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Welcome address

I Conference on Financial Stability/Banco de España-CEMFI

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Governor

Good morning ladies and gentlemen,

It is my pleasure to welcome you to this first **Conference on Financial Stability**, jointly organised by the Banco de España and the Centro de Estudios Monetarios y Financieros (CEMFI). Thank you very much for your interest in and attendance at the Conference.

We have a very interesting agenda for today and tomorrow, structured around six sessions and a panel discussion covering a wide range of topics related to the theory and policy practice of financial stability.

This event is bringing together distinguished speakers and discussants from central banks, international financial institutions and academia - a combination which will offer a diversity of perspectives and also ensure a lively and, for sure, interesting debate over the next two days.

This conference has been possible thanks to the joint effort of Banco de España and CEMFI. I am very grateful to the organisers, in particular to Rafael Repullo, Director of CEMFI, as well as to all the members of the scientific committee responsible for promoting this meeting and selecting the papers to be presented in the programme. This event has aroused particular interest among researchers, with -I am told- nearly one hundred papers having been submitted for just twelve slots. With this auspicious start, I trust this conference may become a regular forum of dialogue between researchers and policy-makers: central banks and financial supervisory authorities have many things to learn from the research carried out in academia, away from the frequent policy-making urgencies that drive the daily workload in our institutions.

Financial stability and macroprudential policy

The last crisis generated a good deal of issues to be dealt with by authorities with a role in financial stability. The experience gained over recent years has shown the importance of safeguarding the stability of the financial system as a whole. We now understand that this ambitious task requires the use of sophisticated analytical tools to identify vulnerabilities at an early stage and anticipate how potential shocks can propagate across the financial system. To this end, both micro and macroeconomic methodologies can offer valid insights, and this is why the conference programme intends to offer a mix of both approaches.

One of the most relevant and obvious legacies from the crisis is the introduction of a fully-fledged macroprudential policy framework.

As we all know, macroprudential policy has, essentially, a twofold objective. On the one hand, it seeks to prevent or mitigate the emergence of systemic risks over the expansionary phase of the credit cycle, as well as to strengthen the resilience of financial institutions against these risks. This is typically carried out through countercyclical instruments, such as capital buffers, which should be accumulated over expansionary periods and, eventually, be released in downward phases in order to smooth total credit over the cycle.

Second, macroprudential policy is concerned with the structural features of the financial system. This is a notion that has to do with the impact on systemic risk arising from the size, complexity and interconnections of certain financial institutions. It is essential that financial institutions duly internalise the impact of their decisions on the whole system, which is generally greater for larger, more complex, more interconnected and less substitutable financial institutions. Capital buffers specifically tailored to the most systemic banks have been introduced in recent years in many countries, within the framework of the G20, the Financial Stability Board and the Basel Committee on Banking Supervision initiatives, precisely to address this issue.

Another interesting tool for financial stability, of potential macroprudential use, are the stress test exercises. Notwithstanding their current limitations, stress tests represent a major effort by supervisory authorities to assess the impact of different adverse scenarios on the financial system, to convey its state of resilience to the public and to inform the necessary follow-up actions.

Summing up, the macroprudential policy toolkit has significantly expanded in recent years. This is a change in the right direction because, beyond conferring new powers to central banks and supervisory authorities, it requires the adoption of a system-wide perspective in policy-making.

This new set of powers has been introduced rather quickly –over a few short years – and this leaves us with a number of questions still awaiting answers.

We need to better understand the effectiveness of the new instruments in improving the resilience of the financial system, in reducing systemic risks, and the trade-offs between different policy options. We also need to understand how macroprudential policies can affect risk-taking attitudes by different agents and to what extent the provision of credit to the real economy may be affected, especially during difficult periods.

After a thorough analysis, it might be the case that the current macroprudential toolkit is still insufficient or incomplete. The European Union’s macroprudential framework is currently under review and different possibilities are being contemplated to fine-tune the applicable legislation and to introduce additional instruments.

Over the last decade we have observed that bank-like activities are increasingly being undertaken by non-banks, in particular the so-called shadow banks. There is a debate about expanding the scope of the macroprudential instruments beyond the banking system. Another area of discussion is whether it will be necessary to introduce borrower-oriented instruments in order to address in a more effective way misalignments in real estate markets. For all these issues, your analyses and new insights are, indeed, important.

So, we have ahead of us a large amount of work and avenues for research. As regards the Conference programme, some of the topics I referred to will be discussed today and tomorrow, as well as the interaction with other policies. Needless to say, macroprudential policy cannot be fully understood without assessing how monetary, microprudential and even fiscal policies may affect financial stability.

Experience at the Banco de España with dynamic provisions

Let me finish by briefly referring to our own experience in dealing with financial stability.

Spain was among the European countries building up very pronounced imbalances over the opening years of this century and, then, going through a very severe crisis. The Banco de España was, I believe I may venture to say, a pioneer in developing macroprudential tools, by introducing countercyclical provisions as early as the year 2000, a short time after the launching of the European Monetary Union. Research carried out at the Banco de España shows that these provisions, although not able to counter the strong credit growth in the boom years, proved effective in smoothing the credit contraction during the early years of the recession.

In addition, “dynamic” or “statistical” provisions –the names more frequently used in Banco de España papers when those provisions were first implemented– were, I think, a kind of inspiration for the countercyclical capital buffer, an instrument developed and agreed by the Basel Committee in 2010, and now widely implemented around the world. Dynamic provisions can also be considered, with some nuances along the way, the precursor of expected-loss provisions. The recent introduction of expected-loss provisions has entailed a change of the accounting paradigm, which, so we think at the Banco de España, was long overdue from a banking supervisory perspective.

Overall, given the acceptance of countercyclical approaches to macroprudential policy, I am sure that the panel discussion tomorrow on the Spanish countercyclical provisions experience will offer not just an interesting study in history, but also some lessons for the future.

Without further ado, I am pleased to open this first Conference on Financial Stability giving the floor now to Rafael Repullo, director of CEMFI, who will chair the first session.

Thank you for your attention.