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The role of analysis in macroprudential policy

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Systemic risks – learning the hard way

- Systemic risk not a "household word" before the Global Financial Crisis
- Systemic risk next to non-existent in macro models prior to the Crisis
- Dialogue between macro and micro level risk scenarios not well established
- Partly reflecting this, the Crisis took us by surprise



It's a complex world

- Systemic risk needs to be better incorporated in economic models
- Systemic risk often non-linear by nature – this adds to the modelling challenge
- Example of a growing field of research:
 - analysis of contagion in networks



Complex risks – complex rules?

- Are complex regulatory rules unavoidable?
- Increasing regulatory complexity was part of the problem
- Simple rules are back
 - To add robustness to existing regulatory framework
 - To safeguard against systemic risks stemming from collective model and measurement risks



Regulation vs. macroprudential policy

- A well-designed regulation is the first line of defence against financial crises, macroprudential policy the second
- Research can help regulators in finding the right balance between the robustness and sophistication of regulatory rules
- Macroprudential policy as "*dynamically adjusted financial regulation*" (Paul Tucker)



High-quality analysis can reduce the inaction bias in macroprudential policy

- Policy-makers need *adjustable, borrower-based* macroprudential tools
 - Adjustable caps on LTV, LTI/DTI, DSTI
- A discretionary use of borrower-based tools is politically sensitive => Inaction bias
- High-quality analysis gives policy-makers confidence in using the tools => smaller inaction bias



Macroprudential policies are particularly needed in the euro area

- With a common monetary policy, macroprudential policies needed to address domestic systemic risks
- In integrated financial systems, systemic risks and problems spread rapidly across sectors and borders
- The current monetary policies can have some unintended effects on the financial system



Learning the lessons while not fighting the last war

- We should not look at the rear view mirror for too long
- Three recent phenomena that require particular attention:
 - Increased importance of the debt securities market
 - Re-emergence of shadow banking
 - Digitalisation



The roles of analysis and judgement

- High-quality analysis and research is necessary to guide regulators and macro-prudential policy-makers

- To complement quantitative analysis, expert judgement and views are still needed to
 - identify weak signals

 - conduct thought experiments on unlikely but possible crisis scenarios

 - avoid the dangers of group thinking

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Thank you!

