Carlos da Silva Costa: Opening remarks – "Bank of Portugal's 2019 Conference on Financial Stability"

Opening remarks by Mr Carlos da Silva Costa, Governor of the Bank of Portugal, at the "Bank of Portugal's 2019 Conference on Financial Stability", Lisbon, 8 October 2019.

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As prepared for delivery.

It is a great pleasure to be here today to open Banco de Portugal's 2019 Conference on Financial Stability.

On behalf of Banco de Portugal and, in particular, of the organising team, I would like to welcome you all!

Although these introductory remarks have to be brief, I would like to set the stage for today's discussions by highlighting what I believe to be the critical premises for a Central Bank's mandate on financial stability and by identifying some of the risks we are faced with today.

As recently noted by ECB's President, Mario Draghi, "[i]t was only after the crisis that there was widespread recognition of the importance of the macro dimension of financial stability."[1]

Central Banks play a crucial role in ensuring economic and financial stability. They conduct monetary policy to achieve low and stable inflation and, as recognised by the International Monetary Fund (IMF), "are well placed to conduct macroprudential policy because they have the capacity to analyse systemic risk."[2]

The global financial crisis provided evidence of the need to contain risks to the financial system as a whole through dedicated financial policies.

Against this background, many central banks that also have a mandate to promote financial stability have upgraded their financial stability functions, including by establishing macroprudential policy frameworks.[3] But to work effectively, macroprudential policy needs a strong institutional foundation.

As advised by the IMF, "[t]he institutional setup should be strong enough to counter opposition from the financial industry and political pressures and to establish the legitimacy and accountability of macroprudential policy. It needs to ensure that policymakers are given clear objectives and the necessary legal powers, and to foster cooperation on the part of other supervisory and regulatory agencies."[4]

Moreover, we also need to keep in mind that safeguarding financial stability does not aim at preventing bank failures in themselves.

Whereas the main focus of microprudential supervision is to safeguard individual financial institutions from idiosyncratic risks and prevent them from taking too much risk, macroprudential supervision takes into account the interactions among individual financial institutions, as well as the feedback loops of the financial sector with the real economy.[5]

As recognised by the Single Supervisory Mechanism, "[b]anks can and should exit the market if they are managed in a risky and unsound manner, or if they are structurally incapable of maintaining their competitiveness based on a sound business model."[6]

In such cases, the authority entrusted with ensuring financial stability should be equipped with the necessary instruments to safeguard confidence and ensure the financing of the economy is not disrupted.

Post-global financial crisis, this has been achieved through the establishment of resolution frameworks whereby the usage of public funds is minimised. New powers and tools have been created and entrusted – in many cases to Central Banks – to ensure that critical operations of banks can continue and value is preserved while losses are mostly absorbed by shareholders and creditors with the aim of preserving financial stability.

New institutions have also been created. The creation of the European Systemic Risk Board (ESRB), nine years ago, was a milestone in this respect.

In sum,

- First, financial stability is inherent to the mandate of central banks;
- Second, microprudential supervision is essential but not sufficient to safeguard financial stability. Macroprudential supervision is also needed and it should be entrusted to the entities that are better placed to assess systemic risks, i.e., the central banks;
- Third, in order to conduct macroprudential supervision and succeed in their mandate central banks need adequate instruments;
- Fourth, financial stability is not about preventing bank failures, it is about safeguarding depositors' confidence and preserving the regular financing of the economy. Adequate resolution and liquidation frameworks, including access to public funds, are thus an indispensable part of the crisis management toolkit.

It should also be noted that the low interest rate environment of recent years may require a more active stance of the macroprudential authorities as it contributed to a build-up of vulnerabilities and risks to financial stability.

Let me now turn briefly to today's programme. Since its inception, macroprudential policy has gradually been implemented in Europe against a unique financial and economic background, establishing itself as an autonomous economic policy area while interacting with other policy domains.

This is a topic that will be addressed at this conference, in particular at the roundtable where the interaction between macroprudential and microprudential policies will be dealt with.

This environment, characterised by crisis legacies, led, unsurprisingly, some macroprudential policy authorities to postpone the use of macroprudential instruments included in the EU legislation, or to gradually phase them in over time.

These decisions were taken against a regulatory framework that assigns some discretion to macroprudential authorities allowing them to tailor their action to the specificities of each country.

The discretion exercised by macroprudential authorities, together with the different risk environments and institutional setups for macroprudential policy across countries, have led, as expected, to some heterogeneity in the action taken by these authorities.

These differences are reflected not only on the type of instruments used, but also on the methodologies, calibration and speed at which measures were implemented. But this is precisely one of the positive features of the macroprudential policy: the adoption of measures according to specific national circumstances.

Based on information gathered by the ESRB, macroprudential measures implemented in the EU rose from 37 in 2014 to 58 in 2018. These data reflect the increasing intervention of macroprudential authorities across Europe – where Portugal is also included – over the past five years, setting the stage for the first session of today's conference.

In this session we will have the opportunity to discuss – benefiting from this increasing experience – the challenges in assessing the effects of macroprudential policy, not only on the financial system and on economic activity, but also on how it interacts with other policy fields.

Another interesting conclusion that can be drawn from ESRB data is that macroprudential authorities have often preferred to use instruments targeted at credit standards, commonly known as borrower-based measures, namely to address the systemic risk arising from developments in the residential real estate market.

As we all know this risk has increased in the majority of the European countries, specifically in some of the bigger cities, as also recently stressed by the ESRB.

Given the well-established interaction between real estate market and the banking sector, and well-known underlying systemic risk, we dedicate a whole session of this conference to the systemic importance of housing and mortgage markets and the transmission channels of related macroprudential instruments. In view of the political dimension of some of these instruments, something we all need to discuss is how best they should be designed and communicated to inform public debate.

Finally, in the afternoon we will also focus on how the high levels of debt of non-financial corporations may impair economic activity and financial stability. This is a topic that definitely gets to the heart of some European countries given the underlying link with the significant increase in non-performing loans during and in the aftermath of the global financial crisis.

Let me conclude.

Macroprudential authorities have been increasingly active in promoting financial stability, despite facing multiple challenges throughout their relatively short existence.

However, the nature of these challenges has changed in tandem with the upturn in economic activity, the strengthening of financial systems, the action taken by other policymakers and the signs of a reversal in the financial cycle, the intensity of which is also conditional on each country's specific situation

Heterogeneity between countries remains and is likely to continue in the future. That is why macroprudential policy is foremost country specific. But this does not mean that we have nothing to learn from each other. It is precisely the opposite, as today's conference programme will show.

I would like to thank you all again for taking the time to join us here today. Many thanks in particular to our speakers and session chairs. I wish everyone a very pleasant and productive day, with insightful discussions both on and off the podium.

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1 Draghi, M. (2019), "Macroprudential policy in Europe", Welcome remarks at the fourth annual conference of the ESRB, Frankfurt am Main, 26 September.

2 IMF (2019), Monetary Policy and Central Banking Factsheet, 28 March.

3 IMF (2019), op. cit.

4 IMF (2019), op. cit.

5 European Central Bank (2014), "Micro- versus Macro-prudential supervision: potential differences, tensions and complementarities", Financial Stability Review – Special Feature C, May 2014.

6 European Central Bank Banking Supervision (2018), Statement on SSM risk appetite, 9 December, available at

www.bankingsupervision.europa.eu/about/mission-statement/risk_ap...