Taking stock of MaP policies. A view from Chile

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IDB-BIS Workshop on Financial Cycles and Policy Responses

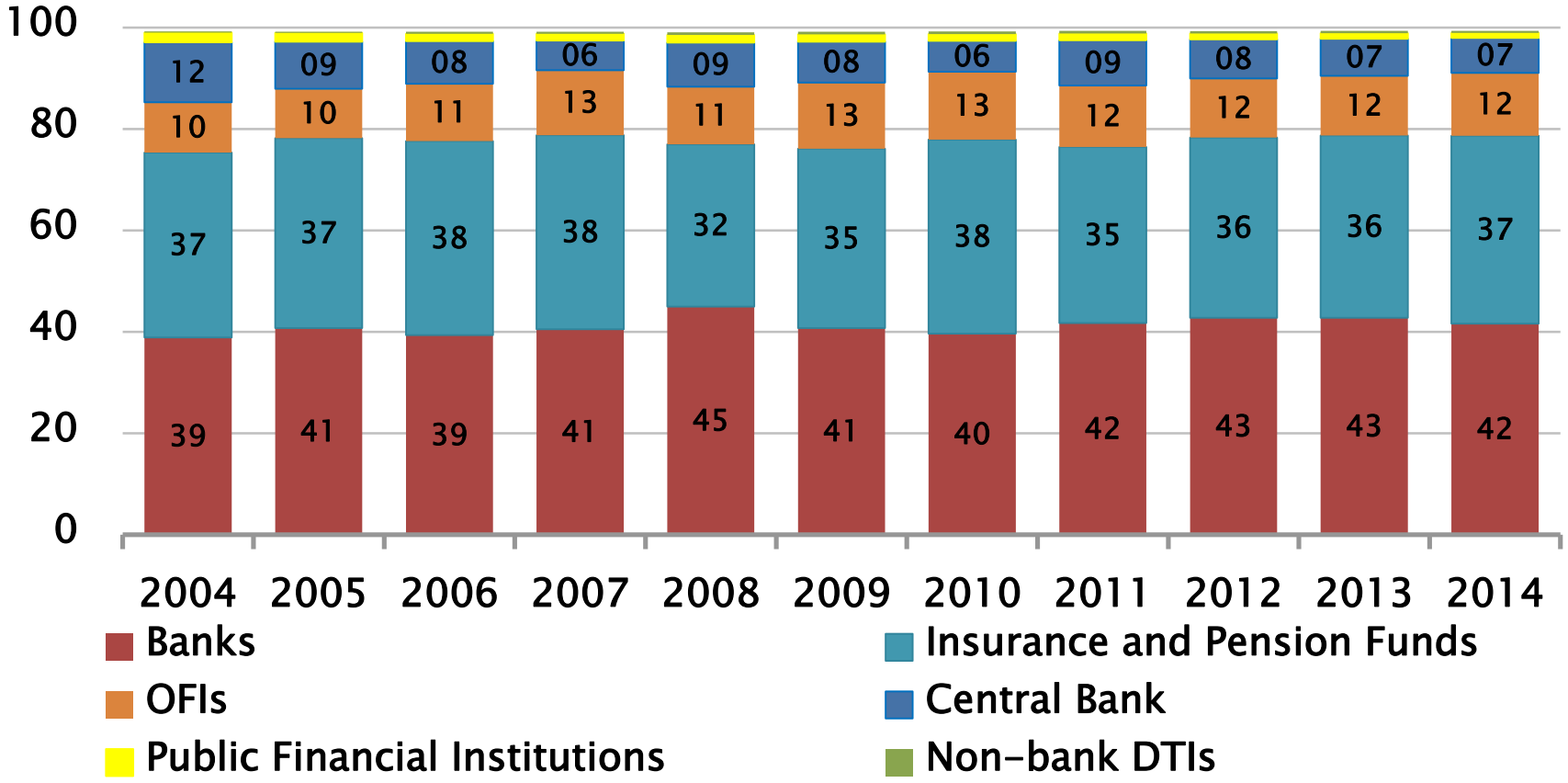
The starting point

- Preserving financial stability has always been at the core of CB functions. But after the crisis it has gained prominence:
  - There is now a consensus about the importance of having a framework for prudentially containing systemic risk→ the rise of MacroPru
- In Chile we have been prudent about macroprudential policies:
  - Not because deep conceptual objections but pragmatic wait and see approach in a context where our financial system was not heavily affected by the GFC.
  - We decided to follow closely the discussion, the literature, and the implementation.
- Why did our financial system fared relatively well? What is our take so far of advances in MaP?

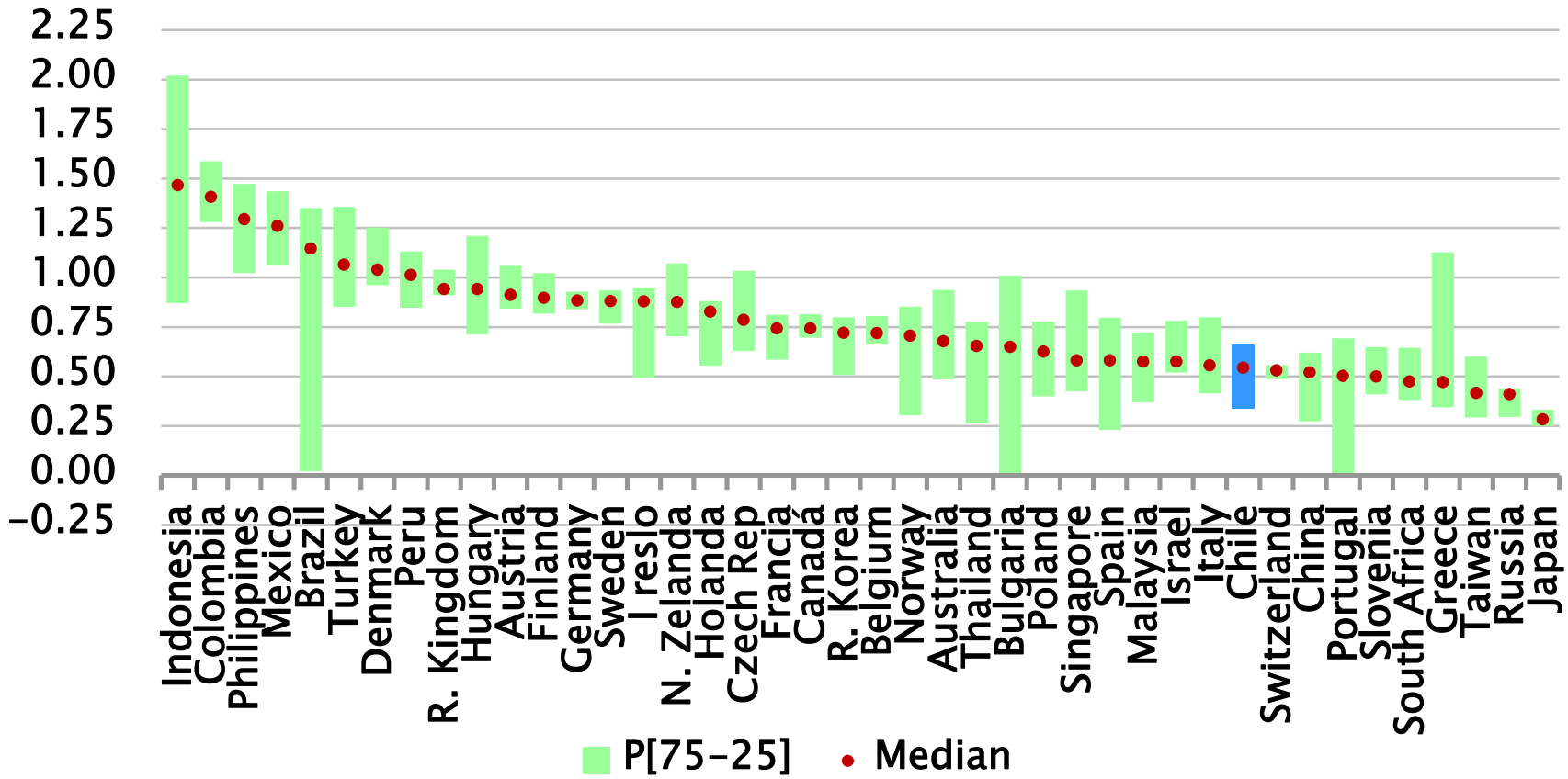
Why did our FS fared relatively well? Simplicity by design

- Dominated by traditional banks subject to strict limits to their activities and risk taking, and good supervision (among others).
- With an important base of domestic institutional investors that tames the impact of international risk appetite on local asset prices.
- Several macroprudential features long embedded in our regulation.
- Close monitoring by the CB aimed at the identification and communication of risks

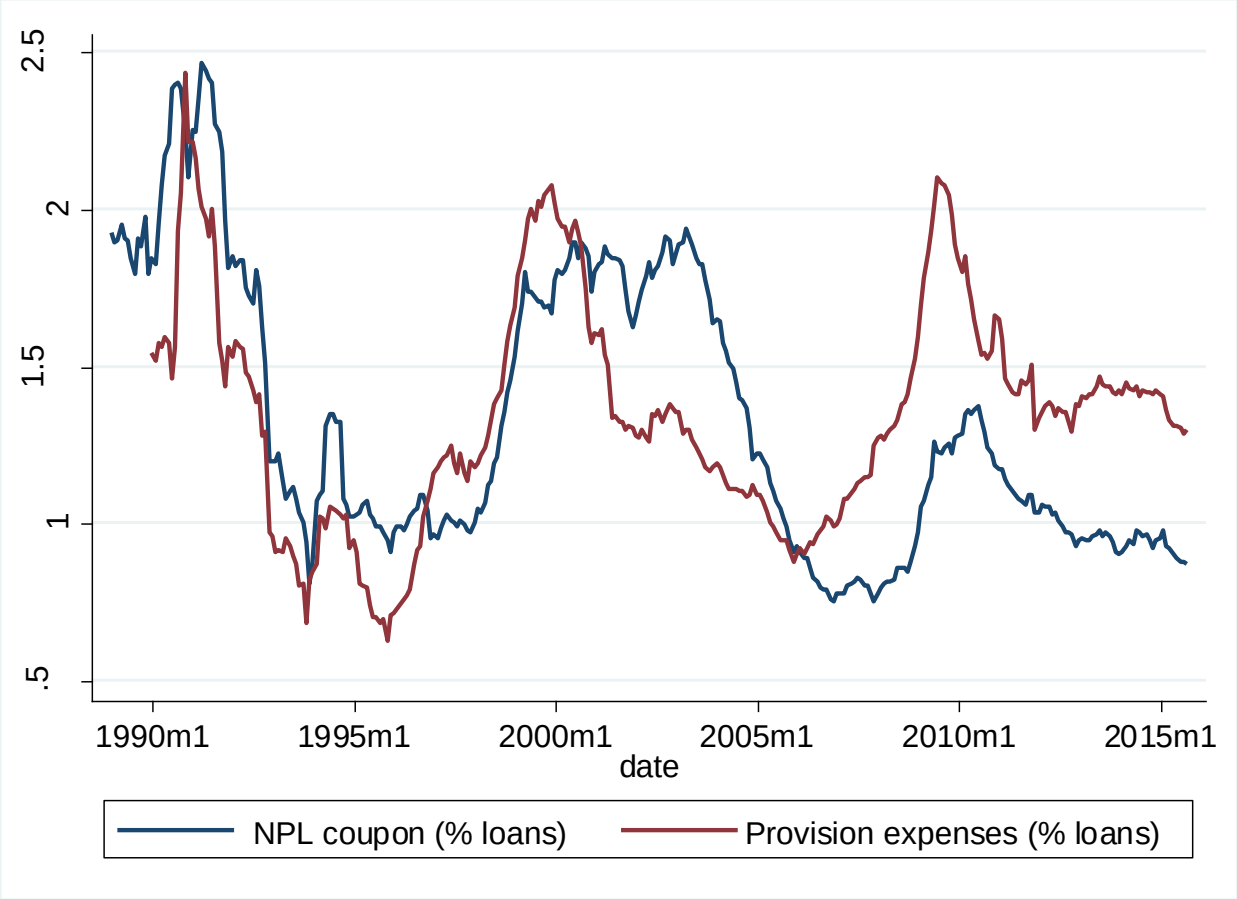
A bank dominated FS with large domestic II



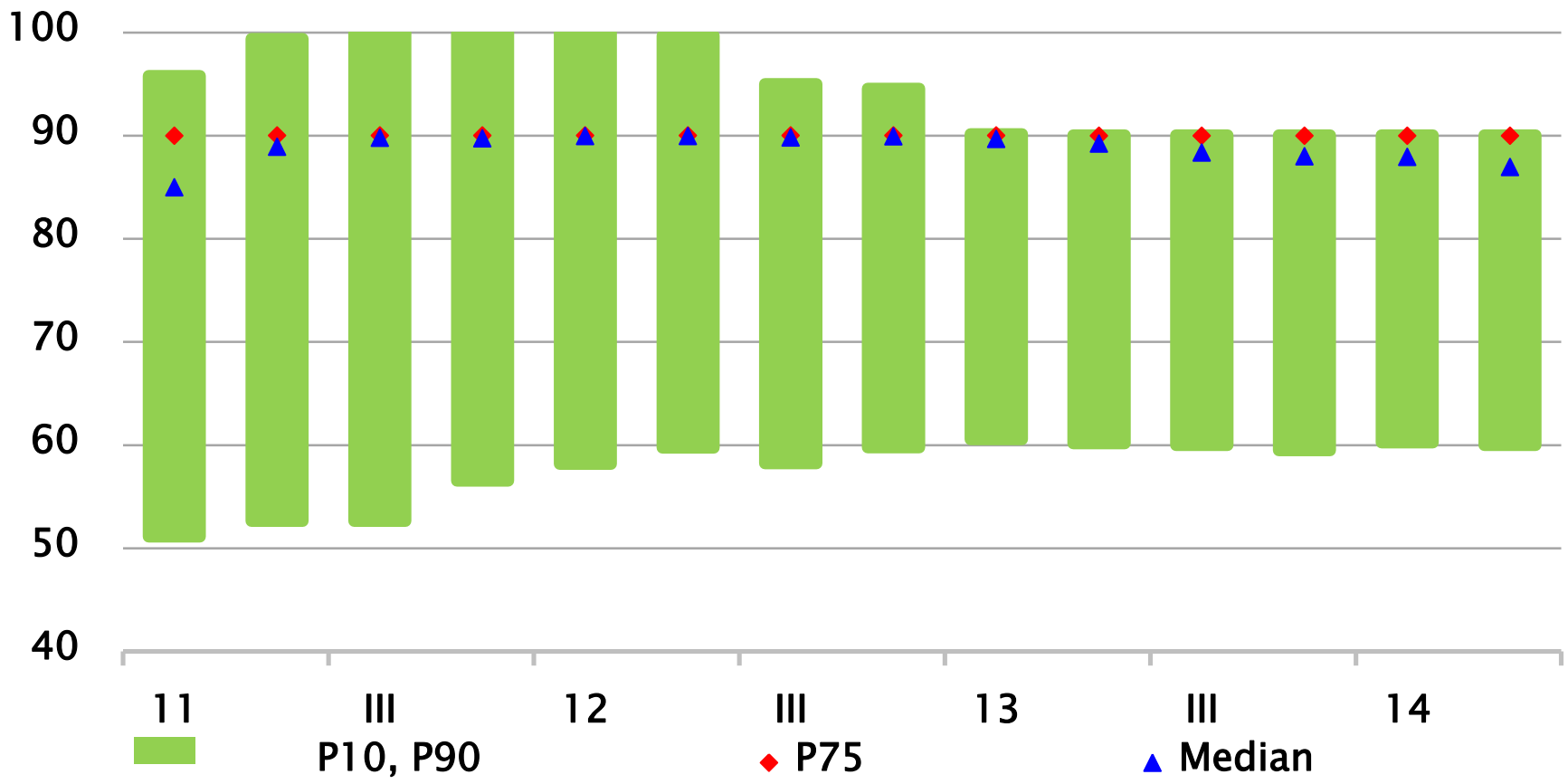
Presence of domestic II may help isolate impact of changes in global FC



Existing regulation has a macroprudential flavor



Close monitoring by CB aimed at identifying and communicating financial stability risks



Relatively broad consensus on the need for tackling cross sectional dimensions of SR

- Reducing TBTF, TITF, market risk, liquidity risk, counterparty risk (CCP): Basel III, G20, PFMIs have made important advances on that regard.
- Reducing incentives to leverage: LTVs, DTI, leverage ratio, etc. adequately and more conservatively calibrated.
- Policies targeted to borrowers seem to be more effective.
- Chile has a conservative regulatory framework restricting size, complexity, incentives, leverage, mismatches. There are clear attempts to contain systemic risk, etc.

Although fewer consensuses on dynamic policies

- Measurement: Identification of credit booms?
- Interaction with other policies: Should MP be used for MaP purposes? Should there be any degree of coordination between MP and MaP?
- Institutional framework: How should MaP policies be implemented?
- Cost benefit analysis: Are they still desirable if one considers all possible costs? For instance, additional uncertainty introduced by discretionary changes in regulation?

Different jurisdictions have taken different stances on this issue

- In general, use of a broad set of indicators and expert judgement to assess the state of the credit cycle.
- Most CB do not use MP for MaP purposes (exceptions through FS on the projections, or inability of taming with other tools).
- In most cases where the CB is the microprudential regulator and supervisor, MaP has also fallen with the CB. In other cases through FSB with different degrees of power.
- There is wide variation in the use of dynamic policies, the CCB being the most widely accepted but sparsely used. Dynamic provisions vice-versa.
- Chile has for long time had some dynamic flavor in its provisioning rules, continuing monitoring and communication of FS risks by CB helps addressing them earlier, importance of local II reduces risks coming from external sector

What is our position so far?

- Our existing prudential framework has several macroprudential elements that helped it navigate through the GFC without continuous policy tinkering.
- We believe macropru should not substitute for adequate macroeconomic policies and good microprudential regulation and supervision.
- We also subscribe the Tilbergen principle and do not consider using the policy rate for financial stability purposes in the regular course of business.
- We target communication and coordination in the FSC (CEF)
- Among dynamic policies, we have supported the inclusion of the CCB in the future LGB and expect to play a role on it.

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