Dimitar Bogov: Economic and financial cycle spillovers – reconsidering domestic and cross border channels and policy responses

Address by Mr Dimitar Bogov, Governor of the National Bank of the Republic of Macedonia, at the 5th Annual Research Conference "Economic and financial cycle spillovers – reconsidering domestic and cross border channels and policy responses", Skopje, 7–8 April 2016.

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Dear Governors, Your Excellences,

Ladies and Gentlemen, Dear guests,

Let me wish you a warm welcome to our fifth Annual Research Conference that we usually host to mark the anniversary of the country's monetary independence. This year's Conference is a kind of a small jubilee considering the fact that for five consecutive years we have been inviting policy makers and researchers from the region and wider to discuss main policy issues and research questions, creating useful interaction and mutual knowledge increment, on which we are very proud. In addition, this year's Conference coincides with yet another great anniversary – celebration of 70 years of central banking activities in the Republic of Macedonia and the conference is among the events that mark this immense anniversary throughout the year.

As you probably noticed, this year we have chosen quite comprehensive and challenging Conference topic: Economic and Financial Cycle Spillovers: Reconsidering Domestic and Cross Border Channels and Policy Responses. Although not a new issue, it has been fully indorsed in the last global crisis and considered to be one of its main lessons that is still widely explored in the central banking and academic community.

In dealing with global and domestic economic and financial cycle spillovers in the last years of turbulent global environment, central banks have broadened their objectives by including the financial stability goal, as well as many creative innovations in their toolkit. In a low or zero interest rate environment, the monetary authorities across the world turn to the use of unconventional monetary policy measures and obviously now, several years after the outburst of the crisis, it is still an ongoing practice for most central banks. While still examining their usefulness, it is difficult to discuss their exit dynamics, even in the case of the FED, although its monetary policy normalization started at the end of the last year. Anyway, it is still debated whether the unconventional instruments and tools created during the crisis will become an integral part of the conventional monetary policy framework. Probably this will depend on country specific circumstances and individual contribution of these newly created instruments and measures in fulfilling policy objectives on price and financial stability. Macro-prudential tools have also been widely used for dealing with specific features of the financial cycles in the last period, aiming to boost financial soundness or provide positive feedback to the economic recovery that has certainly expanded the horizon of their expected impacts compared to the past. Policy measures aimed to support lending, especially in the economies with strong negative loop between private sector leverage and banks' credit risk, will probably stay effective for a reasonable time span. The capacity of economies to cope with these headwinds related to the financial cycle recovery will rely upon providing resilient policy framework and keeping sufficient policy buffers in all segments of the economy.

Obviously, many aspects on the economic and financial cycles have already been observed, with even more still awaiting to be explored. Our latest experience is mainly related to the bust of the cycles, however we need to know if the size of spillovers or effectiveness of our instruments will be the same in the boom stage of the cycle. The seminal work by Borio from 2012, has already provided some stylized facts regarding frequency, duration and leading indicators of the cycles, incorporating the period of the last global crisis. However, we need to disentangle country's specific features of the cycles as a basis for the policy mix design. In analyzing financial cycle, it is necessary to go deeper into bank's balance sheet, and therewith to head towards data granularity as an important platform to better assess banks' risk attitude as well as to appropriately link banks' specifics and their market behavior. Consequently, increasing knowledge of economic and financial cycles requires stronger modeling abilities, enlargement of the analytical base and combining information of both domestic and cross border spillover channels, as a floor for adequate policy responses.

Touching upon the issue of economic and financial cycle spillovers in the case of Macedonian economy, I could refer to the following points. Namely, during the last global crisis, our economy followed relatively quick and steady recovery from the trough at the beginning of the crisis that was supported by the financial cycle pick up. The banking sector has proven to be sound and stable all these turbulent years, with slowdown of lending relative to the pre-crisis period, yet with moderate credit growth rates supportive to the economic rebound. A related point to consider is the solid ground of the banking system taking into account not only the high capital adequacy and liquidity, but also the relatively moderate level of non-performing loans, especially compared to the peer countries of the region. Besides the high foreign capital in the banking system, cross border effects have remained contained, mainly due to the simple framework of banking operations and strict banking regulations. Last but not least, sound economic recovery also transmits positive spillovers to the financial sector developments. Regarding the economic cycle upward movements, we should underline the strong fundamentals of the Macedonian economy that have been obviously fighting off challenges from the trembling global environment as well as domestic political instability since the beginning of the previous year. The main reasons behind these economic performances were the structural changes in the economy in recent years, which supported export diversification and reduction of unemployment. Improved country's economic fundamentals are expected to continue providing support to the financial cycle picking up, although both domestic and external risks are still being present. Regarding policy implementation, besides monetary policy measures, we have also used non-standard monetary policy measures that are still in place, and additionally in several occasions we have modified some of the prudential measures for further strengthening of financial stability.

Managing economic and financial cycle spillovers and putting them on the right track, go beyond monetary policy scope of operation and refer to the overall macroeconomic policy mix. Additionally, international developments and regulation could also affect domestic cyclical movements. Nowadays, we live in a world of ongoing recovery of the advanced economies from the long-lasting crisis, rising vulnerabilities of emerging economies, increasing and unpredictable volatility of the international financial markets and, on top of that, quite persisting geo-political risks. In this complex environment, we need to continue with internal policy coordination and international cooperation.

Therefore, we have been discussing here today quite comprehensive economic phenomena that require multiple angles of observation and profound analysis. Although I believe that the research papers that are going to be presented today will shed light on some of the issues that I have mentioned, this will definitely be a challenge for the researchers in the period ahead, too. As policy makers, speaking today, many years after the onset of the global crisis, we can probably say that many policy challenges are already behind us, but still there are more to come. Therefore, we need to keep on building our institutional capacity and research skills and I believe that today's conference, as a continuation of our previous conferences, will additionally contribute to this goal, not only for us, but also for the participating central banks and other institutions.

I look forward to yet another successful conference, interesting discussions and useful policy messages!

Thank you for the attention!