Banco Central de Uruguay
International Monetary Fund

Financial Stability Institutions
A Brazilian Perspective

Angelo Duarte
Economic Advisor
Banco Central do Brasil

Punta del Este, Uruguay
March 2012

BANCO CENTRAL DO BRASIL

Outline

- Monetary policy and prudential regulation
  - Pre 2008 crisis – simple and separate view
  - Post 2008 crisis – closing gaps
- Financial stability mandate
- The Brazilian experience

Monetary Policy
&
Prudential Regulation

Before and after the 2008 crisis

Pre 2008 Crisis - Macroeconomist / Regulator - Separate Views

	Monetary Policy (MP)	Prudential Regulation (PR)
Monetary Stability (MS)	Well-known conventional instruments and their effects Consolidated theory Institutional framework settled	
Financial Stability (FS)		Effects on risk (credit & asset excess growth) well-known International standard framework established (Basel 2)

Post Crisis – Macroeconomist and Regulator – Closing Gaps

	Monetary Policy (MP) (conventional & unconventional)		Prudential Regulation (PR) (MiP & MaP)	
Monetary Stability (MS)	Well known conventional instruments and its effects Consolidated theory Institutional framework settled **Liquidity trap under zero rate**		**Counter-cyclical effects known and observed, but indirect (through credit)** **Elasticity and lags are still unknown**	
Financial Stability (FS)	**Very low CB rate for too long period might cause excessive risk-taking**	**Restore liquidity, reducing the financial system's stress** **Reduce public debt rollover risk, and consequently enhance financial stability** **Might cause risks to financial stability in the medium and long term**	Effects on risk well-known **International standard framework under revision (Basel 2.5 & 3) address pro-cyclicality**	**Institutional framework needs to be strengthened**

Financial Stability Mandate

Who must be in charge of MaP/FS

Why Central Bank (CB) is the better agency to be in charge of financial stability (FS) ?

- MP and FS are inter-linked
  - Both MP and FS affect macroeconomic environment
  - MP has implications for FS; FS has implications for MP
  - MP and FS are mutually supportive
  - Overlap of MP and MaP instruments
- CB's liquidity function for the economy (including LOLR)
  - Important for both MP and FS
- CB's comparative advantage
  - Broad knowledge of both (macro and micro) economic issues and financial markets

CB – Central Bank
MaP – MacroPrudential Policy
LORL – Lender of Last Resort
MP – Monetary Policy
FS – Financial Stability

Financial stability external governance

- Although CB is the most qualified agency to be in charge of the financial stability mandate, other relevant bodies have an important role in ensuring the stability of the financial system.
- Appropriate arrangements must be made for information-sharing and cooperation with external bodies, such as:
  - Ministry of Finance / Treasury and other domestic financial market agencies (securities, insurance, pension funds, and financial consumer protection agencies)
  - Market participants, especially financial infrastructure sponsors
  - Foreign supervisors

Central bank dual mandates (MP & FS)

- “Normal” times
  - Policies conducted mostly autonomously
    - $\Rightarrow$ Separate committees are preferred
  - Information sharing leads to improved assessment
  - Coordination problems may be mitigated by maintaining the primacy of MP
- Crisis, stressed times & boom-bust periods
  - Earlier and better assessment
  - Easier to design interventions
  - Easier to coordinate policy
  - Faster reaction time

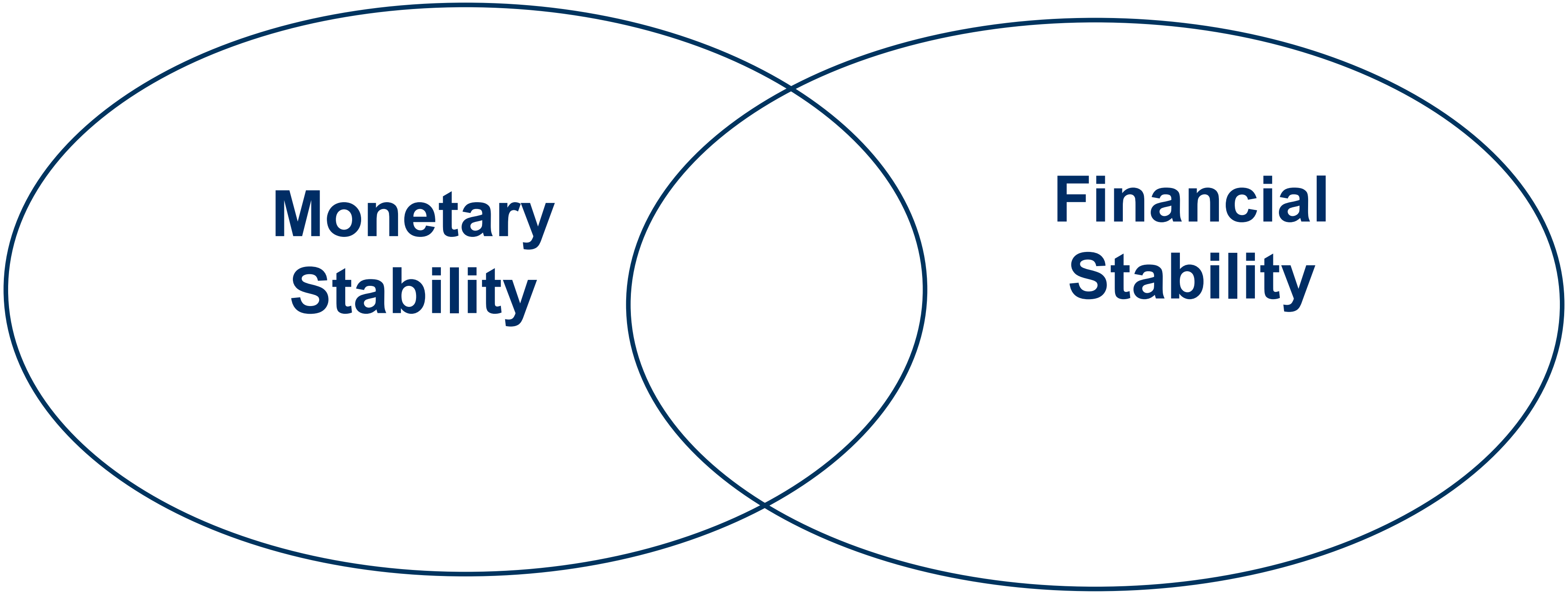
The Brazilian Experience

Institutional Arrangement

- Bank Law (1964)
  - A single piece of legislation that concedes a **broad** mandate to the National Monetary Council and to CB to shape and implement (only CB) the monetary and regulatory policies
  - Other mandates given: exchange rate policy, capital flows, payment systems, supervision, accounting rules, subsidized credit, etc.

- National Monetary Council
  - Composed by the Ministers of Finance and Planning/Budget and the Governor of the Central Bank
  - Establishes the inflation target for monetary policy and prudential regulation guidelines, which must be proposed only by the Central Bank Governor

Central Bank of Brazil



Monetary Policy Committee

Quarterly Inflation Report
Minutes of Meetings

Financial Stability Committee

Quarterly Financial Stability Report
Minutes (not to the public!!)

Coordination with other policymakers

- Financial market supervisors committee (*Coremec*)
  - Coremec brings together the Central Bank and other financial market agencies (securities, insurance and pension funds supervisors) to align rules and discuss supervisory issues
  - Subcommittee tasked with joint monitoring of financial stability

- Capital Markets Group
  - A joint working group of supervisors, National Treasury and federal tax authority in order to create conditions to capital markets development

Brazil's Institutional Model – a Clarification

From the "Session Notes":

	Atlantic model
Institutional integration	Partial
What agency takes decisions	The National Monetary Council*
Role of the government	Active
Separation of policy decisions/control over instruments	Yes
Formal separate coordinating body	Yes
Countries	Brazil

- CB is Monetary Council voting member
- Prudential regulation guidelines must be introduced by CB

- Through National Monetary Council

- CB has leading role in formulating prudential guidelines of the Council
- Broad delegation of policy making powers to CB
- CB has control over instruments

BANCO CENTRAL DO BRASIL

Thank you

BANCO CENTRAL DO BRASIL