



***Monetary and Financial Stability:
A dual role for a Central Bank
Recent lessons***

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MONETARY AND FINANCIAL STABILITY: A DUAL ROLE FOR A CENTRAL BANK RECENT LESSONS

- I. An effective monetary policy requires financial stability
- II. Financial stability requires sound fiscal conditions
- III. Financial stability requires sound international regulation and robust supervisory management

I - AN EFFECTIVE MONETARY POLICY REQUIRES FINANCIAL STABILITY

□ Transmission mechanisms of monetary policy

- Price channel
- Liquidity channel
- Balance sheet channel

I - AN EFFECTIVE MONETARY POLICY REQUIRES FINANCIAL STABILITY

- ❑ Monetary policy need a sound financial system in order to facilitate an efficient transmission mechanism
- 1. Central Banks should pay a great attention to the functioning of the interbank market
- 2. Banks refinancing behavior is essential to assess their liquidity needs
- 3. Macro-prudential oversight requires close coordination between Central Banks and Supervisors

II – FINANCIAL STABILITY REQUIRES SOUND FISCAL CONDITIONS

- ❑ Under stress conditions, sovereign debt management may affect market behavior and alter monetary policy price stability objective
- ❑ This danger is heightened in period of prolonged very low interest rate
- ❑ Central Banks should pay attention to these warning signals

II – FINANCIAL STABILITY REQUIRES SOUND FISCAL CONDITIONS

☐ Central Banks should pay attention to warning signals:

1. Supply of very liquid financial assets in the economy could have similar effects to quantitative monetary easing;

2. Management of sovereign debt short maturities could:

- ✓ Heightened roll-over risks and market volatility;
- ✓ Reduce ability for insurers and pension funds to match their liability duration needs;

3. A bad sovereign management debt could:

- Develop risk aversion which spread over the whole financial system;
- Lead to market segmentation.

III - FINANCIAL STABILITY REQUIRES SOUND INTERNATIONAL REGULATION AND ROBUST SUPERVISION MANAGEMENT

- The flaws in the international regulatory framework
- The G20 initiatives
- Good standards to foster an efficient micro-prudential supervision

III - FINANCIAL STABILITY REQUIRES SOUND INTERNATIONAL REGULATION AND ROBUST SUPERVISION MANAGEMENT

1. Being **intrusive**, beyond reporting

- Avoid over reliance on outside risk discipline :
 - market discipline
 - rating agencies
- Focus on internal control
- Develop governance process
- Pay attention to business model and sources of income

III - FINANCIAL STABILITY REQUIRES SOUND INTERNATIONAL REGULATION AND ROBUST SUPERVISION MANAGEMENT

2. Being **productive**

- on site examinations
- following-up and enforcement
- developing stress tests

3. Being **comprehensive** and adaptive

- Coordination with
 - Central Bank
 - Other Supervisors
- Being «in a constant learning mode»
- Encouraging «best practice» approach