

Macro-Prudential Policy and Systemic Risk: Issues for Caribbean Regulators

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How will Caribbean regulators make MaPP operational?

MaPP authority must:

- refine the set of common MPIs by further narrowing the categorization of time series and cross sectional dimensions of systemic risk into an operational specification of intermediate objectives (different manifestation, hence different toolset in crisis)
- track an empirically robust list of MPIs that each contain information directly linked to an MaPP intermediate objective as well as a corresponding set of instruments available to correct deviations of MPIs from thresholds (i.e., trigger mechanism for activating the timely use of macro-prudential tools)
- publish its MaPP governance framework, including intermediate objectives, 'hard' or 'soft' triggers for MPIs and criteria for systemic risk assessments to rationalize policy response for transparency and accountability (although broad use of judgment is also required)
- publish a Financial Stability Index(es) of composite MPIs for greater signaling value of joint behavior for determining the onset of a crisis (or instability)
- simulate crisis scenarios (NB: responsibility for crisis management plan and resolution is beyond scope of MaPP)

Define MaPP Intermediate Objectives

Financial Imbalances (times series):

- Leverage build-up
- Maturity mismatch
- ‘Undue’ credit/debt expansion
 - Supply side – excessive credit growth rates
 - Demand side - excessive debt growth rates of households, firms and government
- Illiquidity
 - Asset side - liquidity exposure levels (market liquidity risk)
 - Liability side – liquidity funding exposure

Externalities (cross-section):

- Capital adequacy & resilience to shocks
- Direct & indirect exposure concentrations
- Interconnectedness
- Systemic importance
- Misaligned incentives and unintended consequences
- Robustness of structures of the markets, payment and settlement systems

Map MPIs to Intermediate Objectives to Tools

Intermediate Objectives	Examples of MPIs
Excessive intermediation & leverage	<ul style="list-style-type: none"> – Real estate prices and other macro aggregates of imbalances – Implied volatilities & yield spreads – Credit growth & credit to GDP gap measures – NPL ratios – Debt sustainability & leverage ratios for corporates and H/Hs – Changes in lending standards
Maturity mismatch & illiquidity	<ul style="list-style-type: none"> – Liquid assets to short-term liabilities ratio – Liquidity Coverage Ratio & Net Stable Funding Ratio – Loans to deposits ratio & core funding ratio – Share of foreign short-term liabilities – Lending spreads
Common exposures	<ul style="list-style-type: none"> – Share of interbank liabilities in total liabilities – Fiscal Stress Indicators & sovereign debt – Concentrated exposures
Interconnectedness and systemic importance	<ul style="list-style-type: none"> – Bilateral balance sheet exposures – Joint Probabilities of Distress and Network Indicators – CoVaR & CCA (distance to default) measures
Capital adequacy & resilience to shocks	<ul style="list-style-type: none"> – Balance sheet and profitability indicators – Stress tests results – Haircuts and margins on secured financial transactions – Market depth measures

Similar to cross section MPIS, absence of consensus on time series MPIS
 - need to combine (e.g., inertia problem using Jamaica data)

