XXXII ANNUAL MONETARY STUDIES CONFERENCE

KINGSTON, JAMAICA

30 OCTOBER - 02 NOVEMBER 2000

CENTRAL BANKING IN THE CARIBBEAN IN THE 21ST CENTURY MACROECONOMIC POLICY AND FINANCIAL SECTOR STABILITY. HOW THE IMF IS HELPING TO STRENGTHEN FINANCIAL SYSTEMS[1]

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I. INTRODUCTION

It is a great pleasure to be invited here, especially on the 40th Anniversary of the Bank of Jamaica. This is an opportunity to look back at how the IMF has developed its role in helping central banks and to look ahead to some of the challenges of the 21st century.

Financial crises are not new. But the past two decades have seen major financial crises in many countries round the world, including in recent years in a number of hitherto very successful Asian countries. The purpose of this paper is to explain some of the insights we in the IMF have gained, to explain what we are doing to try to reduce the frequency and severity of financial crises, and to focus on the idea of financial stability.

II. A SHORT SLICE OF IMF HISTORY

Within the IMF, the Central Banking Service was set up in 1963 to provide technical assistance and research. Much of our early life was spent helping newly independent countries establish central banks; we moved on to helping members establish and raise the standards of many central-banking functions. Initially our scale and ambitions were modest. We did not, for example, venture into giving advice on the appropriate monetary policy.

Much else has changed: we have grown from a small department to our present strength of nearly 250 staff, including experts from supervisory agencies. Our remit, now broadened and

[1] The views expressed here are not necessarily those of the IMF.

working closely with the World Bank, is to cover financial risks and vulnerabilities potentially in all member countries and in offshore financial centers, while stepping up our technical assistance for members. We are being asked by the International Monetary and Financial Committee[2] to consider taking on new responsibilities for the oversight of countries' arrangements to fight financial crime and money laundering.

From the outset, we did not aspire to have in-house staff knowledgeable in all financial areas: we drew on experts, particularly from central banks, world-wide. We do that more than ever now: last year we used over 300 experts from 50 institutions round the world to help us staff our missions and technical assistance assignments.

We are also making a much bigger effort to reach out to our prospective clients and providers of experts and expertise: in all the main areas of new work in recent years, we have organized outreach meetings. These have taken place on the following subjects:

- Financial sector assessment programs
- Offshore financial centers
- Macroprudential indicators
- Transparency code for monetary and financial policy

The purposes of these outreach meetings is to explain what we are doing, to get feedback, and to end up with a product that is both better and more widely acceptable.

We have also consciously decided, as part of our efforts to make our processes more transparent, to put much more material out in public: see for instance the list of references to IMF papers at the end of this paper, including a series of pieces on the Asian crises. We are also making more use of one of our inbuilt advantages: access to information and analysis on virtually every country in the world: this is a rich and valuable mine of information on what works and what doesn't and in what circumstances.

III. FINANCIAL SECTOR SOUNDNESS

Analysis of risks and vulnerabilities in the financial system starts with an examination of solvency. For an individual institution this means its net worth: the difference between assets and liabilities (excluding reserves and capital). Solvency is easy to define for an individual institution, hard to measure, especially in the case of banks, because there is no market for most loans even in countries with well-developed capital markets; and provisioning is an inexact science at best.

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[2] See the Communique of the IMFC for September24, 2000, on the IMF website

At the level of the financial system as a whole, it is much more difficult to define soundness, even harder to measure it. I see three essential elements for financial stability: the financial sector must in some sense work now; it must be resilient to shocks; and it must be capable of changing as the financial scene develops.

One interesting question is: can we find indicators which will give us some advance warning of unsoundness, of financial instability, at the level of the financial system? Recent work at the Fund on macroprudential indicators[3] is designed to help produce assessments of the strengths and vulnerabilities of financial systems, and to enhance disclosure of key financial information to markets. The customers for this work are: the IMF, in our surveillance work; member countries; and markets and outside commentators.

These indicators are a mixture of traditional macroeconomic variables—such as growth rates, inflation and its volatility, and asset prices—and what we call aggregated microprudential indicators, such as capital adequacy ratios, asset quality indicators, commodity price risks and sovereign yield spreads. These indicators have been chosen mainly on a priori grounds, but also draw on empirical work in the literature.

I would like to be able to give you the message that we now have a model for identifying financial crises in advance, based on a small number of core indicators; or even a composite index. In fact, we are still some way from achieving any of that, though it is our aim to arrive at a small set of key indicators, recognizing that qualitative judgment is as essential as quantitative information and that country circumstances must be taken into account. The reality is that, despite every effort, financial crises will always be with us.

The much greater focus by the IMF in recent years on the financial sector is easily explicable against the background of big financial crises. The costs of these crises—affecting both *developed and developing countries—have run up to 50 percent of* GDP in terms of the fiscal costs to governments that is, the taxpayer, from resolving the crises. In the Caribbean, Guyana in the 1980s and Jamaica in the mid-1990s experienced financial sector crises. For a comprehensive survey of banking problems see the book by Lindgren and other IMF authors entitled "Bank soundness and macroeconomic policy;"[4] and the piece by Klingebiel[5].

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[3] See reference (*1*)

[4] See reference (2)

[5] See reference (3)

IV. Macroeconomic Causes of Financial Unsoundness

Banks' position in the economy makes them vulnerable to big shocks. Banks are in reality highly geared companies, and their solvency depends on maintaining a balance between highly liquid liabilities and illiquid, hard to measure assets. So any shock that hits assets disproportionately or, less commonly, raises liabilities can endanger a bank or even the banking system. And as we learnt again in the Asian crises, shocks that hit banks' customers badly can have a massive impact on banks themselves[6].

Financial sector and particularly banking sector soundness reflect in good part the health of the economy. In a weak economy, there may be few new bankable projects, and many enterprises, even government, may have difficulty servicing debt, and banks' loan portfolios deteriorate. This is followed by higher loan losses in banks, reducing the level of capital and reserves.

Often, the appropriate policy response is to lower interest rates, as the countercylical macro policy. But in some cases the fundamental financial sector weaknesses exposed by a cyclical downturn are too severe: one example is Japan. Here, growth throughout the 1990s was extremely disappointing: what two IMF writers called the "Post-bubble blues" were allowed to linger for a whole decade[7]. And while the excesses of the 1980s boom were bound to be painful to absorb, weaknesses in both macro and micro policies played a big part in this outcome: a failure to use monetary policy in a sufficiently stimulating way early enough and a failure to tackle early enough the deep-rooted problems in the financial sector.

Worldwide, examples of macro shocks to financial systems abound, unfortunately:

- Argentina (1980-82) debt crisis, and recession
- Indonesia (1997-2000) massive depreciation of exchange rate, capital outflows
- Mexico (1994-95) capital outflows, unstable macroeconomic policies and political uncertainties
- Sweden (1990-93) boom and bust, property bubble
- Thailand (1997-1999) boom with big capital inflows, asset bubble, excessive investment
- Venezuela (1994-1996) recession, capital flight, asset bubble

All these economic crises and many more had major effects on the viability of individual banks and of the banking system; because the scale of the shock was large and because the banking and financial systems were weak and vulnerable to shocks.

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[6] Se references (4), (5), (6), and (7)

[7] See references (8) and (9)

Financial supervision is made much more difficult—some will say impossible—by big economic fluctuations. Steps that supervisors can take include:

- The greater the susceptibility of the economy to big fluctuations, raising the minimum capital requirement for all banks: this is being explored now in the second pillar—supervisory review—of the new framework for capital now being worked on by the Basel Committee
- Adequate, timely and forward-looking loan loss provisioning makes the banking sector more robust to shocks, and may encourage banks to be more careful extending new loans
- Greater efforts to match maturities of bank assets and liabilities
- Adequate accounting and measurement techniques are essential tools for financial institutions, the market and supervisors to be able to judge the robustness of the system and individual institutions
- Providing for greater disclosure by financial institutions gives greater incentives to management to avoid taking on unsustainable risks; and gives incentives for management to take earlier action. Again, this is being explored by financial supervisors, including by the Basel Committee in the third pillar—market discipline—of the new capital framework
- Developing close links between supervisors and those responsible for financial stability so that the work of supervisors is informed by analysis of key financial sectors and vulnerabilities.

Much of this is part of the agenda for good management in firms and is therefore in their self-interest. But some, designed to protect the system in circumstances of systemic shocks, like higher levels of liquidity and capital, may not be seen as in the self-interest of individual firms and can only be provided at cost to the economy, whether borne by the banks or more likely more generally. These costs can of course be reduced by a more successful and stability orientated macroeconomic policy.

V. Macroeconomic Consequences of an Unsound Financial System

The last section argued that macroeconomic instability caused unsoundness in financial institutions, especially banks. This section argues the other way round: that unsoundness in the financial system causes macroeconomic problems. Again, here are some examples of how problems in the banking sector made for real difficulties for the economy as a whole:

- Argentina (1980-82) high interest rate spreads, and disrupted credit and payment systems.
- Brazil (1994-97) high spreads and increased caution by banks
- Czech Republic (1991 onwards) high spreads, high levels of nonperforming loans restricted credit

- Ghana (1983-89) low levels of intermediation, high non-performing assets made credit tight
- Japan (1992 onwards) weak bank balance sheets limited recovery, partly through low confidence
- Spain (1977-85) high costs of financial intermediation, both spreads and operating expenses, burdened companies

There are also many examples of unsoundness in financial institutions impacting on monetary policies, frequently by interfering with or seriously damaging the transmission mechanisms of monetary policy:

- Volatility in monetary aggregates (Finland, 1991-94)
- Stickiness in interest rates (Egypt, 1991-95)
- Rates unresponsive to open market operations (Ghana, 1983-89)
- Low monetization/low intermediation make monetary policy ineffective (Poland 1991 onwards)
- High levels of non-performing loans make monetary policy ineffective (Hungary, 1987-96)

The fiscal impact of financial sector problems can be felt on both expenditure and revenue:

- Increased loan losses reduce taxable income
- Financial crises that add to economic downturns lead to big revenue losses
- The less efficient the financial sector, the greater the cost of issuing debt by the government
- Taking over liabilities of failing banks can be extremely expensive, for example through blanket guarantees.

On the external sector, an unsound financial sector can have seriously negative consequences for the exchange rate and the balance of payments:

- The banking sector is a key participant in international trade and capital movements, and in the foreign exchange market
- Any worries about unsoundness in financial institutions, especially worries that are general rather than specific to one institution, will prompt a move into foreign assets and a fall in the exchange rate
- A country's ability to peg its exchange rate, assuming it wants to, depends on the robustness of the financial system. A central bank trying to defend its currency against speculative attack will be inhibited, if not prevented, from raising interest rates substantially if the financial system is incapable of coping with higher rates because, for example, of interest and exchange rate mismatches and weak capital.

The moral is that what goes on in the financial sector, especially in the banking sector, is of interest not just to the institutions or supervisors but is of major concern to anybody

concerned with monetary and fiscal policy. Of course, it is because of these linkages between macroeconomic and prudential issues that supervisors have such a hard time making independent decisions.

The Chairman of the Federal Reserve, Alan Greenspan, recently said this about the role of banks[8]:

> "Many of the benefits that banks provide to modern societies derive from their willingness to take risks and from their use of a relatively high degree of financial leverage. Through leverage.... banks perform a critical role in the financial intermediation process. Indeed, it has been the evident value of intermediation and leverage that has shaped the development of our financial systems from the earliest times. But it is also that very same leverage that makes banks so sensitive to the risks they take and aligns the stability of the economy with the critical role of supervision."

VI. CRISES: PREVENTION AND CURE

The analysis thus far is familiar and indeed predates the Asian crises. The last few years have seen.

- An alarming series of further financial crises
- Crisis management
- Recovery following crises
- A major effort at prevention through the debate and decisions on the so-called international financial architecture

The crises and how they were managed are of course immensely important in themselves for those most closely affected. But they are equally important for the signals they send to all participants in future potential crises: just as influential as the advice from the Fund and the Bank on how to prevent crises is what we actually do or advise as the crises unfold.

VII. MANAGING CRISES

In a financial crisis, the exchange rate and other asset prices may be plummeting, capital flowing out, demand dropping off, some banks are seen to be in a weak position. All this makes for a classic financial crisis: a lethal combination of a macroeconomic shock exacerbating and exposing financial sector vulnerabilities.

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[8] to the American Bankers' Association, September 18, 2000

In these circumstances, the task of the authorities is to restore confidence. There are two main components:

- Stabilizing the macroeconomy, for instance through raising interest rates, stopping excessive central bank credit creation, halting the capital outflow, preventing the fiscal deficit getting out of control.
- Restoring confidence in the financial sector: a combination of a credible policy strategy and actions to begin what is bound to be a long process. This may include, as in the cases of Indonesia, Korea, Malaysia, and Thailand, blanket guarantees to all depositors, liquidity support from the central bank, immediate closing of some financial institutions, restructuring potentially viable institutions or a combination of these measures.

The Asian crises highlighted the linkages between financial sector soundness and macroeconomic stability[9]. The programs designed with IMF and World Bank help to deal with the problems in Asia centered on structural reforms of the financial sectors, since it was clear that macroeconomic measures alone would not have been in any way sufficient. This represented a major departure from traditional IMF programs.

VIII. Blanket Guarantees

In normal circumstances, it is unusual, and highly undesirable, for governments to guarantee all deposits of financial institutions: that in effect nationalizes them, ie takes them into (partial) public ownership. But in a major systemic emergency, the first priority is restoring confidence in the financial system; stabilizing the institutions' liability side; buying time while restructuring work is going on; and preserving the integrity of the payments system.

A blanket guarantee must be made credible if it is to stop the need for liquidity support, and the run on banks. Credibility is helped by: an explicit guarantee; by confirming it in law; and making it part of a comprehensive restructuring and macroeconomic program. Note that if the authorities wish to impose losses on some financial institutions, this must be done before the blanket guarantee is extended.

These guarantees represent very large contingent liabilities for the government—against assets of highly uncertain value. But even the large cost of guarantees may well be less than the potential economic and social costs of a collapse in the financial system.

[9] See in particular references (4), (5), (6), and (7).

IX. CRISIS PREVENTION

Prevention can operate at three levels: the macroeconomy, financial infrastructure, and supervisory.

At the **macroeconomic level**, the need is for steady, stability-orientated macro policies that provide the best conditions for growth and low inflation—easily said. A great deal of Fund analysis, policy advice, surveillance, program conditionality and technical assistance is directed towards creating the conditions for steady growth. The Managing Director of the Fund, Horst Kohler, said in Prague:

"The IMF's focus must be to promote macroeconomic stability as an essential condition for sustained growth. ...The IMF has to concentrate on fostering sound monetary, fiscal, and exchange rate policies, along with their institutional underpinnings and structural reforms...giving particular attention to systemic issues of financial markets...My ambition is...to place crisis prevention and surveillance at the heart of the IMF's activities."

One crucial aspect of stability is the role of the exchange rate. Financial stability has often been seen as being helped by a stable exchange rate; yet the Asian crises demonstrated the real dangers of semi-fixed rates. If the authorities pursue a policy of a fixed rate against the dollar, for example, and if the expectation is that this policy is likely to last for some time, then many financial contracts will be based on this, explicitly or implicitly. If the fixed rate then breaks down because of some shock to the system, then this can create huge problems for financial institutions because of currency mismatches.

The solution lies with the authorities adopting a sustainable exchange rate policy. Supervisors on their own may try to insist that such mismatches do not occur in banks' books; but since it will occur in the books of many of the banks' customers, especially companies involved directly or indirectly in overseas business, the effects on the banks can still be devastating. And it is of course very difficult, in circumstances where the monetary authorities are insisting on the viability of a particular level of the exchange rate, for supervisors to insist on banks and their customers matching their currency liabilities—a policy which will look to the authorities in the central bank and the government like a questioning of the exchange rate link.

At the level of the **financial infrastructure,** the Basel Committee in their work on the Core Principles for Effective Banking Supervision described the following pre-conditions (and the same applies to other areas of supervision such as securities and insurance):

- Well-developed public infrastructure: this includes accounting rules, payment systems and an effective legal system
- Effective market discipline, particularly through greater disclosure and transparency; and the avoidance, wherever possible, of uncertain/implicit/far-reaching guarantees
- Procedures for the efficient resolution of problems in financial institutions
- Limited safety nets

The reason the Basel Committee included these preconditions was that they recognized that the job of financial supervision could not be seen in isolation, but could only be done successfully in an environment with these key preconditions in place.

It is also important to stress the role of competition, particularly foreign competition, in financial services: IMF and World Bank supported reform programs frequently put an emphasis on opening up trade in financial services and the cross-border establishment of firms. This helps to raise efficiency, and bring in new technology and management skills. One reason that there was limited contagion from the Asian crises in Latin America was the opening of the financial systems to foreign competition (as well as strengthening supervision) following the banking crises in Latin America in the 1980s.

At the supervisory level, the international standard-setting role is carried out by a number of supervisory groupings: the Basel Committee, IOSCO, IAIS and IASC. These bodies are recognized as having the authority and the expertise to set standards. Some of these bodies have a wide membership, and Basel, though it has a narrow G-10 membership, is now taking steps to consult widely.

There have been two big, almost revolutionary, changes in recent years:

- A development of supervisory standards believed suitable for all countries, notably in the Core Principles now established in banking, insurance and securities markets
- An acceptance that standard-setting requires a mechanism for assessing compliance.

It has to be recognized that setting out standards in reports or on websites is not enough; investors, commentators and others are increasingly asking whether countries and the institutions in them actually comply with the standards. It is, the cynical might say, easy to agree to standards if nobody checks up on compliance. The reality is that membership of a standard setting group does not carry with it a binding obligation to put all its standards into practice. Moreover, neither peer pressure, nor mutual evaluation, have turned out to be anything like sufficient.

So the IMF and the Bank, *working closely with the supervisors*, have been asked to take on the task of assessing observance of standards and to help countries put in place the necessary legislation and institutions to bring their standards up to international levels. The IMF now makes available in public Reports on Standards and Codes, for those members who wish to be assessed and have the results publicly known. Standards covered relate to: statistics; fiscal transparency; monetary and financial transparency; banking, securities and insurance supervision; payments and settlements systems; accounting and auditing.

X. Financial Vulnerabilities

The work by the Bank and Fund now under way on identifying financial vulnerabilities in individual countries—strengthening countries defenses against the storms that can come from outside or inside—is about promoting financial stability. Financial supervision is a core element in that stability. Fund and Bank teams began in 1998 to conduct limited assessments of observance with Basel Core Principles for Effective Banking Supervision. Thus far, no assessments of supervisory systems in the Caribbean have been completed. In 1999, we moved on to conduct Financial Stability Assessment Programs or FSAPs[10]; and these are designed to give the authorities a comprehensive picture of financial vulnerabilities throughout the financial sector:

- The aim of the FSAP initiative is to help countries avoid or more realistically limit future financial crises;
- We cover all parts of the financial sector—insurance and securities markets, payments and settlements systems as well as banks—and draw on expertise from supervisors and central banks round the world;

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[10] See reference (10)

- This is truly case-by-case, in which each country's financial characteristics are taken into account and related to its overall economy;
- We look at a combination of top-down and bottom-up approaches to financial stability, ie both from the perspective of the macroeconomy and of the financial sector in total; and from the perspective of individual financial firms;
- We bring to bear techniques that have proved their worth elsewhere, such as stress testing of bank portfolios in response to macro and micro shocks; and
- This cannot be a one-off exercise: we shall need to revisit the issues as we see changes in financial markets and the legislative and supervisory structure.

The IMF and the World Bank have made a good start on the FSAP initiative: we have a framework; we have the first 15 or 20 cases. Ahead of us in the Fund and Bank lies a big task: of completing FSAPs on all Fund members and of keeping up standards. We have not yet taken on any of the really big financial centers in the world, like New York, London, Tokyo, and Switzerland.

We are in the process of extending our financial vulnerabilities remit to **offshore finance**[11]: helping the many centers round the world which provide various offshore services—including but not limited to banking, insurance, and fund management—raise their standards to international levels. This is a subject of great importance in the Caribbean, home of many financial centers. The IMF held its first outreach meeting at St. Kitts and Nevis at the end of August 2000. We will shortly be starting on an extensive series of TA missions and assessments of offshore centers, taking account at the same time of the key interconnexions with onshore financial centers.

XI. An Unfinished Agenda

The rapid development of financial markets ensures a full agenda ahead. New instruments, old instruments in new boxes, new technology all mean that central bank and supervisory skills require constant updating. This section hints at some of the main challenges ahead.

For the Fund, and in many cases the Bank, we have more work to do in:

- Making more operational our ideas about macroprudential indicators and in particular deriving a small core group
- Integrating more fully our work on financial vulnerabilities—our FSAPs and more—into our surveillance, TA and program work
- Carrying through our extensive FSAP initiative

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[11] See reference (11)

- Deciding on a policy with regard to publication: this is an upcoming issue for the Boards of the IMF and the World Bank
- Deciding how far the Fund should get into the oversight of anti-money laundering measures, as we are being asked to do by some of our prominent members

The standard-setters have more work to do in:

- Completing and setting a date for implementation of the updated framework for capital for banks; and ensuring that the capital framework is capable of being applied, not only to sophisticated banks in G-10 countries but also to all banks worldwide
- Looking at the different financial sectors to see how far the big supervisory differences reflect real differences in risk
- Setting clearer standards for supervision of liquidity
- Filling in the gaps in supervision. For example: do supervisors need to regulate large financial companies—such as GE capital in the USA—which has sizeable banks as subsidiaries in other countries?
- Trying to reach agreement on common elements in cross-border insolvency arrangements
- Supervising banks on the internet

For our member countries, the future agenda includes extending the country coverage of our financial assessments, deciding on a publication policy—and in particular the role for a published assessment in the context of a credible policy framework—and continuing to work on raising standards of supervision and financial infrastructure.

In the Caribbean[12], I would pick out the following:

- The need to undertake financial assessments of countries in the Caribbean
- As more financial institutions operate across the region and across borders, there is more need for information-sharing between supervisors in the region; and a greater emphasis on effective consolidated supervision of banking groups
- There is a need to raise supervisory standards relating to both onshore and offshore financial activities, and bring together, for instance under the aegis of the ECCB, some supervisory responsibilities
- Greater disclosure and transparency by financial institutions and their supervisors in the region

[12] See reference (12)

XII. MICRO AND MACRO PRUDENTIAL ASPECTS OF FINANCIAL STABILITY

Andrew Crockett, General Manager of the Bank for International Settlements, and chairman of the Financial Stability Forum, gave a stimulating talk recently on "Marrying the micro- and macro-prudential dimensions of financial stability."[13] Crockett notes that achieving financial stability requires inputs from a number of different players:

- Central bankers, in their roles as operators of monetary policy and protectors of payments systems
- Supervisors, in and out of central banks
- Finance ministries, who pick up most of the cost of financial crises; and who are responsible for the legislation governing supervision
- Together with a number of bodies, such as accounting standards setters, and law officers, who provide the necessary infrastructure

He rightly calls for closer links between these bodies in each country: this could take the form, as in the U.K., of a regular meeting between the three main official bodies concerned, on the basis of a published Memorandum of Understanding together with clear and explicit statements of responsibilities of each of the parties.

Crockett puts forward a number of propositions for closer links between those institutions with macro and micro concerns. He looks at different institutions at a point of time and takes as an example a country—Switzerland maybe—with just two very large financial institutions, both clearly of systemic importance to the country's financial stability. Should they be treated the same—eg for purposes of setting capital or liquidity—as smaller institutions? Crockett implies they should not and could instead be subject to, for example, intensified supervision or higher capital ratios. In practice, no countries admit to the latter—setting higher capital—though the former—more supervision—is common. Moreover, among the few countries where supervisors set capital ratios bank by bank, there are many other factors to take into account, as well as systemic importance. One such factor is diversification: large, systemic banks are typically much more diversified than smaller banks and that is a real factor in reducing the appropriate level of capital.

Looking at how risks change over time, Crockett tells supervisors to take better account of the financial cycle in setting supervisory rules. For instance, he suggests that provisioning rules should be set over a complete cycle rather than looking back or just a year ahead—and with that supervisors are increasingly agreed. But he also hints at setting capital and other rules in a cyclical way, higher in the boom and lower in recession. This would enroll the supervisors into the macroeconomic, counter cyclical brigade, hitherto occupied mainly by the forces of monetary and fiscal policy. And here there are real objections.

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[13] See the BIS website: www.bis.org

Firstly, fine-tuning over the cycle is inherently very difficult, as we have found in macroeconomic policy. Empirically, it is difficult to establish that deficient provisioning plays an important procyclical role.

Secondly and more importantly, making regulatory and supervisory tools serve macroeconomic policy goals involves a serious risk of confusing the responsibilities of supervisors with those of other authorities; and the supervisors' job is difficult enough already. It also conflicts with the idea that supervisors should be independent of government. In policy as in so many other areas, division of labor works well. As an example, suppose in a recession that the supervisor discovers that loan loss provisioning by most banks is insufficient; should the supervisor go easy in order to mitigate the recession? Or should he go ahead with enforcing prudent standards in the banks for which he is responsible; tell the central bank what is happening; and leave the bank to take this into account in its setting of interest rates lower than they would otherwise be? The second course seems much preferable. And it should be complemented by supervisors enforcing prudent loan loss provisioning rules at all times so that there is no need to tighten up in periods of recession.

XIII. Conclusion

This survey of financial stability issues on the agenda of the IMF indicates that while much has been achieved in recent years, there is a big agenda ahead.

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(11) "Offshore Financial Centers: the role of the IMF", IMF website, July 26,2000*

(12) For a recent and comprehensive survey, see the paper by DeLisle Worrell and Desiree Cherubin, "Strengthening financial system soundness in the Caribbean: a survey and agenda for further investigation", IMF, 2000, paper given to an IMF and CDB Seminar in February, 2000

*Available on the IMF website: **www.imf.org**