

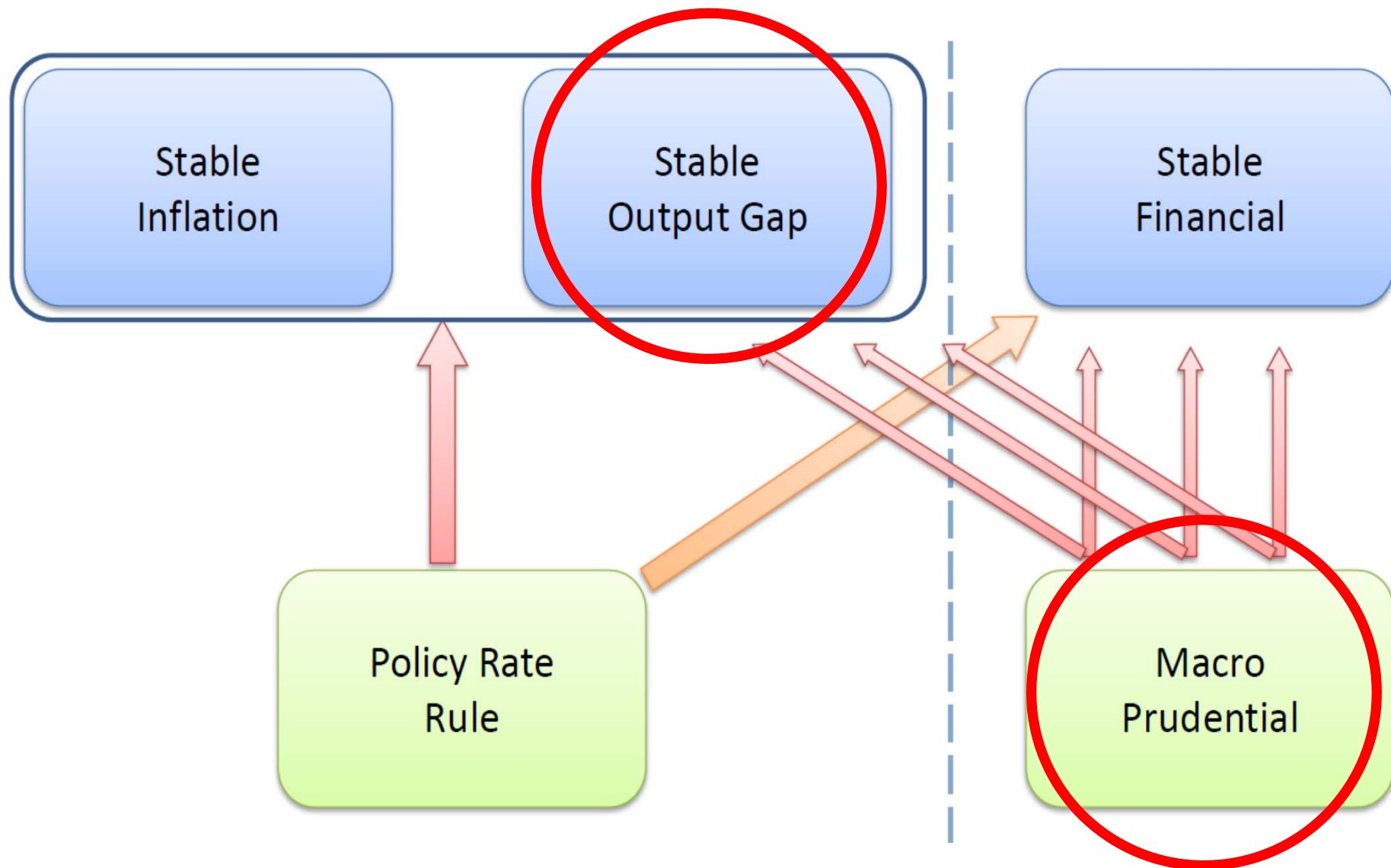


# **The case for the EU-constrained autonomy of local supervisors**

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# **The main lesson from the recent crisis**

- **Central banks need an additional (macroprudential) weapon to stabilize inflation (output gap)**



**Olivier Blanchard, Monetary Policy in the Wake of the Crisis.  
Presentation for the IMF conference „Macro and Growth Policies  
in the Wake of the Crisis”, Washington, 7-8 March 2011.**

## **The main points of the presentation ( 1 )**

- **(1) The goals of the macroprudential policy should not be restricted only to systemic (tail) risk. It should be used for macrostabilization purposes (Goodhart, 2009, Persaud 2009)**
- **(2) Central banks are the most experienced in conducting stabilization policy. They should decide on using prudential tools to stabilize the economy**

## **The main points of the presentation ( 2 )**

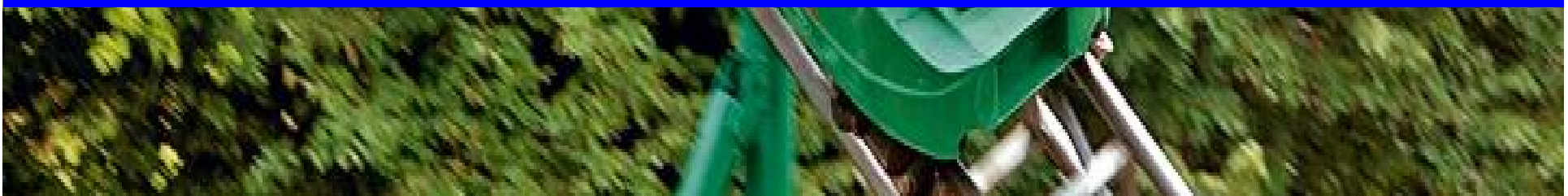
- **(3) Local supervisors should have sufficient scope for autonomy (Persaud 2009)**
- **(4) Single Rule Book (CRD 4) promotes the centralisation of capital and liquidity management within international banks. This poses a serious threat to financial stability at least in the host countries (IMF 2011)**

- **Countercyclical and liquidity charges cannot be set or implemented globally but need to be handled nationally in accordance with national cycles.**

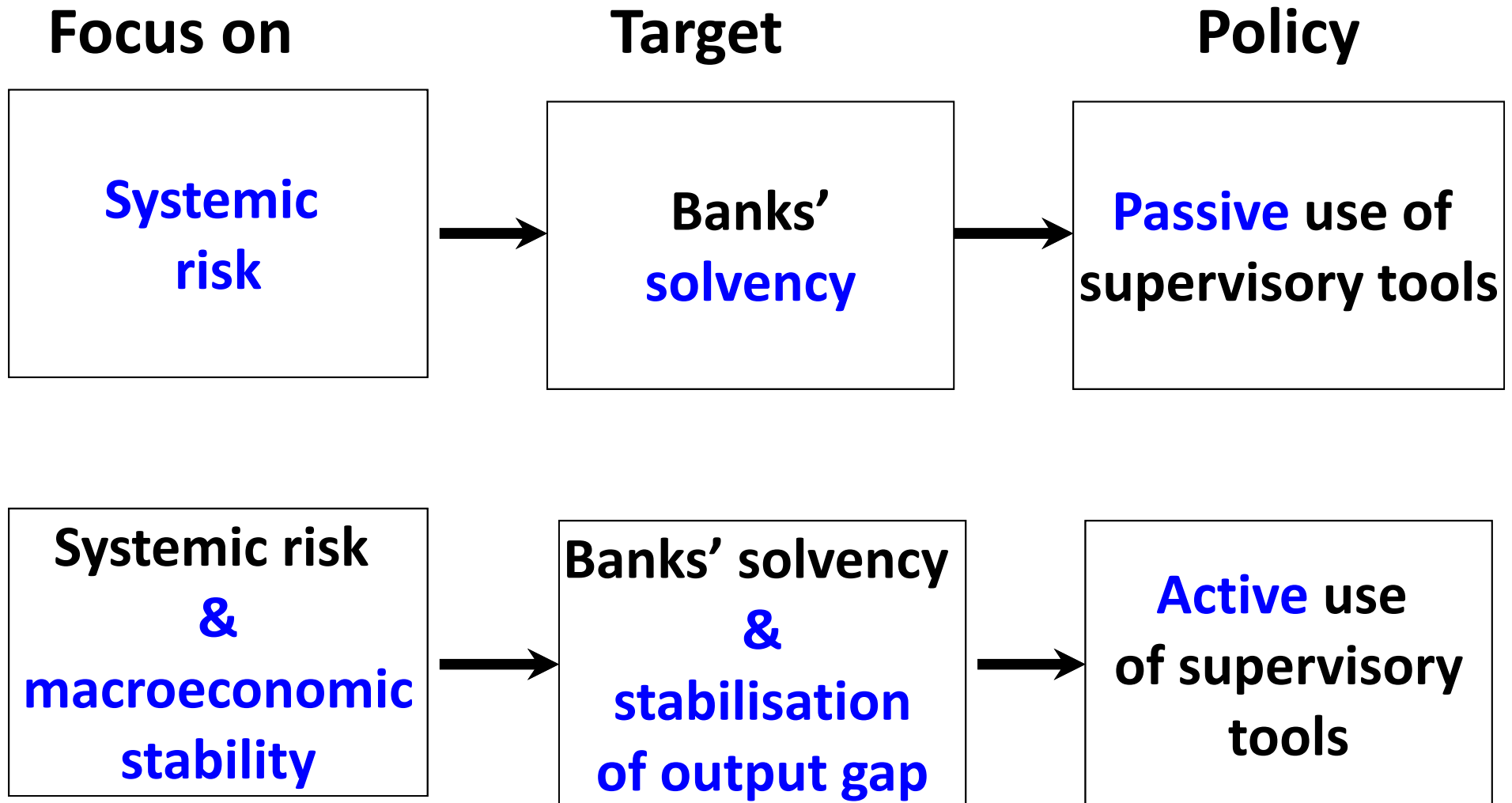
**Avinash Persaud, „Macro-Prudential regulation. Fixing Fundamental Market (and Regulatory) Failures”, The World Bank, July 2009**



**The case for an active  
macroprudential policy**

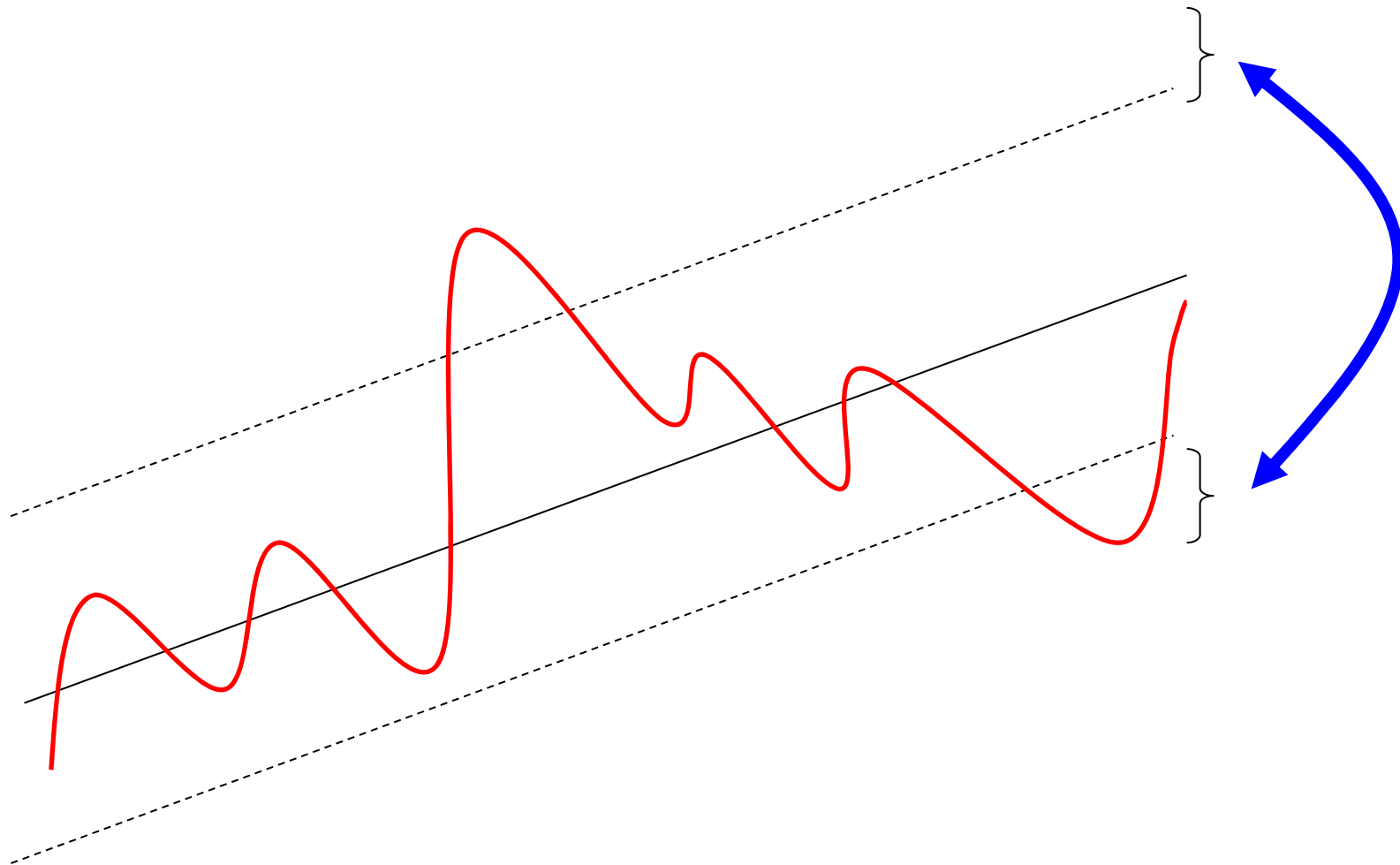


# The two approaches to macro-prudential policy





# Macroprudential policy should not be restricted to the systemic (tail) risk



**Excessive focus on systemic risk  
pushes bank regulatory reform on  
a branch line of passive supervision**



## **The case for an active style of macro-prudential supervision (1)**

- „The purpose of financial regulation is to reduce the amplitude of financial booms and busts, particularly the externalities that are generated in the boom and bust dynamics” (Morris and Shin, 2008)**
- From a central bank point of view the externality is not only systemic risk, but also inflationary pressure during the boom phase of the cycle.**

## **The case for an active style of macro-prudential supervision (2)**

- As illustrated by the experiences of the Baltic states, Portugal, Ireland and Spain, externalities in the form of inflation pressures (appreciation of REER) appear much earlier than the symptoms of a growing systemic risk.**

## **The case for an active style of macro-prudential supervision (3)**

- **„The rationale for regulation of LTVs or LTIs is to (...) reduce the amplitude of economic cycles”.**
- **„LTVs and LTIs should not only be set but also varied over the cycle”**

- **Difficulties in estimating the equilibrium credit growth rate (Blundell-Wignall, Atkinson, 2010) do not rule out an active use of prudential instruments for macrostabilization purposes.**
- **NAIRU and equilibrium exchange rate are unobservable variables, but this fact does not rule out an active use of the interest rate for macrostabilization purposes.**

**Prospects for using macroprudential policy  
for macrostabilization purposes**

- **„Under its current form, Basel III is almost exclusively micro-prudential in its focus, concerned with the solvency of individual banks, rather than being macro-prudential, concerned with the resilience of the financial system as a whole”.**
- **„The language of Basel III is revealing in this regard, with repeated references to greater „loss absorbency” of bank capital”.**

**Hyun Song Shin, „Macroprudential Policies Beyond Basel III”,  
Princeton University, 22 November 2010**



**What is needed** for macro-prudential policy to be used as an effective tool of stabilization policy?

- **A relatively wide scope of discretion in setting capital ratios, liquidity requirements, LTV, DTI, margins, and other supervisory tools (Turner Review, 2009)**
- **Full autonomy for bank subsidiaries in host countries**

- **Maximum harmonization would work like a strait jacket for local supervisors**



## **Risks for the host countries related to maximum harmonization ( 1 )**

- Monetary and supervisory authorities will not be able to use prudential tools to contain unstable lending booms**
- Autonomy of their monetary policy will be harmed, because the influence of interest rate policy will be reduced (IMF 2011)**

## **Risks for the host countries related to maximum harmonization ( 2 )**

- Taxpayers in the host countries would be exposed to the risk generated by banks in home countries**
- Banks in the host countries would not be able to build proper liquidity cushions.**
- Centralization of capital and liquidity management would mean a further liberalization of short-term capital flows**

- **International banks' argumentation rests on the assumption that a full liberalization of capital flows is beneficial to the economy (e.g. UniCredit, 2009).**
- **„There is still an ongoing academic debate on whether countries that remove impediments of foreign capital grow more rapidly than others. This is academic hairsplitting. The historical record of capital mobility is quite clear” (Rodrik, 2011)**

## **What were the main causes of the global banking crisis? (1)**

- **Economizing on capital (maximizing leverage) within large financial conglomerates - TBTF**
- **Rapidly growing scale of the interrelated wholesale interbank (short-term) lending (Shin, 2010)**

## **What were the main causes of the global banking crisis? (2)**

- **Large international banks were too big to monitor and manage their risks effectively (Bookstaber, 2008, Haldane, 2010)**
- **Large universal banks are too big to resolve in an orderly way without ringfencing between retail and investment banking (Vickers' Commission, 2011)**

**Does maximum harmonization address  
these issues properly?**