BANK FOR INTERNATIONAL SETTLEMENTS

Opening remarks by Hiroshi Nakaso, Deputy Governor of the Bank of Japan

The Global Financial Crisis was a catalytic experience for many central banks around the world, in part because they met new challenges in their role as ultimate providers of liquidity to the financial system. Confronted with the need to provide credit to institutions and markets that faced unprecedented liquidity constraints, they often had to develop new facilities to deal with sudden liquidity shortfalls and make new arrangements for mutual cooperation, since these shortfalls spilled across national borders.

The motivation for this report lies precisely in these experiences. The institutional and regulatory landscape has evolved since the crisis but the lessons remain highly relevant – above all, that LA should be provided swiftly but only when there is a clearly identifiable liquidity problem and when other tools are unavailable. It should also be supplied in ways that keep moral hazard to a minimum.

The overall message is that central banks need to prepare in calm times in order to be effective in providing liquidity assistance in times of stress. The report lays out eight principles that make this message concrete in the context of three specific challenges.

The first challenge arises because internationally financial institutions operate and fund themselves in several currencies. This makes it more likely that liquidity shortfalls in such an institution will involve more than one currency, but also that liquidity stresses can affect several jurisdictions simultaneously. Central banks in the home and host jurisdictions will need to cooperate and coordinate their actions. The form of cooperation depends on their national liquidity assistance frameworks, which determine among other things whether the institution is eligible to receive assistance, and if so, what collateral it would need to provide. One message of the report is that central banks need to be aware of how their national frameworks interact. In addition, operational issues matter. For example, before a central bank provides liquidity assistance in a foreign currency it needs to have arrangements in place to access that currency.

The second challenge covered by the report is transparency. Over the past few years, there has been increased emphasis on transparency in many aspects of central banking, including the provision of liquidity assistance. Transparency is a necessary ingredient of accountability but it may have other implications. Depending on the circumstances, the disclosure of a liquidity assistance operation while it is taking place could amplify the stress it is meant to mitigate. There can be a trade-off here with promoting financial stability. The report discusses the trade-offs between transparency and the need for flexibility in the timing of disclosures.

The third challenge covered in the report reflects the growing role of financial markets in channelling credit from savers to borrowers. Throughout the crisis, central banks supported the working of important funding markets either by engaging directly as a participant or, indirectly, by supplying liquidity to key players. The report discusses the instruments that are available to channel liquidity to markets and the implications for central bank cooperation.

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