SUPERINTENDENCIA DE BANCA, SEGUROS Y AFP

PERÚ

Operationalizing Macroprudential Policies in Peru: lessons and experiences

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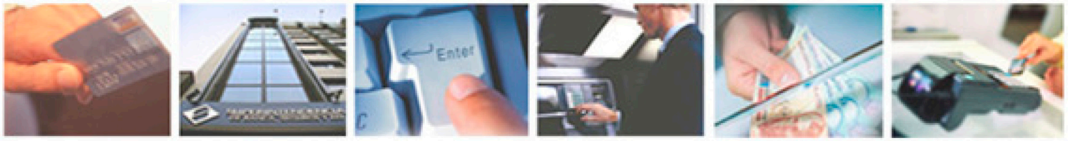
Outline

I. The Peruvian System

II. Rationale for our design features

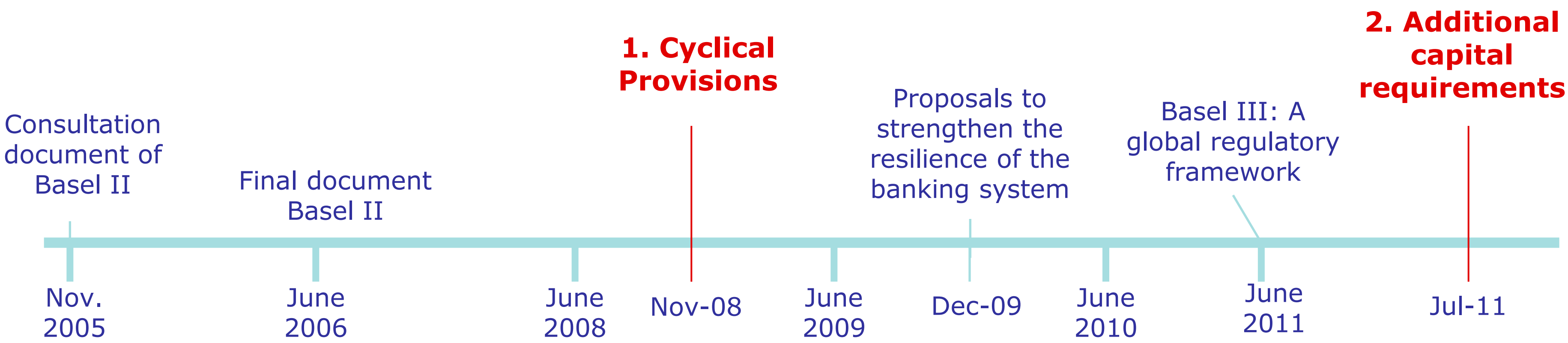
III. Lessons learned



I. The Peruvian System

Timeline

- Peru has implemented macroprudential regulation before Basel III.



- But their effectiveness has not been truly tested yet. The impact of the 2007-08 crisis on the Peruvian economy was neither permanent nor severe.

Macroprudential regulations in Peru

- The scope of implementation covered a number of macroprudential rules:

  - Cyclical provisions
  - Cyclical capital buffers
  - Limits to over-borrowing (retail loans)

  rules to tackle excessive leverage

  - Limits on FX global positions
  - Limits on FX forwards exposures
  - Limits on FX derivatives (for pension funds)

  rules to tackle currency mismatch

- Additionally, our Central Bank imposes and controls cash reserve requirements in both domestic and foreign currency.

Key features of our macroprudential regulation

- **Rule-based**: yes, but an adjustable rule.
- **Cyclical**: based on GDP growth.
- **Simple**: a “yes-no” accumulation rule.
- **Level playing field**: a single rule book for all our firms.
- **Moderate**: buffers depend on banks’ risk profile and range from 1.3% to 5% of risk-weighted assets.

II. Rationale for our design features

Why rule-based policies?

- Rules or discretion?

Discretion: Authority or committee is free to act in according to its expert judgment.	**Rules**: Procedures that constrain authority's possible actions, making predictable its decisions.

- The predictability of rules facilitate communication with industry.
  - In upswings, rules make easier to increase requirements.
  - In downturns, rules mitigate the stigma associated with the use of buffers.
- Calibration is difficult (real and credit fluctuations are not perfectly synchronized and cycle amplifiers might vary) so rules are **improvable / adjustable** (but only when needed).

Why cyclical rules?

- In the case of capital and provision buffers, we were looking for an indicator that, ideally, had reflected both real and credit cycles.

- GDP was a natural candidate. But real business cycles not always coincide with credit cycles.

- Credit/GDP ratio compares real and credit cycles. But in emerging economies (where intermediation is very low) this ratio always has a positive trend.

- The SBS mixed short and medium-term indicators based on GDP growth.

Bank lending to GDP ratio
(as of 31 December 2010)

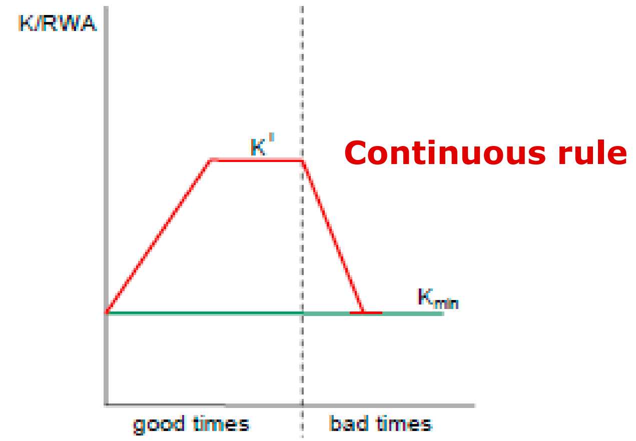
Country	Ratio
France	134%
Germany	132%
Spain	231%
UK	224%
USA	232%
Peru	18%
Ecuador	26%
Argentina	29%

Source: World Bank indicators

Why simple rules?

- The SBS applies a simple discrete (yes/no) rather than a continuous accumulation rule.

  - Small banks can't raise fresh capital from equity markets → they depend on retained earnings to increase their capital levels → they need to predict when additional capital will be needed.
  - A simple predictable rule allows banks to build up buffers well in advance.
  - A proper transition period is also helpful. Our banks have a one-year window (after the rule is activated) to meet requirements.

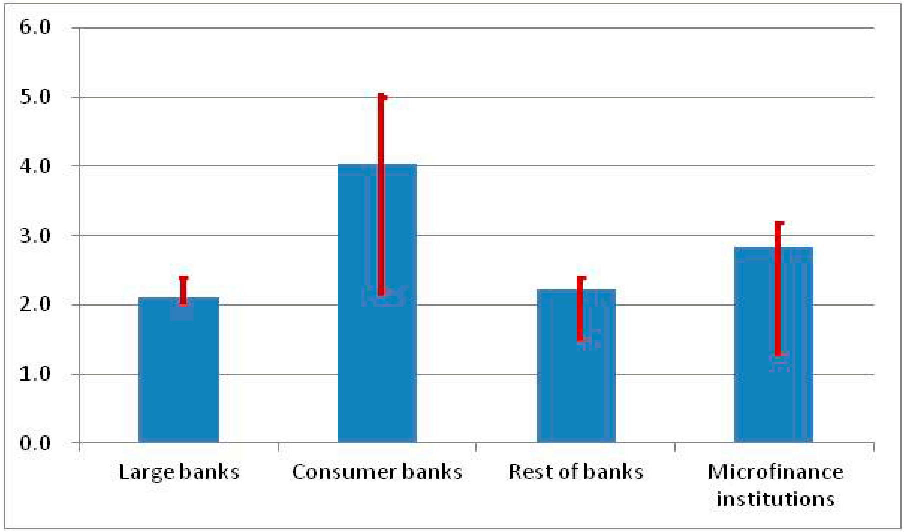


Why a single rule-book?

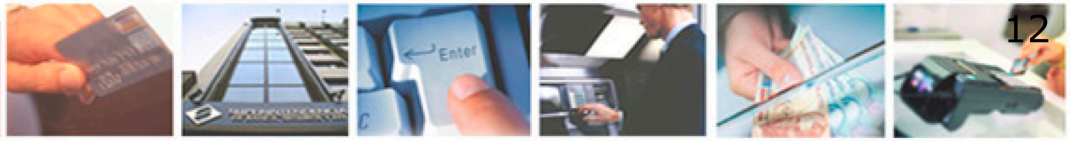
- The SBS has set up a common methodology to estimate both capital and provisions' buffers.

- A single rule book doesn´t mean all banks have the same requirement.
- Charges depend on the risk profile (portfolio composition) of each firm.
- Firms with a large share of retail loans get higher requirements than banks with a large share of corporate portfolio.

Countercyclical Capital Buffer
(% of risk-weighted assets)



Red lines indicate the minimum and maximum buffers in each type of institution.

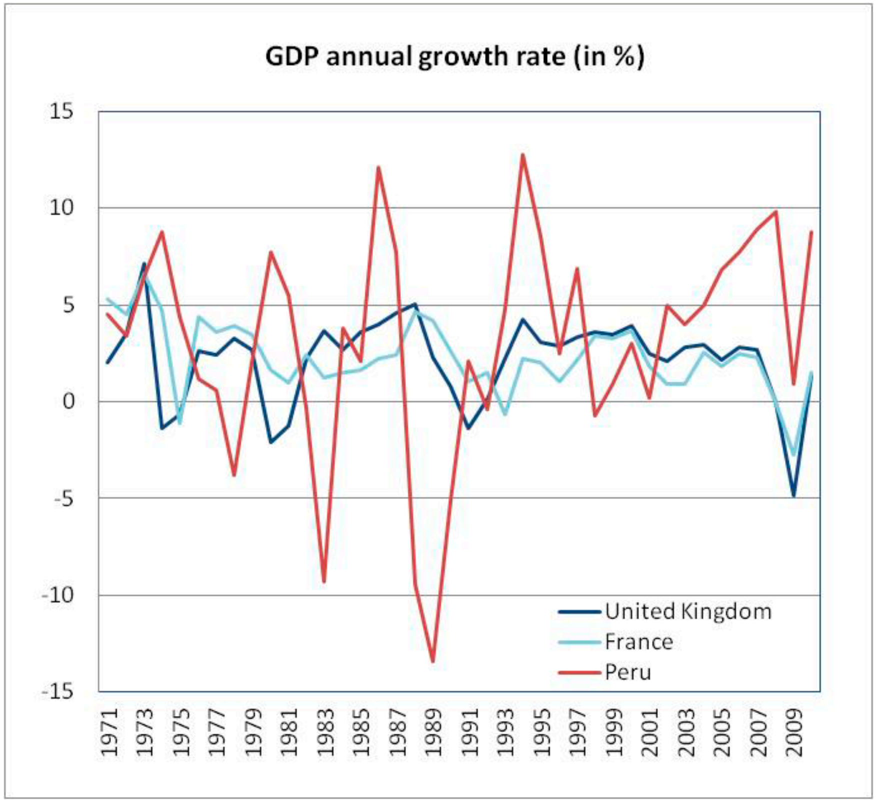


Why moderate policies?

- Analyses suggest there are benefits in terms of resilience, but it is unclear whether these policies can curb the cycle.

- In Basel and Brussels, regulators are discussing whether the buffer should be **capped at 2.5%** of risk-weighted assets.

- Our countercyclical buffers range **from 1.3% to 5%** because:
  - we know our cycles have more amplitude than those of developed countries.
  - we have questions about the buffers´ effectiveness.



Effectiveness in terms of resilience

- In October 2011, the IMF and the SBS conducted a stress test based on a pessimistic macroeconomic scenario given by IMF.

	2011	2012
US GDP growth	0.75	-2.00
China GDP growth	8.50	4.00
Peru GDP growth	5.80	2.00
Peru construction GDP growth	4.00	0.00
Peru Domestic demand growth	7.80	3.00
Copper price var.	-5.00	-40.00
Fishmeal price var.	-16.00	-40.00
Peru credit growth rate	14.69	5.00

- Under this scenario, capital ratios in Peru could fall from 13.2% to 12.3% on average.
- Provisions and capital buffers allow the financial system to absorb these shocks and maintain capital ratios above the minimum (10%).

Effectiveness to curb the cycle?

- Evidence is unclear on whether provisions (and capital buffers) are able to limit a rapid credit expansion.
- In Peru, the supply of credit grew fast during both the activation and reactivation period.

	Bank lending (annualized growth)
Activation period (Dec. 2008 - Aug. 2009)	**19.2%**
Deactivation period (Sep. 2009 - Aug. 2010)	**5.9%**
Reactivation period (Sep. 2010 - Nov. 2011)	**24.7%**

- Because it is difficult to assess whether these high credit growth rates are part of our financial deepening process, we need to be moderate to avoid unintended consequences.

III. Conclusions

Lessons we have learned

- Preference for **predictable** and **adjustable rules** rather than pure discretion.

- **Simplicity** and **moderation** prevent unintended consequences such as increases in lending cost or contractions in lending supply.

- Macroprudential rules seem to be effective in terms of **resilience** but there is limited evidence on whether they can curb the credit cycle.