SPEECHES

Opening Remarks

SEACEN / IMF Workshop in Financial Stability and Financial Soundness Indicators
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Opening Remarks by

SWD. Murniastuti
Deputy Director of Banking Research and Regulation Directorate
Bank Indonesia

Distinguished guests and speakers,

Resources Persons,
Ladies and Gentlemen,

Good morning and selamat pagi.

First of all, it is a great pleasure to welcome all of you to Kuala Lumpur, and let me express our deepest regret that the bomb blast in Bali on the evening of 1 October has made us decide to relocate the SEACEN – IMF Workshop from Bali to Kuala Lumpur. Nevertheless, despite the difficult situation we are now facing, I am sure once again Bali would regain its reputation as paradise island, and therefore I sincerely hope that all of you would have a second chance to experience Bali in the near future.

I would like also to thank Mr. Subarjo and staffs from the SEACEN Centre, for their generous effort to make this seminar possible, and also to honored speakers Mr. Schellekens from IMF, Ms. Chan from MAS and Mr. Peng from HKMA and all delegates from SEACEN member countries, for waiting so patiently during relocation and for understanding our country's situation.

At this opportunity I would like to acknowledge the SEACEN Centre and the IMF, whose workshop series have provided an excellent opportunity for member central banks to foster closer ties amongst central bankers, facilitating exchange of knowledge and experiences among the participants and enhancing the level of collaboration between central banks. I hope that you will walk away from this workshop with greater awareness on the importance of Financial Soundness Indicators and Stress Testing, and return home with new ideas and knowledge to deal with the issues and challenges posed in this rapidly changing business environment.

Ladies and Gentlemen,

There is no consensus generally accepted about what do we mean by "financial stability". Andrew Crockett (the former chairman of BIS) has explained that financial stability refers to the stability of financial institutions and financial markets forming a financial system. In addition to what Crocket explained, Ian J. Mc. Farlane, expressed that "financial stability is the avoidance of crises". In addition, to define financial stability we have to look at the sources of financial crisis or instability as it has contagious effect. ECB defines financial stability as "a condition whereby the financial system is able to withstand shocks without giving way to cumulative processes, which impair the allocation of savings to investment opportunities and the processing of payments in the economy"

Within the context of financial stability, it is necessary for us to focus on the soundness of financial institutions that have significant influence on the overall financial system. Adverse developments of these institutions have devastating impacts on the health of a financial system. A bank or financial institution can be described as sound and stable if it is able to demonstrate the ability to meet its obligations to customers without external assistance (from the government or a competent authority). Whenever it is not possible for that institution to settle obligations falling due, it can be said that instability has occurred. This stringent definition is a result of crisis in many countries including Indonesia.

Ladies and Gentlemen,

The most fundamental rationale for a central bank to safeguard financial system stability is **that monetary and financial stability are two sides of a same coin.** Monetary policy has significant implications for financial stability; while on the other hand, financial stability is the most elemental pillar for effective monetary policy. To support my argument we have to look at the history of central bank establishment that is basically for preserving financial stability. History shows us that the establishment of Federal Reserve System and Bank of England, for instance, was aimed at rescuing financial system from collapse. The monetary policy mandate came later after financial stability function.

Therefore, preserving financial stability for a central bank is a core task, as monetary policy and financial stability are interlinked. If monetary policy is mismanaged, inflation may soar and have adverse impact on the performance of financial institutions and financial markets. For instance, soaring inflation reduces real income and this has contagious effect to the quality of bank loans. Very tight monetary policy has also some risk to financial stability. During the early 1990's Indonesian banks had increasing rate of distressed loans due to soaring interest rates. Tight monetary policy is often associated with high probability of financial institution failure. On the other hand, financial stability has significant implications to monetary policy. For example, more effective bank supervision will reduce the probability of bank failures and increase public confidence on banking system. This condition will prevent a flight from broad money and improve the rate of inflation in short run through variety of mechanisms. In practice, stable banking system contributes significantly to long-run effective monetary policy.

Ladies and gentlemen,

One of the aspects of the current emphasis on Financial stability is the collection of statistical information needed to assess the risks and strengths of financial system. Such information may be referred to as Financial Soundness Indicators, or FSIs, about which you hear more later. In the research and consultations of FSIs, a recurring theme for analysts, policy officials, and practitioners was the need for information on financial sector exposures and risk related to the residential and commercial real estate and construction. Numerous experts cited an apparent relationship between collapses in real estate prices and financial sector stress and crisis. Moreover, frequent mention was made about the absence of timely and reliable information, or sometimes the complete absence of any information, about the condition of real estate market.

Ladies and gentlemen,

Macro stress-testing to arrange of techniques used to assess the vulnerability of a financial system to “exceptional but plausible” macroeconomic shocks. Stress-testing at the level of individual institutions has been widely applied by internationally active banks since the early 1990s. Bank regulators require the use the use of stress-tests for monitoring both market and credit risks. Macro stress-testing, as tool of to assess the vulnerability of entire financial systems, is instead much more recent. It has been an important component of the Financial Sector Assessment Program (FSAPs) launched by the IMF and the World Bank in the late 1990s and has become an integral part of the financial stability toolbox of policymakers.

Macro stress-testing has received considerable attention in the last few years. Central banks and international organizations have taken the lead in this area of research, given their particular concern for financial stability issues.

Ladies and gentlemen,

In view of the necessity for the monitoring of financial stability by the central banks across the border of each member country SEACEN, closer co-operation and knowledge sharing among members need to be conducted periodically and systemically. Development in global financial markets and banking supervision are two of the most important issues to solve besides fostering market discipline in each member country. Cross-border surveillance is one of the important techniques for preserving stability in the SEACEN area, in this extent will be pleased to contribute.

Ladies and Gentlemen,

Safeguarding financial stability is the core function of a modern central bank, as important as conduct of monetary policy. Instability triggers multidimensional crises and the cure for such catastrophe creates substantial amount of fiscal cost borne by taxpayers. As Indonesia’s experience, threats to financial stability may arise from many sources including external driven currrency crises. As markets are increasingly globalised, preserving financial stability must be an important cross-border issue to follow up by all SEACEN members.

Once again I would like to say that despite our current situation, Bank Indonesia is very proud to be given an opportunity to host this important workshop. We have noted that both the SEACEN Center and the IMF are leading centers of excellence for training and research in financial stability system. In the face of rapid globalization and financial innovation, the need to train our central bankers and supervisors to keep abreast of developments and to continually upgrade skills becomes all the more important. In this regard, I am utmost confident that the SEACEN Centre and the IMF will continue to be world-class centers for promoting co-operation in research and training in central banking policy and operations, as well as in macroeconomic, financial and bank supervisory issues. Therefore, I strongly believe that your participation in this seminar will prove to be fruitful and productive.

On this note, I am pleased to declare this workshop open and wish you a successful and beneficial workshop and a pleasant stay in Kuala Lumpur.

Thank you.
Kuala Lumpur, 5 October 2005
