Macroprudential policy framework

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Thank you, Governor Ingves. In this panel, I would like to cover some issues concerning the establishment of a macroprudential policy framework, including its necessity and objective, macroprudential policy tools, and institutional arrangements.

1. The necessity and objective of macroprudential policy

The first part is the necessity and objective of macroprudential policy. Before the global financial crisis, the primary purpose of traditional market policy was price stability, in the belief that focusing on price stability would eventually deliver financial stability. At the same time, financial supervision focused on the soundness of individual financial institutions, in the expectation that this would ultimately underpin the stability of the financial system as a whole.

After the crisis, we learned that financial stability cannot be achieved by traditional monetary policy or microprudential policy alone. It is now clear that the objective of macroprudential policy is to prevent the accumulation of financial systemic risks. However, not enough research has been done on methodologies to identify and measure systemic risk factors.

2. Macroprudential policy tools

Until now, the capital ratio, liquidity ratio and leverage ratio have been at the centre of our discussions on macroprudential policy tools. These are actually based upon microprudential tools with adjustments to contain potential sources of systemic risk such as procyclicality and interconnectedness.

We need to develop and utilise a variety of additional policy instruments because, first, the final Basel III package is scheduled to be fully implemented by 2019 and, second, the available tools, especially capital, liquidity and leverage ratios, may be limited in their effect. Although the agreed policy tools including capital, liquidity and leverage ratios are available, central banks should still play a role in preventing financial crises and developing appropriate policy tools in times of crises.

In this sense, we need further study on the effectiveness of using monetary policy as a means of promoting financial stability. In this regard, reserve requirements and loan-to-value (LTV) ratios need to be our top priority. They may be useful tools for controlling the funding and operating behaviour of financial institutions. Reserve requirements may also be used as an effective tool for controlling system liquidity if their target is expanded from bank deposits to the liabilities of financial institutions, especially wholesale funding. The LTV ratio and

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asset-based reserve requirements could also be useful tools for targeting the asset side, given that procyclicality is driven by asset fluctuation at financial institutions.

3. Institutional arrangements

Several major developed countries have recently set up separate bodies for macroprudential policy, as distinct from their microprudential supervisory bodies. These are mostly structured as a committee, a council or a board, in which the central bank, government and supervisory authorities all participate.

Macroprudential policy committees tend to be formed either under the central bank (Type 1) or as an independent body (Types 2 and 3). The chairman of this committee can be either the central bank governor as, for example, in the United Kingdom, Belgium and the European Union; or the Secretary of the Treasury (as in the United States); or the head of other relevant bodies based on a rotation scheme, as in, for example, Hungary.

Table 1 shows the different types. Type 1 countries have an integrated microprudential supervisory framework, and the macroprudential policy committee was established under the aegis of the central bank. Examples of this type include the United Kingdom and Belgium: the governors of the Bank of England and the National Bank of Belgium chair these committees. Type 2 countries have a diversified microprudential supervision framework, and these countries have established an independent macroprudential policy committee. Examples include the United States and 27 countries in the European Union. Type 3 countries have an integrated microprudential supervision framework and have set up an independent macroprudential policy committee. Hungary exemplifies this approach.

Table 1

Major developed countries' macroprudential supervision framework

Type 1	Type 2	Type 3
• An integrated microprudential supervision framework • MPP[1] committee under central bank • UK (chairman: BOE Governor) • Belgium (chairman: NBB Governor)	• A diversified microprudential supervision framework • An independent MPP[1] committee • USA (chairman: Secretary of the Treasury) • EU 27 countries (chairman: ECB President)	• An integrated microprudential supervision framework • An independent MPP[1] committee • Hungary (chairman rotates every year)[2]

[1] Macroprudential policy. [2] Central bank, treasury department, financial supervisory authority.

Concerning the pros and cons of setting up a macroprudential policy committee inside or outside the central bank, a committee under the central bank is better positioned for a faster decision-making process, clearer lines of responsibility, and political and fiscal neutrality. On the other hand, an independent body can be a better option for its ability to focus specifically on financial stability. At the same time, the central bank's credibility is safeguarded. Table 2 sketches out the pros and cons of these two schemes.

Table 2

**A comparison of pros and cons:
external committee versus an internal committee of the central bank**

	Central bank internal committee	Independent external committee
	(UK, Belgium)	(US, EU, Hungary)
Prompt decision-making	○	X
Clear role and responsibility	○	X
Political and fiscal independence	○	▵
Expertise in related institutions	X	○
Central bank's credibility	▵	○

Whatever type of macroprudential policy framework is chosen, the central bank should play a key role in assessing systemic risks, because central banks have expertise and analytical capacity in a comprehensive overview of the financial system and macroeconomy.

Second, central banks play the role of lender of last resort, bearing the massive costs of crisis management as evidenced by the greatly expanded balance sheets of central banks in major developed countries since the recent crisis. Table 3 shows that the balance sheet of the Federal Reserve has expanded 2.4 times between 2008 and 2009. For their part, the Bank of England and the Sveriges Riksbank have expanded their respective balance sheets by 3.1 and 3.3 times.

Table 3

**Expansion of central bank balance sheets
during the global financial crisis**[1]

(unit: multiple)

FED	ECB	BOE	Canada	Switzerland	Sweden
2.4	1.1	3.1	1.3	1.6	3.3

[1] From December 2007 to December 2009.

Third, we need to find an appropriate policy mix between monetary and macroprudential policies as they are highly complementary.

And fourth, price stability is a narrow mandate for central banks compared to their potential capacity for financial stability. Also, it is critical to make a proper role assignment and establish a cooperative relationship between the central bank, the government and supervisory policy authorities during normal times. Central banks can effectively function as a lender of last resort in times of crisis when provided with sufficient information on financial institutions during normal times.

Lastly, in the case of Korea, there has not yet been a full-blown discussion of the macroprudential policy framework. Rather, we are just taking steps to improve the current policy coordination framework.

The Bank of Korea seeks to monitor systemic risk factors, issue early warnings and recommend policy responses to a crisis. However, the Bank has no explicit mandate for financial stability, and these efforts will not bring about any changes in relevant policies.

Among G20 member countries, only Korea and Australia do not state “financial stability” as an explicit objective of their central bank acts. So, including financial stability as an explicit objective in the Bank of Korea Act will be the first baby step to ensuring financial stability.

I will finish here. Thank you.