Mexican Ministry of Finance and Public Credit

How the Fund can help the region in developing macroprudential policies?

High Level Seminar on Macroprudential Policies to Achieve Financial Stability

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The comments will be centered around two topics:

1. What are macroprudential policies and what should our current priorities be with respect to their design, implementation and use?

2. Given these priorities, what is the best way for the IMF to help us in the process of developing macroprudential policies?

To start the discussion, it is necessary to define what we understand as macroprudential policies:

- Different from the classical demand management tools such as fiscal, monetary or exchange rate policies, though these also have effects on financial stability → Macroprudential policies complement these tools, as otherwise there can be too many objectives and too few instruments.

- Two instruments (fiscal and monetary) can be used to pursue two targets (inflation and the output gap). In general, they will not be enough if there are more than two targets, with a natural third target being financial stability.

- In addition, traditional tools may be to blunt to respond to some imbalances such as bubbles in asset markets or procyclicality in financial operations, including credit.

- They can build on microprudential policies, but they are also distinct. The focus of microprudential policies is on the health of individual institutions, macroprudential policies look at the health of the financial system in its entirety.

Therefore, macroprudential policies can be characterized as follows:

- A complement to traditional macromanagement tools, allowing us to target a wider set of objectives and to respond to additional shocks, in particular those which can have negative effects on financial stability.

- Help to deal with specific problems that could eventually have systemic implications (e.g. changing the stance of fiscal or monetary policies has economy wide implications, implying that they are inefficient tools to respond to a bubble in the construction sector).

- As the focus of macroprudential policies is the financial system, tools that already exist can be used but with adjustments to control for the cycle or the generation of imbalances in particular sectors of the economy.

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While the general principles may be relatively clear, there are a lot of important questions on which there are no firm conclusions:

- In general, what are the pros and cons of different instruments?
- How do we take into account country characteristics such as the degree of openness of the capital account, the level of development of the financial system and the exchange rate regime?
- How much do we adjust them in response to shocks or to attain particular targets? We already have a lot of information, and analytical frameworks, to assess the effect of changes in monetary and fiscal policies; we do not have them for macroprudential policies.
- How should they coordinate with traditional macro policies? Monetary and fiscal policies have effects on the financial system; how much do we want to build on or compensate for changes in these two policies with macroprudential policies or vice versa? What should be the appropriate mix of fiscal, monetary and macroprudential policies to respond to a given set of shocks?

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This implies that one first, and major priority, is to undertake additional work to gradually answer these questions.

- This implies that both the IMF and individual countries need to undertake a significant amount of research and analysis.

- The IMF has a very advantageous position, as the lack of information at the individual country level implies that in this initial stage looking at the international experience with different individual instruments and experiments is likely to be the best source of answers.

- The IMF has already done a lot of work on this but it needs to continue, in particular on finding the different pros and cons of alternative instruments, and what are the effects of changes in these. This is a more general agenda that goes beyond country-specific FSAPs, technical assistance or article IV consultations.

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As a second stage in this process, countries need to develop specific policies.

- Most of the work has to be done by local authorities, as they have the best knowledge about domestic conditions.
- The IMF can play a strong complementary role communicating the experience of other countries with similar characteristics, informing of where the state of the art is at the international level, and aiding in the estimation of the effects of different policies.
- Given that the initial development and use of macroprudential policies will require very specific work, the FSAP and special technical assistance are probably the best ways alternatives.
- However, the FSAP has three problems: i) infrequent, ii) includes many other financial sector topics, and iii) may not include the macro management expertise that may be required to develop a framework that promotes adequate coordination between different policies.
- The FSAP teams do get a sense of most issues in the financial system. One can potentially benefit from this by having the teams carrying out technical assistance being similar to those that carried out the latest FSAP for the country, complemented by macro management specialists.

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At a third stage, once a framework has been developed and policies are being used, a process of continuous evaluation is required to assess if these are having the desired effects or if adjustments are required.

- The most important part of the work also needs to be done by local authorities, who will be seeing what is happening in real time.
- For initial assessments, article IV missions can be useful in helping to identify and quantify the effects of the different policies.
- If major changes or deviations are observed, requiring significant adjustment to the framework and instruments, technical assistance missions that have the time and specialized knowledge will probably be more useful.

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As a set of general conclusions:

- We are at an early stage in the development and use of macroprudential policies at a global level. We need the IMF to continue working on understanding the different alternatives for these policies, as well as in gradually developing a set of first best practices as a reference.

- In spite of this, we already have to start developing our own policies. The IMF can help in this initial stage by doing detailed and specific work to help us to decide what are the best instruments for our particular circumstances, and on constructing specific estimates of their effects.

- Even in the case of macromanagement policies that have been in place for a long time, such as monetary and fiscal policies, we need to continuously review their effect and improve the framework under which they operate (eg. inflation targeting). This need for continuous reviews, updates and adjustments will be even stronger for macroprudential policies. The IMF can play a valuable role by helping in this review and in keeping us up to date on international developments as experience accumulates at a global level.