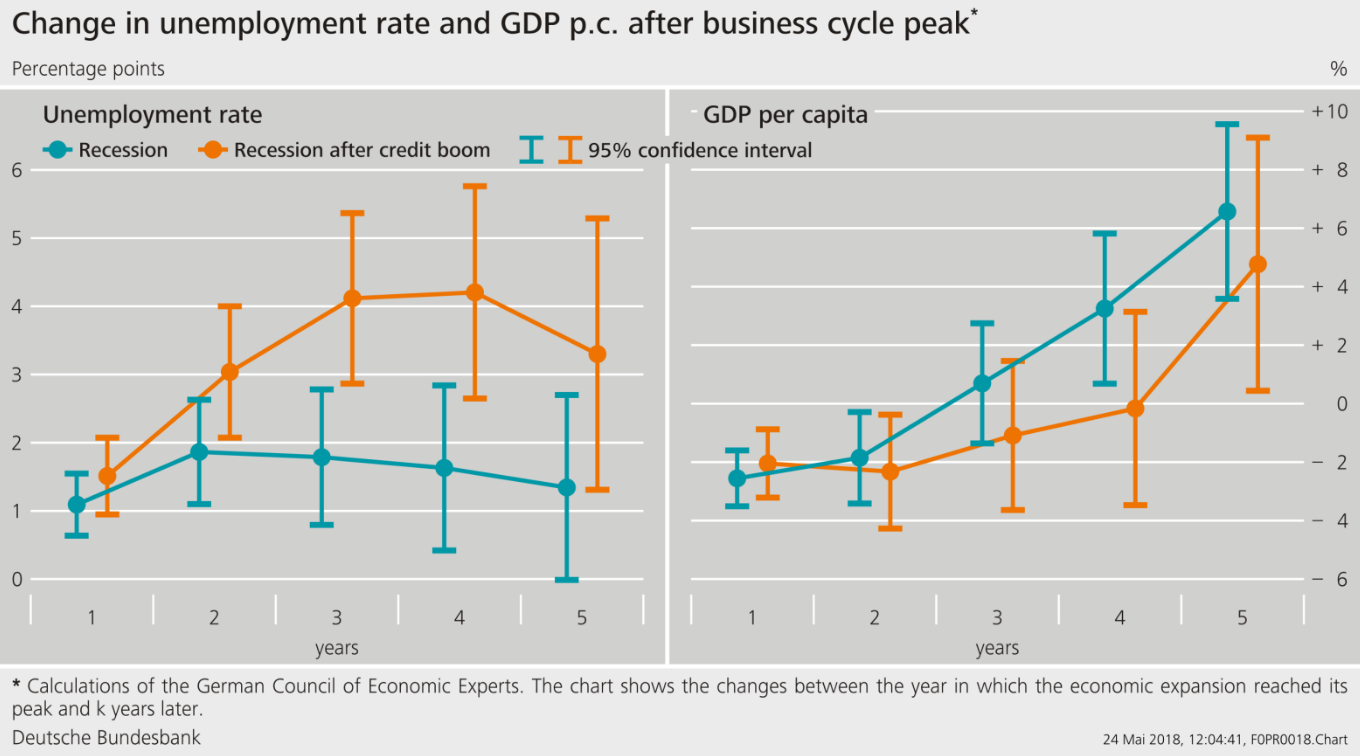
Macroprudential Policy: Safeguarding Financial Stability

Dr. Jens Reich, Deutsche Bundesbank, DG Financial Stability

Berlin – October 24th, 2019

Financial crises are costly for the real economy…

Change real economic indicators during standard recessions and recessions that were preceded by a credit boom, 150 countries 1970-2011.



…have long and lasting effects on public finances…

Which measures effected public debt more intensly in Germany?

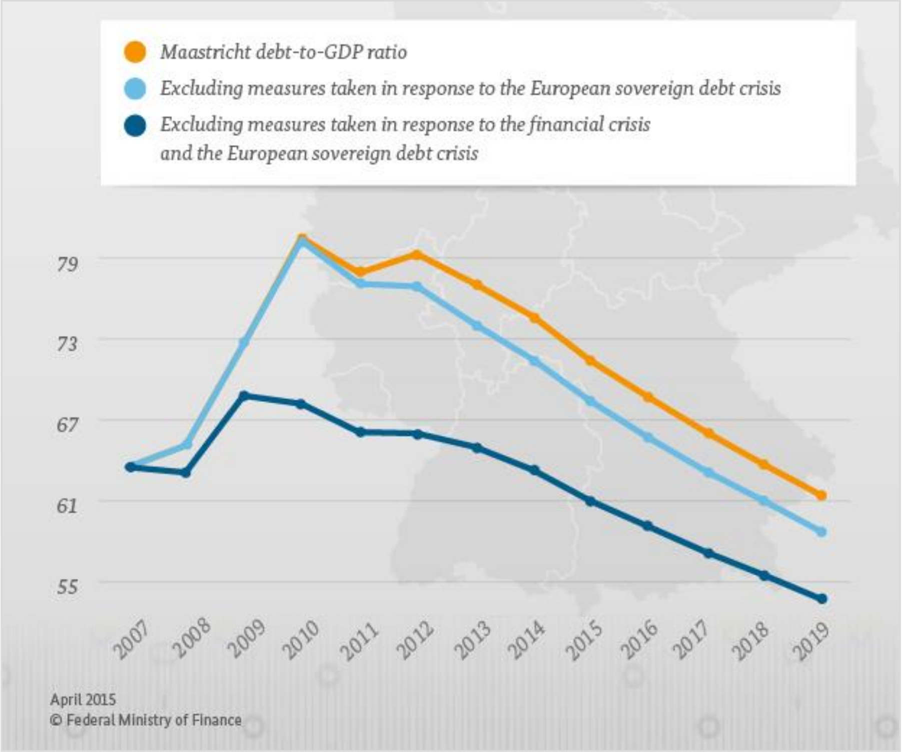
1. Support of the banking sector during and after the financial crisis.
2. Measures teaken in the context of the european government debt crisis.
3. The impact of both were almost identical.

To answer the questions please open www.menti.com and enter the following Code: 10 59 94.

Results

…have long and lasting effects on public finances…

Debt impact of stabilization measures taken in connection with the financial crisis and the European sovereign debt crisis.



Source: Ministry of Finance (2018). Graphics: Fiscal and budgetary policy. Link.

I. Financial stability

II. Macroprudential policy

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I. Financial stability

II. Macroprudential policy

Systemic risks and financial (in)stability

Definition and sources of systemic risk.

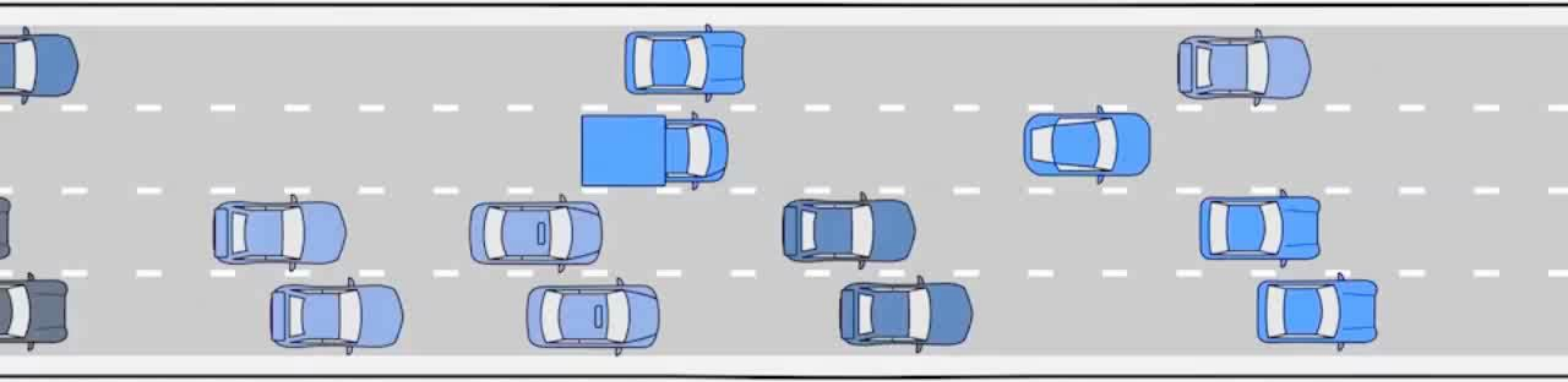
We consider the financial system stable if

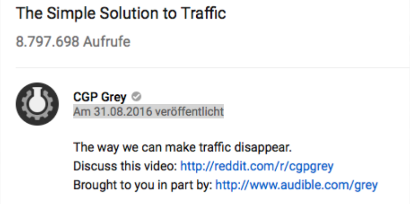
- it provides its functions while market participants constantly adjust to changing economic conditions.

A stable financial system

- is able to absorb idiosyncratic and macroeconomic shocks – in particular in times of economic upheaval.
- mitigates contagion and feedback effects, i.e. the FS neither triggers an economic contraction nor amplifies an exogenous shock.

A financial system is instable if shocks hit vulnerabilities.

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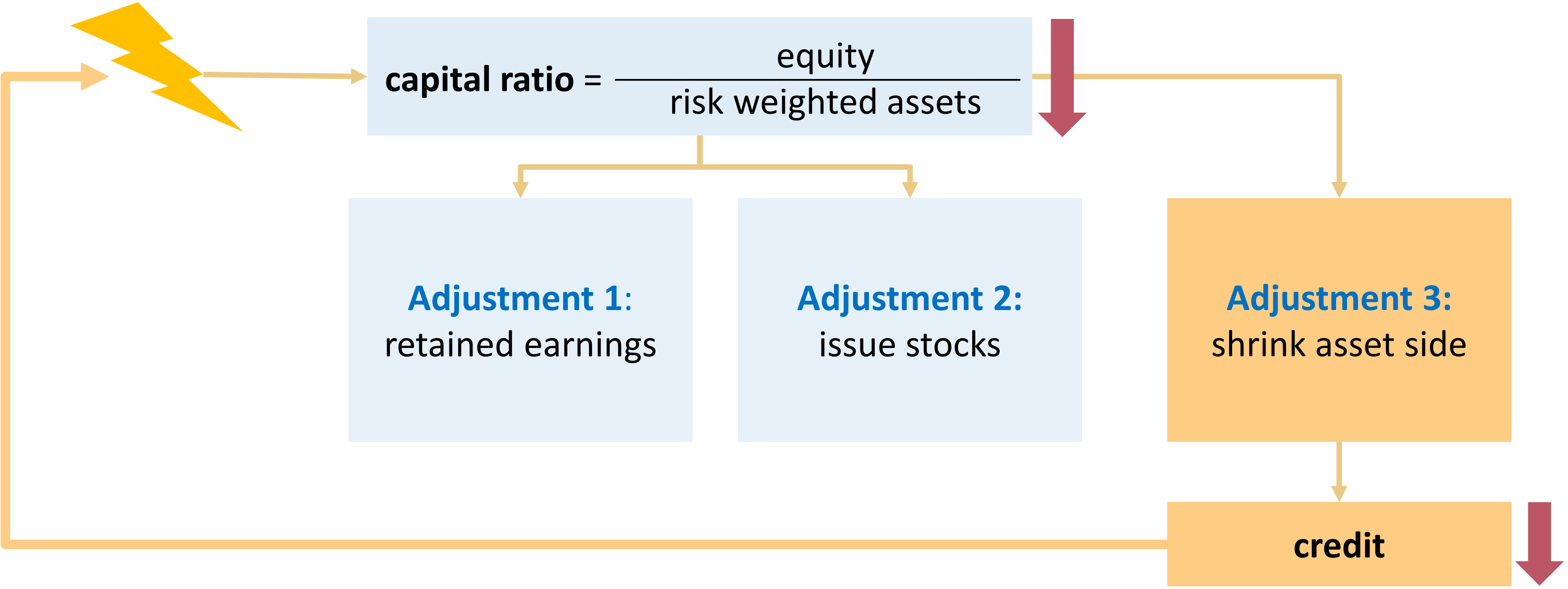
Systemic risks and financial (in)stability

Definition and sources of systemic risk.



Systemic risks and financial (in)stability

Definition and sources of systemic risk.

Systemic risk arises from **(structural) vulnerabilities of systemic risk**:

- excessive risk taking of large banks and implicit government guarantees for these institutions („too big to fail“),
- the nature of the financial system as an interconnected network („too connected to fail“),
- many banks making the same kinds of bad bets („too many to fail“);

Cyclical vulnerabilities of systemic risk (excessive credit growth); and

vulnerabilities with stuctural and cyclical elements:

- systematic underestimation of (in particular credit) risk,
- overvaluation of assets and loan collateral, e.g. real estate, or
- excessive period transformation (in particular interest rate risk).

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… or make traffic safe again.

safety distance

speed limits

Macroprudential Policy: Safeguarding Financial Stability

I. Financial stability

II. Macroprudential policy

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II. Macroprudential policy

Macroprudential Policy
…and its toolkit.

Financial Stability

Financial System

- Banks
- Insurer
- Markets
- Infrastructur

Vulnerabilities

- credit growth and leverage
- maturity/liquidity transformation
- exposure concentration
- SIIs, incentives/ moral hazard
- financial market infrastructures

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3 main categories of macroprudential instruments:

1. **soft**: communication
2. **intermediate**: warnings and recommendations („formal“ communication)
3. **hard**: interventions (e.g. capita-related instruments, sustainability-related instruments, liquidity and funding ratios)

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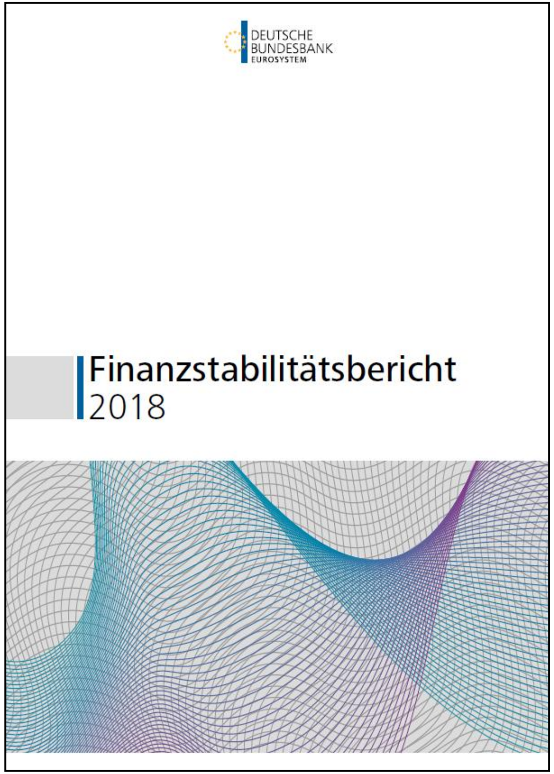
Macroprudential Policy

…and its toolkit: communication.



Key messages:

- **Cyclical risks have built up in the German financial system during the long period of growth and low interest rates:**
  - Potential underestimation of credit risk
  - Potential overvaluation of assets and loan collateral, e.g. real estate
  - Interest rate risk
- **If economic conditions deteriorate unexpectedly, these risks may occur at the same time, reinforce each other, and lead to herding behavior in the financial system (aggravating negative developments).**
  - The existing buffers may not be enough to limit contagion effects within the financial system or negative feedback effects to the real economy.
- **Now is the time to build sufficient buffers against unexpected developments.**

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maximum applies**

Buffer	Requirement	Description
O-SII Buffer / G-SII Buffer / SRB*	0 - 5%*	Extra CET1 buffer for TBTF risks
Countercyclical Buffer	0 – 2.5%**	Extra CET1 buffer for cyclical risks
Capital Conservation Buffer	2.5%	Extra CET1 buffer (micro+macroprudential)
Net Pillar 2	3,6% (Ø in 2017)	Bank-specific additional supervisory requirement (micro+macroprudential)
Tier 2	2%	Basic requirement (Basel III)
Additional Tier 1	1.5%	
Common Equity Tier 1	4.5%	

* Systemic risk buffer.
** In certain cases can be the sum of SII & systemic risk buffer.
*** Assumed upper bounds (values can be higher).

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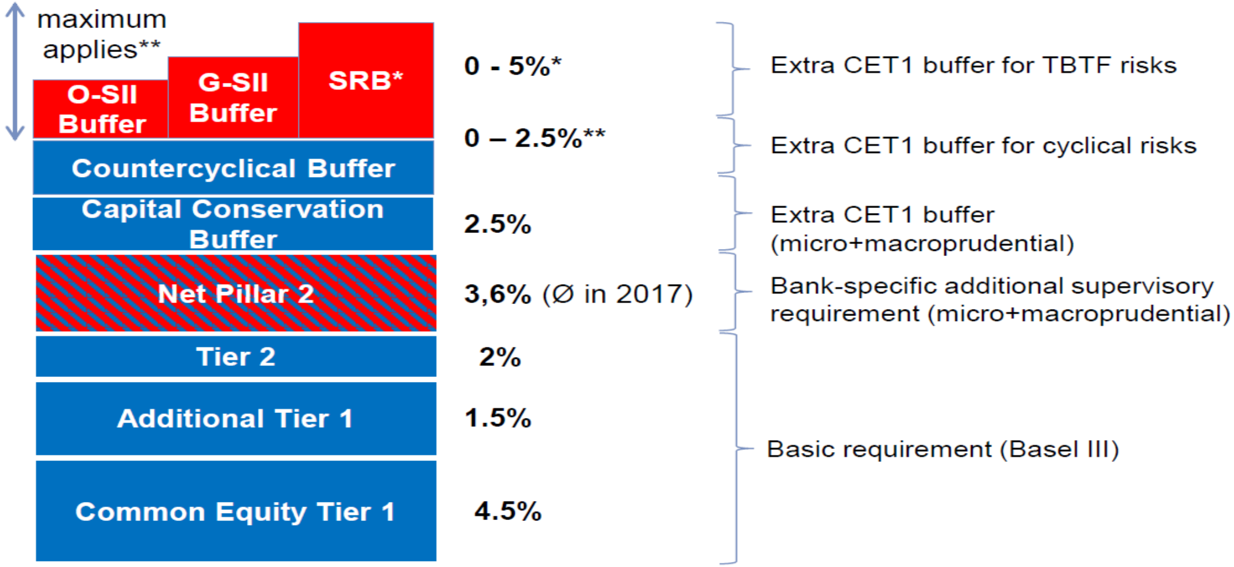

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Dr. Jens Reich, Deutsche Bundesbank, DG Financial Stability

Frankfurt - July 17th, 2019

Backup

Macroprudential Policy

…and its toolkit.

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Financial System

Banks

Insurer

Markets

Infrastructur

Vulnerabilities

credit growth and leverage

maturity/liquidity transformation

exposure concentration

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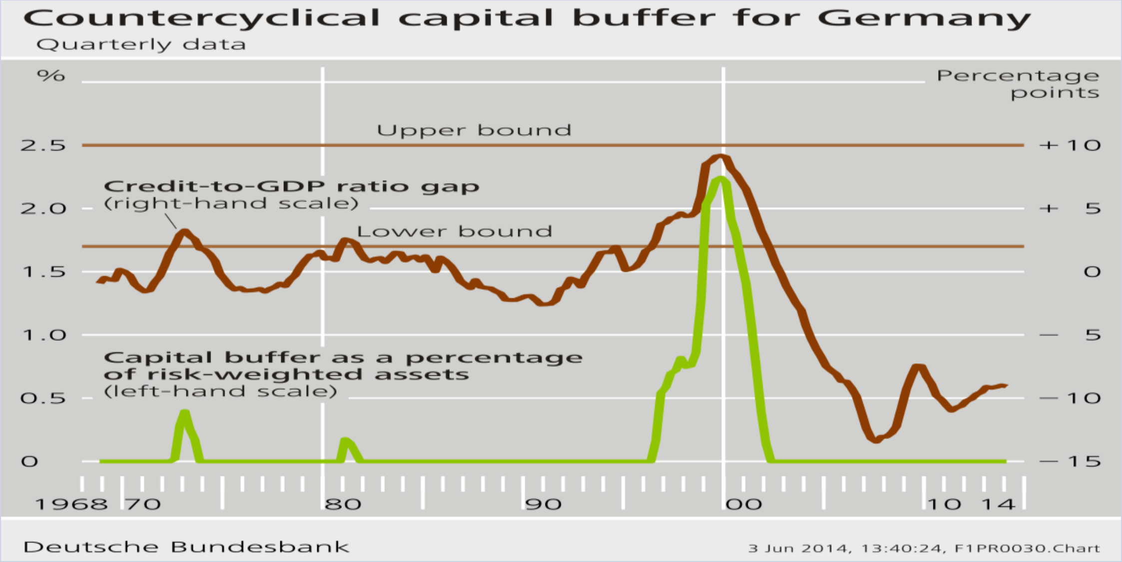
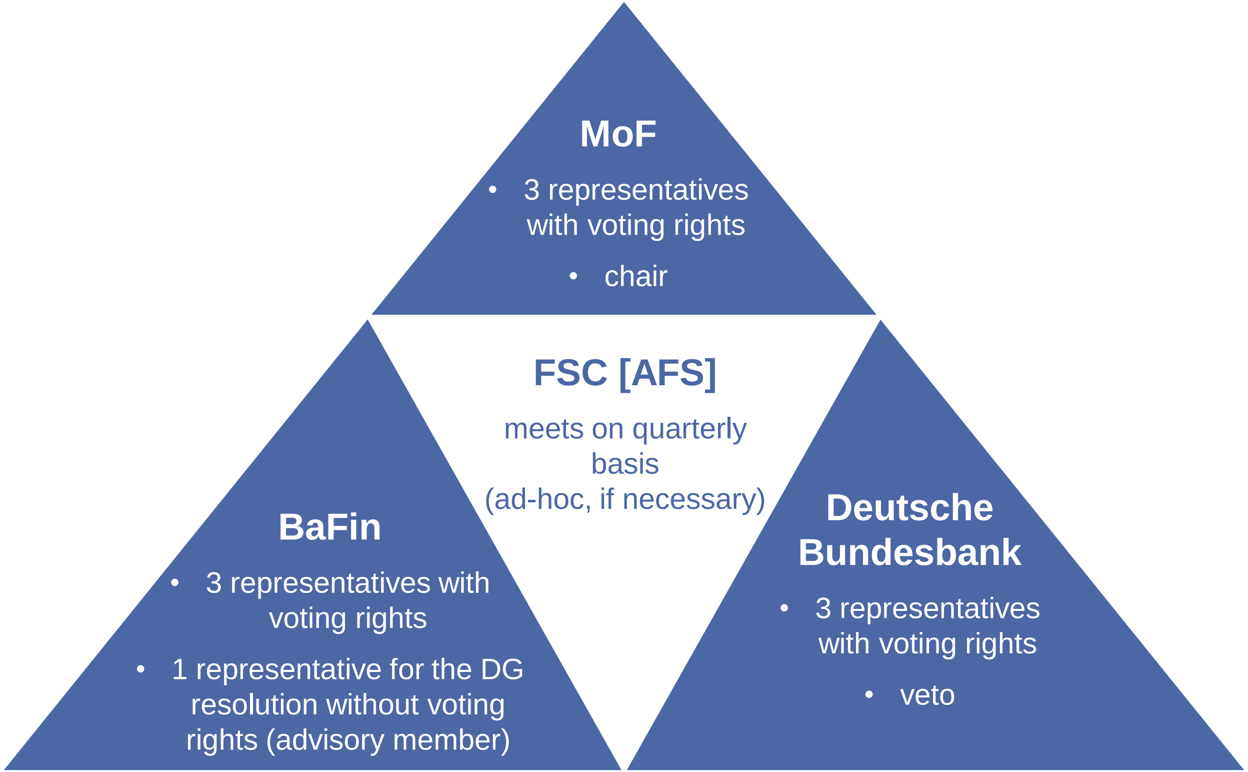
BCBS: L=2; CCCB=0 and H=10; CCCB=2,5



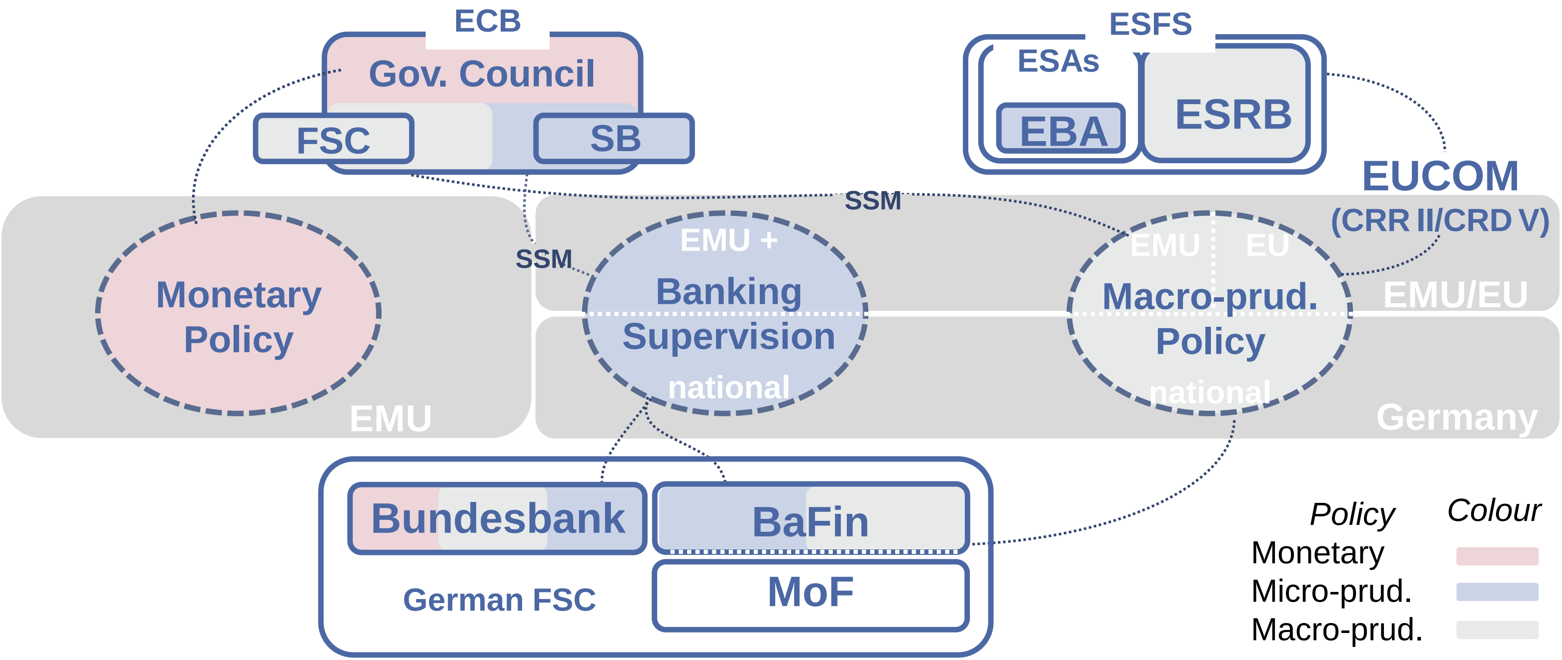
“Operationalising the countercyclical capital buffer” ESRB Occasional Paper Series No. 5 / June 2014

Macroprudential Policy

…and its toolkit: **warnings and recommendations**.



Macroprudential Policy
…and its coordination in Germany … in its European context.



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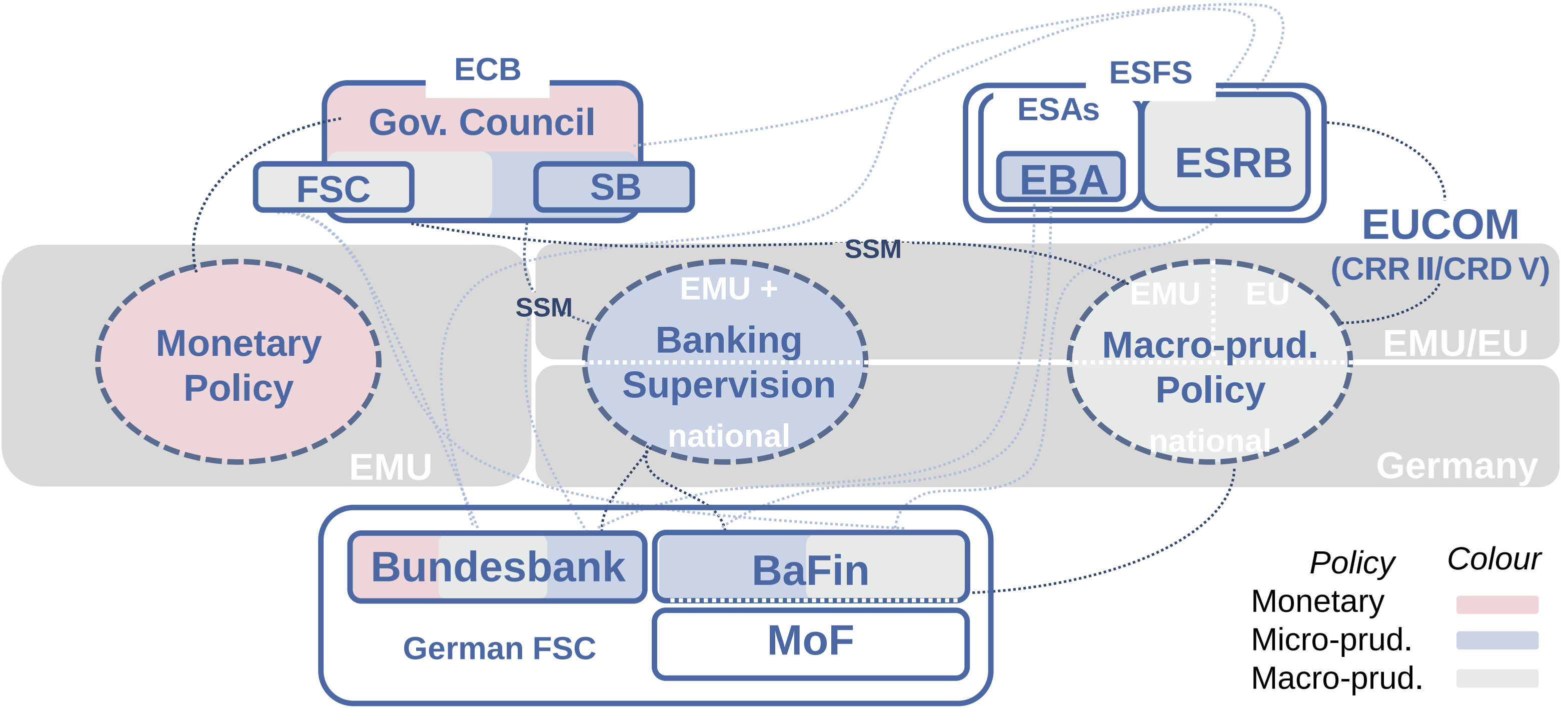

Macroprudential Policy

…and its toolkit: **warnings and recommendations**.

AUSSCHUSS FÜR FINANZSTABILITÄT

Empfehlung

vom 30. Juni 2015

zu neuen Instrumenten für die Regulierung der Darlehensvergabe
zum Bau oder Erwerb von Wohnimmobilien

AFS/2015/1

Erster Teil

Der Ausschuss für Finanzstabilität (im Folgenden „Ausschuss") hat auf der Grundlage von § 3 Absatz 2 des Gesetzes zur Überwachung der Finanzstabilität vom 28. November 2012 (BGBl. I, S. 2369), geändert durch Artikel 21 des Gesetzes vom 4. Juli 2013 (BGBl. I, S. 1981) (im Folgenden „Finanzstabilitätsgesetz"), folgende Empfehlungen beschlossen:

Empfehlung A – Neue Instrumente für die Regulierung der Darlehensvergabe zum Bau oder Erwerb von Wohnimmobilien

Der Bundesregierung wird empfohlen,

1. die Schaffung von Rechtsgrundlagen zu initiieren, die der Bundesanstalt für Finanzdienstleistungsaufsicht (im Folgenden „Bundesanstalt") die Befugnis einräumen, unter grundsätzlicher Berücksichtigung etwaiger einschlägiger Empfehlungen des Ausschusses gewerblichen Darlehensgebern nachfolgend aufgeführte Beschränkungen bei der Vergabe von grundpfandrechtlich besicherten Darlehen zum Bau oder zum Erwerb von im Inland belegenen Wohnimmobilien aufzuerlegen, wenn dies erforderlich ist, um einer drohenden Störung der Funktionsfähigkeit des Finanzsystems oder einer Gefahr für die Finanzstabilität in Deutschland entgegenzuwirken:
   a. Vorgabe einer Obergrenze für den Quotienten aus dem gesamten Fremdkapitalvolumen einer Wohnimmobilienfinanzierung und dem Marktwert der als Sicherheit verwendeten Wohnimmobilien zum Zeitpunkt der Darlehensvergabe (im Folgenden „Kreditvolumen-Immobilienwert-Relation");

1

Recommendation to the German government to establish a legal foundation for the creation of **borrower-based macroprudential instruments for the housing sector:**

- capping the LTV ratio
- setting an amortisation requirement
- capping the debt service to income ratio
- capping the debt to income (DTI) ratio

Macroprudential Policy

…and its toolkit: warnings and recommendations.

Empfehlung

des

Ausschusses für Finanzstabilität

vom 27. Mai 2019

zur Erhöhung des antizyklischen Kapitalpuffers

AFS/2019/1

A) Empfehlung zur Quote für den antizyklischen Kapitalpuffer

Der Ausschuss für Finanzstabilität (im Folgenden „Ausschuss") hat auf der Grundlage von § 3 Absatz 2 des Gesetzes zur Überwachung der Finanzstabilität vom 28. November 2012 (BGBl. I, S. 2369), zuletzt geändert durch Artikel 24 Absatz 35 des Gesetzes vom 23. Juni 2017 (BGBl. I S. 1693) (im Folgenden „Finanzstabilitätsgesetz" oder „FinStabG"), folgende Empfehlung beschlossen:

Der Bundesanstalt für Finanzdienstleistungsaufsicht (im Folgenden „Bundesanstalt") wird empfohlen,

> gemäß § 10d Absatz 3 Satz 2 des Kreditwesengesetzes (KWG) die Quote für den inländischen antizyklischen Kapitalpuffer in Höhe von 0,25 Prozent des nach Artikel 92 Absatz 3 der Verordnung (EU) Nr. 575/2013 ermittelten Gesamtforderungsbetrags ab dem 3. Quartal 2019 festzulegen.

Recommendation to the Federal Financial Supervisory Authority to increase the countercyclical capital buffer from 0% to 0,25%, due to:

- low interest rates and growth: credit risks might be underestimated; resilience of the financial system could be overstated,
- revaluation of assets, the value of collateral might be overestimated,
- interest rate risk and credit risk could occur simultaneously,
- risks can be mutually reinforcing in the financial system.