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Macro prudential Supervision Tools in the European Banking System

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Abstract

The recent financial crisis has reoriented policymakers from micro prudential supervisory to systemic orientated regulation and macro prudential supervisory frameworks. This paper presents a macro prudential approach for monitoring the banking system soundness in the European Union. Using panel data techniques we have estimated the impact of the macroeconomic environment on two key financial soundness indicators of banking systems from 27 countries. Also, we have developed a macro prudential supervisory framework for identification and monitoring the systemic risks, from both backward and forward-looking perspectives.

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1. Introduction

In this paper, we aim to research several elements related to macro prudential banking supervision. Firstly, we analysed in short the concept of macro prudential supervision. Subsequently, we turned to the study of institutional problems related to the macro prudential supervisory activity at the level of the European Union (EU). The next step was the setting up of a framework for macro prudential analysis. Finally, our paper turns to an empirical approach to identify macroeconomic variables that have been having a significant impact on two aggregate bank indicators in the banking systems of the European Union Member States.

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2. The framework for macro prudential supervision

The recent financial crisis has led to a re-thinking of the analytical approaches and of the policies concerning financial stability. The crisis has determined a greater focus on systemic risks, the inclusion of the financial sectors in macroeconomic models, and the shift away from the micro prudential to the macro prudential approach in regulation and supervision Borio, 2011.

Clement, 2010; Galati and Moessner, 2011; and Borio, 2011 analysed retrospectively the use of this term. References to it were first made in the 1970s in the minutes of the Cooke Committee, the forerunner of the present-day Basel Committee on Banking Supervision, as well as in a document issued by the Bank of England. Nonetheless, the term has become more widely used in the context of the current financial crisis. An increasing number of researchers produced detailed papers concerning the macro prudential policies for conferences (e.g. Shirakawa, 2009; Nijathaworn, 2009; Tumpel-Gugerell, 2009; Bini-Smaghi, 2009; Kohn, 2009, and Brouwer, 2010). ‘Macro prudential’ actually defines a trend or a perspective of the framework for regulation and supervision; it signifies the fine-tuning of the elements of this framework from a systemic perspective, rather than from the perspective that considers the security and soundness of each individual institution; it suggests a ‘top-down’ approach that allows for the emergence of a security benchmark that considers the system as a whole, and fosters sound individual institutions; finally, it states clearly and explicitly that the risk emerges as a consequence of the collective behaviour of the financial institutions (i.e. endogenous) and not independent from the influence of these institutions (i.e. exogenous).

2.1. The lack of clarity of the institutional framework for macroprudential supervision

In order to perform the macro prudential supervision efficiently and secure the soundness of the banking system, it is necessary to clarify some of the structural aspects of the implementation of macro prudential policies at European level and of the authority in charge of macro prudential supervision. This observation concerns in particular the banking systems since it is the core element of any financial system. A study conducted collaboratively by the Financial Stability Board(FSB), the Bank for International Settlements (BIS), and the International Monetary Fund (IMF)(2011) identified 5 relevant aspects that require clarification: the mandate; the competencies and instruments; accountability and transparency mechanisms; the composition of the decision-making body; the mechanism for the coordination of internal policies.

The macro prudential mandate needs to be clearly and explicitly stated. In this way, the members of the staff working in the institution itself will gain a good understanding of the assignment of the tasks: who does what and why. The formal mandate can improve the clarity of the decision-making process; prevent passivity and blockages in decision-making, especially in cases where opinions diverge. It is essential to hold the necessary competence when calling on directly on other organizations to provide information, especially in cases when the data is not available to the authorities in charge of macro prudential supervision. When data is available and is collected by other institutions, it needs to be established who will have the competence to access the respective data bases. Furthermore, the necessary competencies for establishing, using and directly fine-tuning the macro prudential instruments need to be secured, especially in the case when the mandate and the control of the instruments are not within the responsibility of the same one institution. Another challenge emerges when it comes to establishing accountability in a situation when there are no clear and efficient benchmarks. This issue is further complicated by the problem of the side that supports the costs of the macro prudential measures. In many situations, the macro prudential supervision bodies are responsible to the Parliament. For instance, at the level of the European Union, the European Systemic Risk Board is responsible to the European Parliament.

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