

# Executing Financial Stability at the Bangko Sentral ng Pilipinas

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# What is Covered and the Approach

- Financial stability relies on **macro-prudential policies** to manage systemic or system-wide risks
- As defined by the FSB-IMF-BIS, macro-prudential policy uses prudential tools that:
  1. **Dampen the build-up of financial imbalances**
  2. **Contain the speed and sharpness of downswings**
  3. **Address common exposures that are sources of contagion and spillover risks**



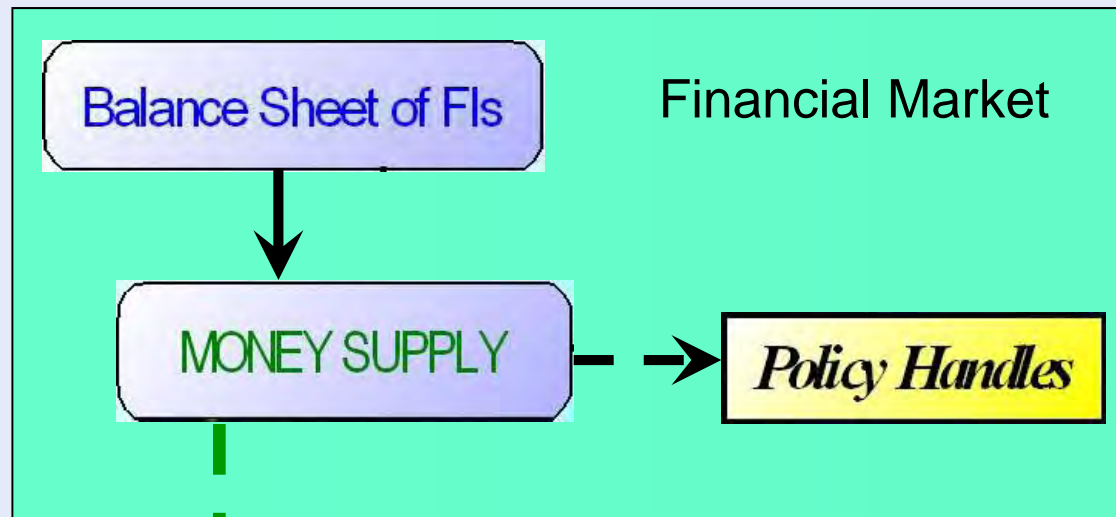
## Defining (the Yet Missing) Macro-prudential Indicators

*Different analytical capabilities may be needed for the macroprudential task. Macroprudential policy cannot properly be conceived as a mere adding up of microprudential concerns. For financial stability, the co-variances between institutions' positions are perhaps of greater concern than the positions themselves, though the individual exposures remain relevant. The risk of contagion and the potential for non-linear system dynamics cannot be assessed by observing individual components alone. Systems analysis is required. In addition, interaction between the non-financial business cycle and the financial sector may be a crucial consideration. ... complete range of instruments uniquely oriented to macroprudential policy has not yet been developed, let alone deployed.*

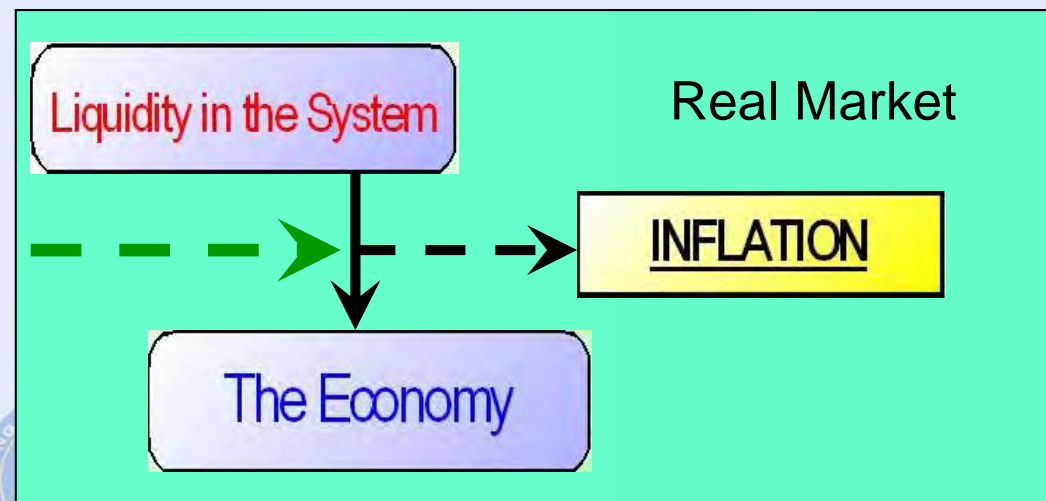


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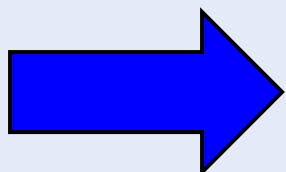
# Functional Relationship Between the Financial Market And the Real Economy



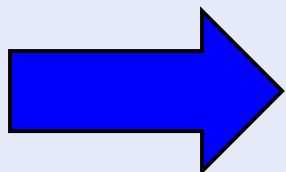
- Financial market regulation is always “macro” plus “micro”
- Financial market is inherently risky



# Supervising in a Macro-Prudential World



We know that financial markets are risky ... *the real question is what/how risks are regulated*



$$\sigma_p^2 = \omega_a^2 \sigma_a^2 + \omega_b^2 \sigma_b^2 + \frac{2\omega_a \omega_b \rho_{ab} \sigma_a \sigma_b}{}$$

Today, as before, we still worry about the health of the system

**TRADITIONAL  
RISKS**

Except that we are more worried about contagion and spillovers today



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# What is Covered and the Approach

- The issue is **system-wide risks** ( $\sigma_p$ ) and the way transactions, assets, agents, markets, rules, events are all **inter-connected** ( $\rho_{ab}$ )
- Each of the policy-generating institutions will continue to focus on their respective mandate

- However, we need to understand:
  1. How risks co-mingle
  2. The path they take when co-mingling



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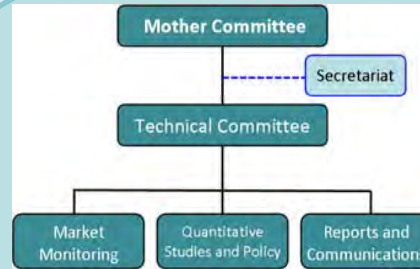
# Execution of Financial Stability at BSP

1. Creation of a High-Level Financial Stability Committee at the BSP
2. Creation of the Financial Stability Coordinating Council (an inter-agency body)
3. Pushing the Frontier on Stress testing



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# Execution of Financial Stability at BSP



## Financial Stability Committee

**Price Stability**

**Stable Banking System**

**Reliable Payments System**

**Foundations**



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# Approaching Financial Stability in the Philippines

## Financial Stability Coordinating Council

### Financial Sector Forum

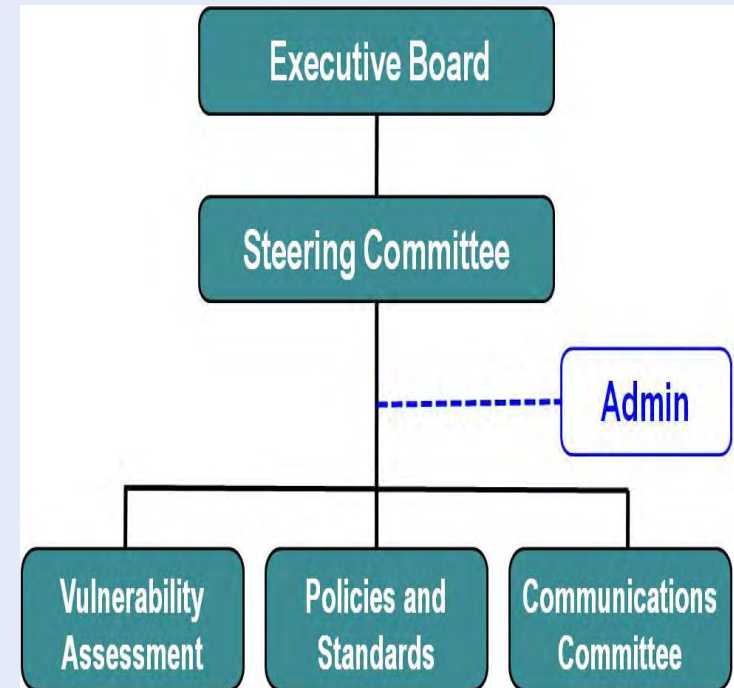


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# Financial Stability Coordinating Council

## Policy Items

1. Financial Crisis Management
2. Non-Bank Sources of Credit
3. Managing Capital Flows (Real Economy Impact)
4. Reforms Relevant to the Capital Market
5. Corporate Leverage



# Pushing the Frontier on Stress Testing

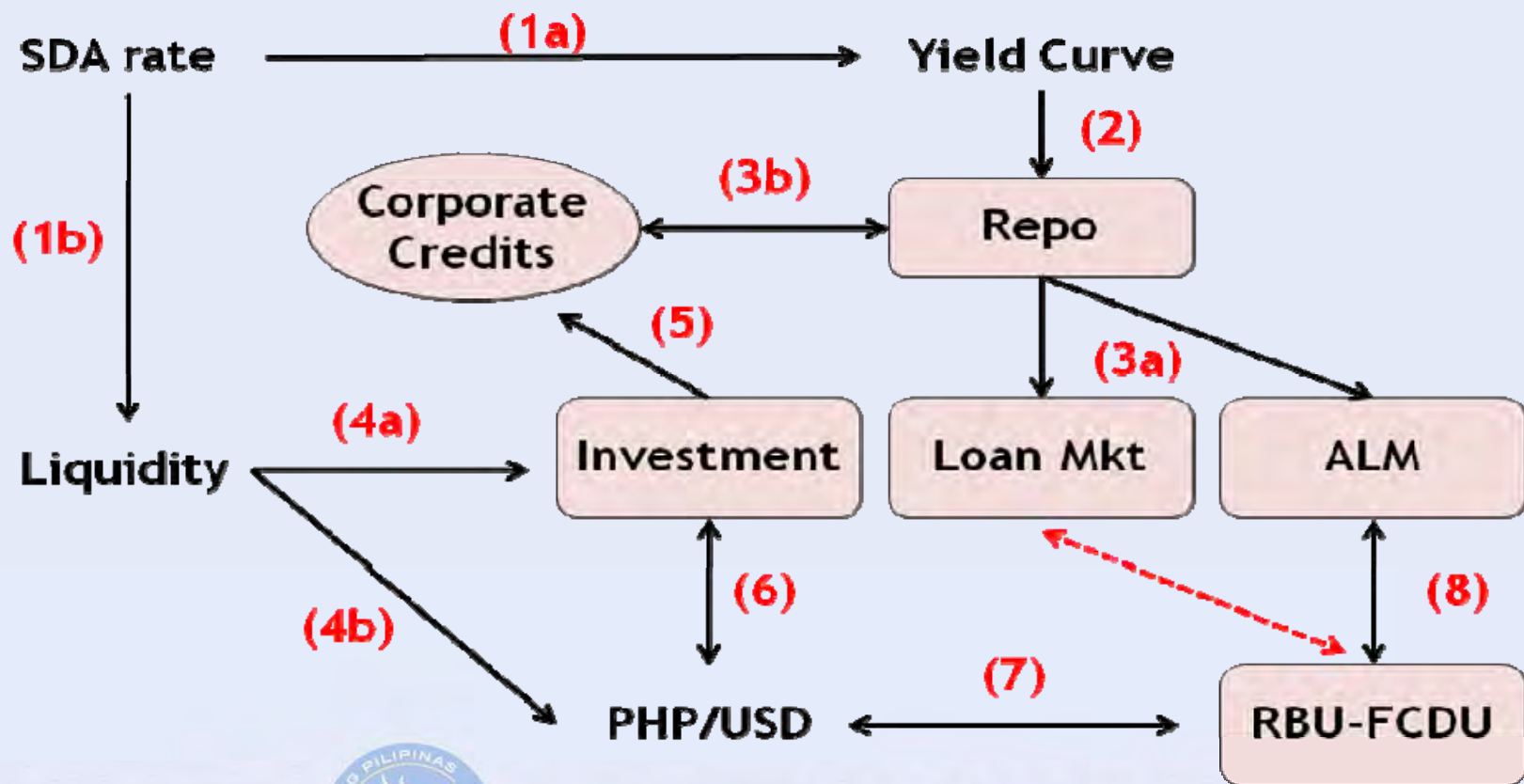
- Semestral stress testing on all banks
- Stress Testing by Risk Category –
  - Credit Risks
  - Market Risks
  - Liquidity Risks
- Providing a uniform platform to test for system-wide risks.



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# Pushing the Frontier on Stress Testing

## Reconsidering the Evolution of Risks



*Final thoughts...*



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# Paradox of Financial Regulation

- o *Financial stability is not a unique state defined by absolute values of indicators. Instead, there are **multiple possible combinations** which allow a system to thrive and address the evolving needs of its constituents.*
- o *Financial stability is not the micro-foundations of macro policy and not the macro translation of micro behaviour. Instead, it binds macro, monetary, financial, infrastructure and fiscal policies together so that **transaction-level risks can be understood in terms of their systemic implications***
- o *To move forward, we need **sharper tools, a harmonized view** on managing & mitigating financial risks, and a **commitment towards cooperation & coordination**.*



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## Developing Skill Sets

*... it would be very useful to develop staff who have the expertise of a macro-financial economist, the preciseness of a financial engineer, the orderliness of an accountant, the eloquence of a commentator, the imagination of a physicist and the perspective of a market practitioner ...*

***Gov. Amando M. Tetangco, Jr.***

*(lifted from his session remarks at the BOJ-BIS High-Level Seminar “Financial Regulatory Reform”, November 2010)*



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