

## Zhou Xiaochuan: Macro-prudential policy – Asian perspective

Opening remarks by Mr Zhou Xiaochuan, Governor of the People's Bank of China, at the High-Level Seminar on "Macro-prudential policy: Asian perspective", Shanghai, 18 October 2010.

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Distinguished Managing Director Kahn,

Distinguished First Deputy Managing Director Lipsky,

Ladies and Gentlemen,

Good Morning! It is a pleasure to meet friends old and new in Shanghai in this beautiful autumn to discuss macro-prudential policy. On behalf of the People's Bank of China, I want to extend the warmest welcome to representatives from international organizations and officials from central banks, ministries of finance and financial regulators.

Reviewing the global financial crises in history, we know that a crisis will prompt fresh institutional reforms in addition to causing massive damages. Since the outbreak of this round of crisis, the international community has agreed on the need to strengthen efforts to implement macro prudential policy. In the past few decades, the many new developments in financial sector undergone, as reflected in positive feedbacks and pro-cyclicality in the economic and financial system, worked together with various other factors and ingredients such as insufficient early warning, inappropriate management and contagion, and produced the worst crisis since the "Great Recession".

A key lesson from this crisis is that risk prevention should focus not only on single financial institution or single sector, but also on systemic risks. Macro-prudential policy is the very solution that addresses systemic risks.

After the outbreak of the crisis, the International Monetary Fund and the Financial Stability Board stated clearly that implementing macro-prudential policy should be central banks' responsibility. Countries have since then also enhanced central banks' macro-prudential policy functions in their financial reform. At the request of G20 financial summit, the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS) and other standard-setting bodies are working to develop institutional arrangements and tools to strengthen macro-prudential policy, establish mechanism to mitigate pro-cyclical factors, raise regulatory standards on systemically important financial institutions, and improve risk disposal and settlement arrangements.

The international practice of strengthening macro prudential policy will be a boost to China's financial reform and development. The Chinese financial system has basically withstood the shocks of the recent crisis because of the following reasons. First, continued economic growth has created a benign environment. Second, after the Asian financial crisis, joint stock reform of state-owned commercial banks enhanced their overall strength and resilience and strengthened the foundation for financial stability. Third, the financial legislation system and supervision ability has improved. Fourth, the financial market, including delivery of services and product innovation, was not sophisticated, and this helped ward off crisis.

Currently, China's financial system faces the challenge of guarding against systemic risks. On one hand, to address deep-rooted problems in the economic structure and the uneven and unbalanced growth, it is necessary to adopt sustainable and sound macro-economic policies; the expansion of domestic credit supplies remains strong and cross-border capital movement contains potential risks. Excessive liquidity, inflation, asset price bubbles, periodic non-performing loans and other risks may build up and undermine asset quality and resilience of China's financial sector. On the other hand, in the past few years, many financial institutions are offering cross-sector and cross-market products; financial share-

holding companies have established complex internal structures and moved into diversified businesses; new-type of financial institutions are heavily involved in the financial market activities. Given China's domestic situation, the stability of the financial system and macro-economic policies are directly related. Due to the large share of bank credit in total financing, there is a close relationship between fluctuation of credit supply and economic cyclical change on one hand and systemic financial risks on the other. Therefore, the establishment of counter-cyclical adjustment mechanism is our priority in strengthening macro prudential policy. The People's Bank of China, with a mandate in China's macro-economic management and financial stability, needs to build a counter-cyclical adjustment mechanism to increase flexibilities in macro-economic management. Meanwhile, it is necessary to strengthen monitoring on systemically-important financial institutions to prevent and properly manage potential systemic risks.

Macro-prudential policy is a relatively new concept in China. To avoid misunderstanding and simplification of it as just capital requirement, capital buffer, liquidity, leverage, etc, first of all, we need to clarify its essential meaning, framework and concrete content. In general, firstly macro-prudential policy is counter-cyclical. Secondly, it needs to deal with market failure such as herding phenomena to enhance financial market soundness and prudence of market participants. Thirdly, along with globalization, rapid expansion of financial market, increasing complex financial instruments and trading, it is necessary to formulate and implement broader international standards.

Today, thanks to an IMF initiative, we gather to discuss macro prudential framework based on lessons learned in crisis, to analyze macro prudential policy tools and their effects, to reflect the changing roles of central banks in macro prudential management. We need to reexamine the relationship between monetary policy, financial stability and macro prudential management, and its policy implications. These are very challenging topics and deserve thorough discussion.

I wish this seminar a great success!

Thank you!