediation outside the banking system itself, with the larger role being played by the unregulated “shadow banking” system. This unregulated area has led to an increasingly opaque network of interconnected financial relationships across a wide range of institutions, markets and instruments. At the micro level, the new developments may well be seen as innovations that facilitate the functioning of the financial system. But on a more macro level, they create new financial stability risks

due to the lack of adequate regulation and increasing maturity and liquidity transformation.

Financial contagion, regulation and systemic risk: micro and macro aspects are intertwined

The complex and highly interconnected structure of our new financial system means that financial stability risk can materialise at both a micro and a macro level. At the micro level, there is now a broad recognition of the need to properly monitor those “too big to fail” actors like major financial institutions that take too much risk for themselves which can spill over to the rest of the system. There is still a role to play for the prudential regulation developed over the past few decades for “traditional” banking systems. This micro approach can be a useful tool to prevent the “idiosyncratic risk” of failure of individual institutions, especially those that are deemed as being of systemic importance.

However, the importance of the role of interconnectedness and of counterparty credit risk in channelling stress into the entire financial system means that the authorities should also take a macro approach in regulation and supervision. Here the focus should be more on preventing “systemic risk” from building up. This macro view means focusing more on system-wide concerns on top of the sole protection of depositors in banks.

How should we balance the need for prudential supervision at the level of individual institutions and the new macro focus on financial risks? Obviously we must develop adequate analytical frameworks that take into account the entire financial system. We must also set up new macroprudential regulations and policy tools to increase the resilience of the financial system.

I welcome the opportunity today to reflect on these new and more comprehensive datasets and indicators, which are needed to deal with these issues.

New statistical frameworks for financial stability analysis

The need for more comprehensive datasets

The recent financial crisis showed us that conducting financial stability policy is more an art than a rule-driven exercise. This means that authorities must have the flexibility to adapt to emerging, unexpected issues as events unfold.

This flexibility is also required on the data front. More comprehensive datasets and indicators are needed for the systemic understanding of the financial system. While traditional, microfinancial approaches were based on granular, individual information at a point in time, we need to look deeper to assess fragilities. To capture “fat tails” and be prepared for “black swan” events, we must look at a wide range of macroeconomic, monetary and financial statistics. This is the only way to understand complex, unexpected spillover effects across the financial system. And we need to conduct this assessment over time, to spot the progressive build-up of vulnerabilities that can at the beginning go unnoticed. To this end, national authorities – and here central banks have a key role to play – are developing adequate frameworks to integrate granular data into a macro perspective.

The experience of Turkey in combining micro- and macro-level data

What is the Turkish experience in this area? A key initiative we took was designing a macroprudential policies dataset on aggregate leverage and maturity mismatches. As a first step, we decided initially to monitor the speed of loan growth, which has become a key reference for macro policy objectives. At a later stage, though, it became clear to us that financial intermediation was shifting away to a certain degree from the domestic banking sector to global financial markets. This required the monitoring of non-financial corporations' cross-border exposures as a result. The foreign exchange risk of those non-financial corporations was tasked to the Central Bank of the Republic of Turkey, which set up a comprehensive micro and macro data integrated statistical framework. The macro layer comprises foreign exchange assets and liabilities of Turkish companies based on national aggregates. The micro layer is based on the central bank's Company Accounts publication and the database of the Risk Center at the Banks Association of Turkey, in which one can integrate micro-level evidence on the degree of liability dollarisation and company specifics, and thereby of the currency risk embedded in the Turkish corporate sector.

This integrated framework has proved to be instrumental in understanding the transmission of institution-level fragilities to macrofinancial stability risks. Non-financial companies in Turkey have, on aggregate, a significant amount of foreign currency-denominated debt, with a substantial short position in foreign currency which is often perceived as a source of currency risk or vulnerability by market participants. The firm-level dataset helped us to dig deeper into the numbers. Long story short, our work helped us to identify better the currency risk of non-financial companies through a firm-level analysis. In particular, we observe that the currency risk of non-financial firms in Turkey might be lower than what macro aggregates have implied.

Looking ahead, we are investing in a high-quality micro-macro framework to capture household finances. Our plan is to generate a nationally representative micro-level panel dataset including information on families' balance sheets, pensions, income and demographic characteristics. The information from these two datasets will strengthen our analysis capacity and deepen our understanding of macroprudential policy transmission mechanisms.

The importance of international cooperation – the G20 Data Gaps Initiative

However, we should not forget that the financial system is global. The last financial crisis showed the importance of cross-border linkages in today's closely integrated economies. The need for monitoring and managing the build-up of financial stability risks underscores the importance of having available and comparable information across countries. It also puts a premium on international cooperation, which is indeed improving markedly. Our presence here today, in a workshop involving central banks from all over the world, is evidence of this progress.

Let me finish my opening remarks by highlighting the sheer importance of the G20 Data Gaps Initiative in this context. The starting point was the realisation that, while the crisis was not due to the lack of statistical information, there were important data gaps that needed to be addressed to prevent or at least mitigate the next financial crisis. Taking the lessons of the crisis to enhance our statistical apparatus is

not a new idea. This was exactly what our predecessors did in the 1930s, as they developed GDP measures and national income accounts in order to better analyse economic upturns and downturns including events like the Great Depression. Likewise, the data gaps initiative is calling for new statistical requirements, mostly, but not only, focusing on the financial sector. G20 economies and international organisations are working in close cooperation to close these data gaps, which will help us to have a more comprehensive and accurate picture of the global economic and financial system. And this enhanced statistical information framework will be based on better integration between the micro and the macro perspectives.