

Second Financial Stability Conference of the
Banco de España and of the CEMFI
Madrid, 3 and 4 June 2019

Rafael Repullo and Jesús Saurina (*)

(*) Rafael Repullo is Director of the Centro de Estudios Monetarios y Financieros (CEMFI), and Jesús Saurina is Director General of Financial Stability, Regulation and Resolution of the Banco de España.

**SECOND FINANCIAL STABILITY CONFERENCE OF THE BANCO DE ESPAÑA
AND OF THE CEMFI
MADRID, 3 AND 4 JUNE 2019**

The Banco de España, in cooperation with the CEMFI, organises a biennial conference on financial stability. The papers presented at it are selected by a scientific committee from those received in response to a call for papers. The committee for the 2019 conference consisted of Ócar Arce (Banco de España), Steven Ongena (University of Zurich), José Luis Peydró (Universitat Pompeu Fabra), Rafael Repullo (CEMFI), Hélène Rey (London Business School), Tano Santos (Columbia Business School), Jesús Saurina (Banco de España), Isabel Schnabel (University of Bonn) and Javier Suárez (CEMFI).

The second conference was held at the headquarters of the Banco de España in Madrid on 3 and 4 June and attended by around 100 participants. The topics broached and discussed included the macroeconomic effects of capital requirements, regulatory implications of the simultaneous bankruptcy of banks and firms, the effects of capital buffers on credit, the effectiveness of macroprudential measures based on borrowers' characteristics, the financial determinants of macroeconomic risk and the relationship between monetary policy and systemic risk, and macroprudential policy.¹

The opening address was given by Governor Pablo Hernández de Cos and, in addition, there were two keynote speakers: Agustín Carstens, general manager of the Bank for International Settlements (BIS), and the Nobel Prize winner Lars Peter Hansen, of the University of Chicago. There were five sessions of presentations and discussants, followed by a general debate in which the audience participated. The sessions closed with a panel discussion on governance of the institutions responsible for macroprudential policy, chaired by Margarita Delgado, Deputy Governor of the Banco de España. Set forth below, by order of intervention in the conference, is a summary of the addresses by the four speakers mentioned above.

- Pablo Hernández de Cos, in his address entitled “A framework for the CCyB”, highlighted the major role that may be played by countercyclical capital buffers (CCyB) in both boom phases and economic recessions. In the first situation, the activation of the CCyB combats excessive credit growth, while in a cyclical downturn the availability of the previously accumulated CCyB reduces the risk of credit contraction by banks and thus helps to mitigate the fall in economic activity and the deterioration of bank profits. Arguably, then, it is desirable to build up (activate) the CCyB in periods of economic growth, even in the absence of excessive credit

¹ The conference programme, the papers discussed and the presentations made by the participants are available at the Banco de España website (https://www.bde.es/bde/en/secciones/sobreelbanco/Conferencias/Segunda_Confere_c056e94ac91a661.html).

growth, so as to use (release) the buffer in subsequent recessions. However, taking a broad time perspective, the effects of building up and running down capital buffers are not symmetric.

According to a recent study of 150 years of financial cycles in Spain,² an increase of 1% in the CCyB may reduce credit growth in the cyclical downturn by 1% if the buffer is activated before the expansionary phase of the credit cycle, and by 6% if it is activated in the boom phase. The different elasticities indicate that the cost of late activation may be much higher than the cost of early activation. It is also necessary to analyse whether it is better to deactivate the CCyB all at once or gradually. As regards the adoption of decisions, it seems more appropriate to act according to the principle of “guided discretion”. This is because an automatic rule would be premature in the current situation, in which the use of macroprudential instruments has been extended to include their interaction with monetary policy, a development which must be studied in depth. The activation of any instrument requires an impact analysis, both an ex ante one including the various options available, and an ex post one studying the efficiency of the tools used.

- Agustín Carstens, in his presentation entitled “The role of regulation, implementation and research in promoting financial stability”, highlighted the importance of academic research after the last crisis, because of its contribution to understanding financial stability and designing new regulations. Academic analysis has helped the authorities and, in particular, the Basel Committee on Banking Supervision (BCBS) to identify and assess financial vulnerabilities of both a structural and a cyclical nature. In this way, academia has helped to build a more robust financial system.

Financial regulation has changed significantly following the crisis. Previously the basic element consisted of the capital ratios then in force. The current framework, however, has added major additional elements such as liquidity standards, macroprudential instruments and higher loss-absorbing requirements for systemically important banks. A larger number of measures provides protection from regulatory arbitrage and from the erosion of those measures over time.

The BCBS has made use of academic research to design and calibrate of the post-crisis measures. Specifically, the Committee studied in depth the existing literature on capital requirements and their long-term economic

² M. Bedayo, Á. Estrada and J. Saurina (2018), *Bank capital, lending booms, and busts. Evidence from Spain in the last 150 years*, Working Papers, No. 1847, Banco de España.

impact, and that on the design of the macroprudential framework, particularly of the CCyB. Academics can enlighten regulators, furnishing the analytical rigour and empirical evidence required by the authorities to implement their policies against financial system vulnerabilities. The agenda of researchers for the near future may take into account the issues that are currently of most concern to regulators most concern, such as the risk appetite of investors in a low interest rate environment, the exposures of the non-bank financial sector, the risks inherent in new financial market players and the risk concentration of central counterparties.

- Lars Peter Hansen presented the paper “Pricing uncertainty induced by climate change”, which uses the framework of decision theory under uncertainty to address the challenges posed by research into the economics of climate change. In particular, he highlights three components of uncertainty: risk (with probabilities given by a model), ambiguity (with unknown weights for alternative models) and uncertainty over proper model specification.

The assessment of potential government policies on, for example, carbon emission taxes, requires the building of structural dynamic models of the relationship between the economy and climate change in which uncertainty plays a key role. The aim is not to provide accurate estimates of how big the adverse effects will be or when they will occur, but rather to analyse the likelihood of major long-term economic consequences that are difficult or impossible to reverse. From this standpoint, waiting until we know exactly what will be the ongoing effect of carbon emissions may mean that the measures to be taken will end up being extremely costly.

- Margarita Delgado emphasised that the model of macroprudential policy governance in the various countries is key to understanding the challenges faced by the authorities. Specifically, the structure in the European countries is particularly complex, with three levels which have to be coordinated: i) the European Systemic Risk Board (ESRB), set up in 2010 to ensure financial stability in the EU; ii) the European Central Bank, which, through the Single Supervisory Mechanism (SSM), has macroprudential responsibilities for the euro area since 2014; iii) national authorities, that in Spain being the Spanish Macroprudential Authority – Financial Stability Board (AMCESFI by its Spanish abbreviation) since March 2019.

Within the national authorities, the diversity of models in place, the number of institutions participating and the different distribution of tasks among them indicate that there is no optimum model for the design of the authority and of macroprudential policy. Moreover, the decision-making process is

intricate in some countries, with the consequent risk of a potential bias towards inaction by the authorities. The role of governments – acting through finance ministries – in macroprudential policy poses a trade-off between greater legitimacy and greater independence. Against this backdrop, the next financial crisis, come when it may, will be the litmus test of the efficacy of the various governance models.

To wind up, the Deputy Governor underscored the valuable work of the scientific committee and the participants in the various sessions and thanked them for their contribution to the success of the Conference. This biennial event has become a key feature on the Banco de España's calendar, and it is in line with the traditional importance it attaches to financial stability issues, as shown by the many papers published since 2001 in the *Financial Stability Review* and, of course, by the dynamic provisions established to address credit cycles, in force from 2000 to 2016.