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Unrestricted

Basel Committee on Banking Supervision

Consultative document on Countercyclical Capital Buffer Proposal, July 2010

COMMENTS BY THE BANK OF FINLAND

The Bank of Finland welcomes the introduction of countercyclical capital buffers. From past experience we know that monetary and fiscal policies alone are not always sufficiently efficient to counteract credit cycles and excessive leverage. Currently there are few, if any, concrete macroprudential policy tools available.

The countercyclical capital buffer would be a useful tool to protect the banking system against potential future losses and deterioration in banks' lending ability, when excess credit growth is associated with a build-up of system-wide risk. National authorities should have full discretion to impose this buffer whenever the time is right. It would be equally important to let these buffers diminish during downturns.

Certain details concerning the practical implementation of the proposed new countercyclical tool are still open and need to be elaborated.

Scope of objectives

The Committee states that the countercyclical capital buffer is primarily not meant to be used as an instrument to manage credit cycles or contain asset prices, although this moderating effect is likely to be achieved as a positive side effect. The recent crisis showed that the bursting of an asset price bubble can severely affect banks and the real economy through various channels. The discussion on the range and scope of macro-prudential tools is still in its infancy and we might, at a later stage, need to reconsider widening the suggested objective of the countercyclical capital buffer so that it could, at the discretion of the authorities, also be used to contain credit cycles and asset prices.

Timing and availability of statistics

Timing issues are highly relevant to the practical implementation of the basic idea. The buffer should affect bank lending during the build-up phase, not when the cycle has already turned. Even though banks as lenders likely take into account any capital requirement that is known to become binding in the near future, a shorter delay than the proposed 12 months is worth considering.

Another problem of the implementation may be the unavailability of real time statistics. The problem is probably more severe in the case of national accounts than in the case of credit aggregates. One has to wait for several months for preliminary quarterly national accounts. This "actuarial delay" may add several months to the policy reaction time. Combining the proposed 12 months rule, this delay and the time it takes to make the administrative decision on the buffer would make this new policy tool slow to react to changes in the environment.

One could consider the possibility to use lagged nominal GDP instead of the latest available statistics. This could help to alleviate the problem of unavailability of real time data. More importantly, the ratio of total debt to lagged GDP may be a particularly good indicator of credit cycles. At least in the short term, excessive credit growth can boost GDP growth, making it more difficult to detect the build-up phase with an indicator based on non-lagged GDP.

International coordination

Credit cycles are often highly correlated between countries. Nationally based macroprudential policies – such as setting the jurisdictional countercyclical buffer – can be an ineffective response to such cross-country cycles and build-up of system-wide risk. While the jurisdictional reciprocity mitigates level playing field concerns, national authorities may still be reluctant to impose stricter requirements on their national financial institutions than those prevailing in neighbouring countries (“the first-mover disadvantage”). This calls for cross-border cooperation to overcome the coordination problem. We urge the Committee to pay attention to the difficult issue of international or regional coordination of national macroprudential policies. For an analysis, see the article “Towards a European macroprudential policy” by T Saarenheimo in Bank of Finland Bulletin 1/2010.[1]

[1] http://www.bof.fi/NR/rdonlyres/3B81D8B9-0648-4C17-8E1B-92F3CECC5644/0/b_1_2010.pdf

Other issues

The idea to use the buffer only under extreme circumstances may involve some drawbacks. If this policy tool were used very seldom, a political and psychological barrier might be created, and policy makers might be unwilling to introduce the buffer even at times of need. Adjustments in the requirement should not be seen as dramatic decisions indicating inevitable future emergency situations. The buffer requirement could be fairly low most of the time and subject to relatively frequent minor changes.

In some cases developments in different sectors of the economy may differ. For instance, the housing market may become over-heated because of excessive lending whereas loans to the corporate sector may develop sluggishly. Therefore, sector specific buffers, briefly mentioned on page 9 of the consultative document, would likely be required to complement “macro capital buffers”.