Challenges for Economic Growth and Financial Stability in Asia

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Path Ahead is Clearly That of Financial Stability

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Path Ahead is Clearly That of Financial Stability

• We may not have a universal definition but we have always known the parts that must “fit”

• Or, we can look at the market facets that must be in place to sustain market development
For the BSP, the Functional Objectives are Set

Financial stability is achieved when the **governance framework of the market** and its **financial infrastructure** enable and ensure the smooth **functioning of the financial system** conducive to **sustainable and equitable economic growth**.
• Financial stability is not a unique state defined by absolute values of indicators. Instead, there are *multiple possible combinations* which allow a system to thrive and address the evolving needs of its constituents.

• Financial stability is not the micro-foundations of macro policy. It is not the macro translation of micro behaviour. Instead, it binds macro, monetary, financial, infrastructure and fiscal policies together so that *system-wide risks can be pre-identified and mitigated*.

Financial stability and system-wide risks are *relative* concepts
The changing role of the central bank
The Traditional Pillars of Central Banking

- Monetary Policy
  - Money Supply
  - O/N Rate
  - Real Economy

- Banking Policy & Supervision
  - Banks

- Market Infrastructure
  - Public
The Likely Focus Under Financial Stability

Liquidity and Monetary Mgt

Fin Institution Risks

Payment System Risks

Contagion

Central Bank with FS Orientation

This is a completely different strategic mindset . . .

Which will require new competencies and new tools . . .
The New Ingredients Cannot Be Trivial

1. Expertise of a macro-financial economist,
2. Preciseness of a financial engineer,
3. Orderliness of an accountant,
4. Eloquence of a commentator,
5. Imagination of a physicist,
6. Structure of a legal mind, and
7. Perspective of a market practitioner ...
A Policy Agenda Moving Forward . . .
Anchoring the Agenda with a Clear Target

- Macroeconomic Measures
- Granular Foundations and Network Measures
- Illiquidity and Insolvency Measures
- Forward-Looking Risk Measures
- Cross-Sectional Measures
- Stress Tests

31 Measures of Systemic Risk
Liquidity as a Potential System-Wide Risk Target

- Banking Book (Reserves)
- Funding Liquidity
- Macroeconomy
- Public
- Non-Bank Financial Market
- Yield Curve (Price Liquidity)
Liquidity can become the binding constraint

... It is not just an issue of having enough liquid assets for prudential oversight

... but also how liquidity affects the real economy
The Piping of the Market DOES Matter

- Central bank *role* in the financial market infrastructure cannot be understated

- Central bank *liquidity* is a principal premise why CBs are inherently concerned with (if not the lead agency for) financial stability

- Clearing and settlement in central bank funds ensures *efficiency* in terms of mode of execution (electronic) and settlement (good and final value)

- In most Asian jurisdictions, banks are still the *dominant* players in the financial market
The Piping of the Market DOES Matter

U.S. Dollar Clearing and Settlement Network

- **FX Settlements**
  - Settlement Banks
- **Central Counterparties (CCPs)**
  - Settlement Banks
- **Fed Account**
- **Large-Value Transfer Systems (LVTS)**
  - Government Securities Clearing
- **Retail Systems**
- **Central Securities Depositories (CSDs)**

The Challenge of Nurturing Governance

Banking is a business of leverage and gapping

- **Conflicts of interest** are intrinsic to financial markets
- **Corporate governance standards** may be of use
- **Compliance** though is a mindset that needs to be nurtured
- **Capital adequacy** cannot be the only benchmark

“Too high” a CAR position comes at the expense of leverage
All the Pieces Must Reinforce Financial Stability

Key Foundations
- Risk and Capital
- Market Conduct

Overarching Policy

Further Forward
- Capital Market Development
- Inclusion, Education & ConProt’n

FINANCIAL STABILITY