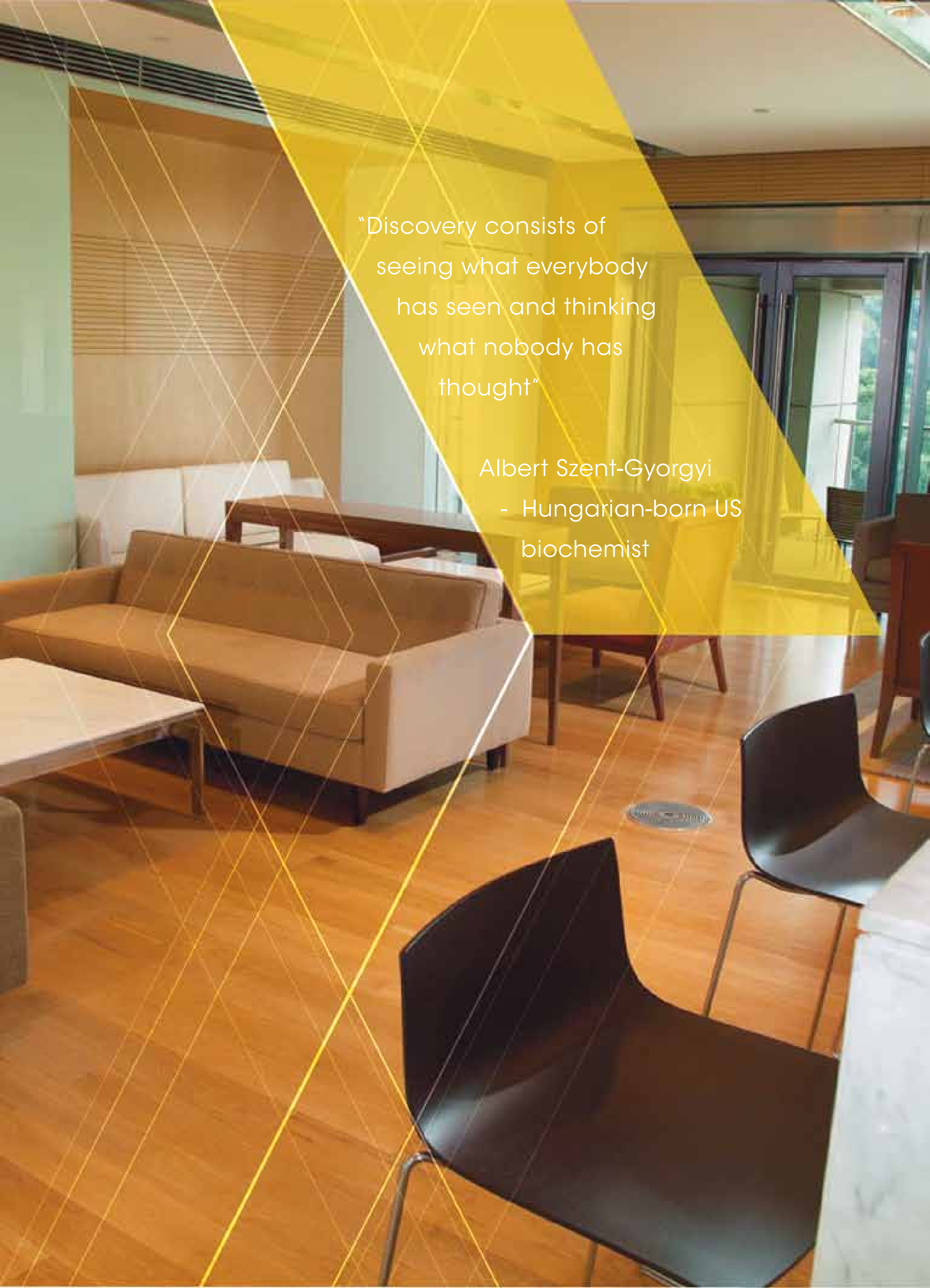
RESEARCH PROGRAMME



"Discovery consists of
seeing what everybody
has seen and thinking
what nobody has
thought"

Albert Szent-Gyorgyi
\- Hungarian-born US
biochemist

RESEARCH PROGRAMME
FOR FINANCIAL YEAR 2013
JANUARY – DECEMBER 2013

1. RESEARCH PROJECTS

R1. INTEGRATING MONETARY POLICIES WITH MACROPRUDENTIAL FRAMEWORK (SIGNATURE RESEARCH)

Rationale

It is clear that a sound financial system is a prerequisite for an effective implementation of monetary policy. This is well illustrated by the current global financial crisis. Due to the interconnectedness of the global financial systems, central banks are increasingly given the mandate to include financial stability in addition to price stability. This calls for central banks to rethink the current framework for monetary policy to include macroprudential policies to fulfill these dual responsibilities. It is recognised, both on theoretical and practical grounds, that although monetary policy is an integral component of the policy framework for financial stability, it has limitations. For example, the efficacy of monetary policy is questionable in an environment where consumer prices and asset prices move in the opposite directions.

The escalating prominence of the macro-financial linkages also implies that there is now a widespread recognition of the need to focus on pro-cyclicality issues, systemic risk and internal and external shocks on the overall economy. Clearly, the consequence of implementing macro-prudential policies will have a direct bearing on the conduct of the monetary policies and vice versa. Thus, both sets of policies need to be manifested into a coherent and effective approach which can mutually reinforce and support each other to achieve both price and financial stability. Therefore, monetary and macro-prudential policies may be most successfully implemented in the presence of an overall policy framework that fosters complementary management of monetary policies with macro-prudential policies There is, thus, a need to critically examine potential synergies, trade-off and conflicts between them.

Apart from mutual consistency in implementing both monetary and macroprudential policies domestically, there may also be need for policy coordination in the international dimension. It may be therefore necessary to examine the possibility of cross-border collaboration in implementing both set of policies consistently.

Objectives

1. To propose macro-prudential tools to mitigate systemic risk and procyclicality compatible to monetary policies,
2. To discuss macro-prudential framework in the context of macroeconomic policies in the SEACEN context; and
3. To access potential cross-border collaboration in implementing macro-prudential policies.

R2. GREATER FINANCIAL INTEGRATION AND FINANCIAL STABILITY (30TH ANNIVERSARY CONFERENCE AND SIGNATURE RESEARCH)

Rationale

The financial system is much getting increasingly globalised and integrated. Thus, to implement a domestic financial sector agenda, one must give due consideration to what is happening cross border. For example, there is enough compelling evidence to indicate that there is increased correlation between domestic liquidity and the global financial environment. This interconnectedness between financial sectors has also gone beyond to the other sectors of the economy - through the so-called macro-financial linkages. Macro-financial linkages, a direct indication of the deepening globalisation and financial liberalisation, consist of continuous feedback loops between two sectors. This implies that with greater integration, one needs to view the financial sector holistically in order to have an explicit understanding of the connectivity between the macroeconomic and financial conditions.

Many have argued that the financial integration is now an irreversible process and the benefits of financial integration will outweigh the cost of financial contagion. In the long run, the pros of the increase in efficiency of the financial system far offset the cons of potential build-up of imbalances and transmission of adverse shocks. On the other hand, others have argued that financial integration per se is not always beneficial. One has to take into context the nature and type of financial integration. The question then is that given this scenario, what is the nature of this relationship between greater financial integration and financial stability? How does one implement a consistent set of macroeconomic and supervisory policy to safeguard financial stability?

Greater financial integration also implies that we can no longer afford to ‘ring-fence’ in the name of national interest. There is little second guessing that we require realistic regional initiatives and actions. This calls for a well-defined framework of cross-border cooperation and collaboration.

Objectives

1. To analyse the implication of greater financial integration on monetary and supervisory policies;
2. To assess the optimal nature of financial integration from the financial stability point of view in the SEACEN context; and,
3. To access potential cross-border collaboration and realistic regional initiatives in implementing financial stability policies.

R3. MORTGAGE FINANCE AND CONSUMER CREDIT: IMPLICATIONS ON FINANCIAL STABILITY

Rationale

The rapid growth in household debt in mortgage and consumer credit offers both opportunities and challenges. Household debt offers several advantages: better access by households to credit facilities for consumption smoothing, a new source of income for financial institutions, and portfolio diversification for the banking sector. In the longer term, a healthy and vibrant household finance sector also facilitates a shift towards domestic demand that will help rebalance the export-oriented growth model of many Asian economies. However, high levels of household debt may heighten an economy's vulnerability to instability and crises. Such problems have been seen in boom-bust cycles in some credit card markets, rapid house price increases in several economies and the recent global financial turmoil.

Regardless of the sustainability issues of household indebtedness may pose on the economy, it has important macroeconomic implications. The household sector will be more sensitive to movements in interest rates and changes in household income such as unemployment. The sensitivity of household sector to interest rate changes will depend on whether the interest rate is predominantly fixed or variable over the life of the loan. This feature which affects the location of interest risk in the economy determines whether household, financial intermediaries or pension funds are most exposed to changes in interest rates. In turn, this will influence the determination of policy rates by central banks.

Under these circumstances, questions naturally arise for central banks. What are the appropriate financial surveillance framework to assess the early sign of stress and build of risk? What are range of risk indicators available as assessment tools for regulators? What is the appropriate policy response to address the challenges? And, in particular, how should central banks react as vulnerabilities rise and as worst case scenarios materialise? Therefore, there is a growing need for specific attention to be paid to the household sector's risk profile, which has become an important input into monetary and financial policymaking.

Objectives

1. To identify the factors behind the build-up of household debt in the SEACEN economies;
2. To establish the appropriate indicators and techniques used to identify and assess the risks;
3. To learn lessons from the experiences of SEACEN economies in ensuring continued soundness of the household sector and promoting a sustainable property market;
4. To identify asset price bubbles and determine its impact on financial stability; and
5. To envisage measures to mitigate the development of asset price bubbles;

R4. ANALYTICAL FRAMEWORK IN ASSESSING SYSTEMIC FINANCIAL MARKET INFRASTRUCTURE (FMIs)

Rationale

Financial Market Infrastructures (FMIs) play a critical role in the financial system and the broader economy. FMIs facilitate the clearing, settlement and recording of monetary and other financial transactions. Thus, FMIs are important for the effective implementation of monetary and fiscal policy. Equally important is their effect on the efficient functioning of financial markets in order to maintain and promote financial stability and economic growth.

Although FMIs performed well during the 2008 global financial crises, the events highlighted important lessons for effective risk management. A broader systemic stability focus is one of the key lessons that have emerged. There is consensus that FMIs is one of the first places where financial stress from credit and liquidity problems can manifest itself. These vulnerabilities faced by FMIs may expose the financial system to contagion risks and domino effects. These shocks through liquidity dislocations or credit losses can be transmitted across domestic and international financial markets. In April 2012, the international community through the Committee of Payment and Settlement Systems (CPSS) of the Bank of International Settlements (BIS) published a set of standards and practices for the design, operations and strengthening of FMIs. While these are laudable developments, there is a need to develop an analytical framework to address interconnectedness and contagion effects of systemic FMIs.

Objectives

1. To discuss an analytical framework to assess systemic financial market infrastructure;
2. To develop a quantitative model to analyse systemic financial market infrastructure; and,
3. To propose a regional information sharing scheme to assess cross-border risks pose by systemic FMIs.

2. CASE STUDIES

In line with the strategy to link research to learning, the Research and Learning Contents Department in 2013 aims to prepare 3 case studies based on the research projects and 3 by subject matter experts relevant for learning programmes.

3. SEG ACTIVITIES

SEACEN will continue spearhead activities for the SEACEN Expert Group (SEG) on Capital Flows. Specifically, the following activities are proposed for 2013:

• 10th SEG Meeting

The 10th SEG Meeting which is to be held in 2013 aims to provide a forum for SEG members to exchange views on current issues of common interest related to capital flows. The theme of the Meeting will be decided in consultation with Co-chairs of the SEG. The Meeting will be held back-to-back with the seminar on financial stress indices.

(i) Exchange of Data on Capital Flows

SEACEN will continue to facilitate the exchange of data in the confidential SEG database system. SEACEN will also make efforts to expand the SEG membership from the current 17 and improve participation and timeliness in data sharing.

(ii) Assessment of Capital Flows

SEACEN will prepare twice a year brief reports on capital flows to be circulated to members, which include the Financial Stress Index (FSI) and Expectation (Forward Looking) Survey. The consolidated Exchange Market Pressure (EMP) Index, which has forward looking indicators as an initial stage of the Early Warning System (EWS) composite index, is already included in previous reports. The forthcoming reports will analyse capital flow movements in a more forward looking manner.

(iii) Collaboration and Information Sharing

- On line Secure Real-time Forum

The purpose of this online forum is for SEG members to exchange the most current information on capital flows. To ensure confidentiality, only full SEG members are allowed to participate in the proposed forum.

4. PUBLICATIONS

1. 4 Research Studies
2. 8 Staff Papers
3. 6 Case Studies
4. 4 Occasional Papers
5. 2 SEACEN Economic Letters
   (provides insights on topical global/regional issues, disseminates findings of research studies, staff papers, occasional papers and other research output)
6. 2 SEG Reports
7. 3 Background Papers for High-level Meetings
8. Guide to SEACEN Bank Watch 2013
   (web publication)
9. SEACEN Profile 2013
   (web publication)
10. Annual Report 2013
11. SEACEN Programme 2013
12. E-alumni Update
    (4 issues)
13. SEACEN Key Economic Indicators
    (web publication)