

# **Macroprudential Stress Testing & Macroprudential Policy: Some Observations**



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# Macroprudential Policy

- \* Primary prudential tools to limit systemic risks
- \* Building & realising buffers
- \* Procyclical feedback between asset prices and credit
- \* Arrest structural vulnerability arising out of interlinkages & common exposures



# Macroprudential Policy: Challenges

- \* Measuring systemic risk remains inherently difficult
- \* Uncertain transmission process
- \* Prone to boundary problem and cross-border arbitrage
- \* Optimality of regulatory discretion vis-à-vis quantitative calibration



# Macroprudential Policy: Modelling Challenges

- \* How to generate crisis-consistent estimates?
- \* How to capture non-linear impact?
- \* How to guard against model risk?
- \* How to factor in structural changes?



# Stress Test Framework: India

- \* Tests for both time and cross-section dimensions
- \* Macro-stress test to assess vulnerability against macroeconomic shocks
- \* Tests contagion risk through network analysis: goes beyond banking system
- \* Time dimension captured through single factor sensitivity analysis: e.g. credit, interest rate & liquidity



# Translating Analysis into Policy

- \* Limitation of data: backward looking balance sheet data; how to filter out noise; how far is market forward looking?
- \* Information privacy issues; skills for data collection and compilation
- \* Acceptable model for quantification of risks on a consolidated basis.



# Translating Analysis into Policy

- \* How to achieve a strong governance structure when success is not easily measurable
- \* Macroprudential policy authority: interaction with monetary policy
- \* Accountability framework while providing for country specificity

