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MACROPRUDENTIAL REGULATION: THE SHIFT IN THE GLOBAL ECONOMIC

In the aftermath of the recent global financial crisis the concept of government regulatory role has drastically changed. Failure to develop a policy that would create a net positive effect for the economy as a whole revealed how ill prepared the leaders of the global economy were. The new shift of the economic paradigm implies transfer from a more detailed and segmented vision to a high level perception of the economy not only on the country scale, but on a global scale as well.

It became clear that systemic risk is a far more important subject than the combination of individual risks concentrated in certain sectors of the economy or even specific companies. Government targeting policies (inflation targeting, unemployment targeting etc.) have little effect if the pressure built in one area of the economy transfer elsewhere. Further understanding of such shift created a new concept in economic theory-macroprudential regulation.

The essence of the theory is in expanding the scope of economic regulation to a whole economy with its intricate risks, higher number of involved factors and a growing complexity of interconnections of these elements. The concept of macroprudential regulation expanded to encompass global economic relations. The goal of such regulation is to make decision on economic policies based on expected outcome for global economic system as a whole. Understanding the mechanism of effective macroprudential regulation has become a challenge for the financial officials.

Over the years we have developed a large range of metric to assess the individual industry risks as well as risks of concentrated in specific niches of corporate sector. The

biggest obstacle in the way of macroprudential adaptation is development of systemic risk metrics. How will the shift in the risk in baking sector influence the same metric in manufacturing, consumer sector, real estate market? How will government policy implementation or targeting of specific macroeconomic indicators cascade into every little element of the economy (not only of national economy but potentially global economy).

Basel III became an important cornerstone in the development of macroprudential regulation. The new standards mandate the implementation of preventative and proactive analysis in the banking sector as well as facilitate creation of a number of important regulatory tools.

There are many other issues that financial leaders have to overcome while implementing regulatory policies, one of them being “leakage” of intended effect. This effect occurs more and more often as global financial system becomes more interconnected and the regulatory subordination grows more opaque. As an example, regulatory norms directed at national banking system would not always spread onto financial institutions that are regulated by foreign structures. Thus these “unregulated” parties will diminish the intended effect of a specific macroprudential program. Such specificity posed a serious problem during discussion of the interbank transaction fees that could potentially be levied on French banks. This leads to a point that macroprudential regulatory policies would be coordinated between different governments, while taking into consideration national interests and regional/global interdependencies. Basel III is expected to eliminate some of “leakages” through taking into considerations differences in national financial regulations. Political decision making, however, should act along the lines of financial regulatory measures.

Implementation of macroprudential regulation requires a set of tools that is thoroughly selected and approved amongst the international financial regulators. For now one of the most effective and generally accepted tools is countercyclical capital buffer. The tools is expected to prevent transitioning of the risk between corporate and

public sector while at the same time distributing systemic risk over a much higher number of years. This tool has been tested in some European countries and proved to be effective as a way to mitigate the risks across multiple economic sectors (such as consumers; market, banking sector, manufacturing, services, real estate).

Macroprudential regulation is a result of a natural progression of economic theory in the direction of a more thoughtful and informed decision-making. Successful regulation, according to the new approach encourages proactive measures rather than de-facto reactive regulation. While some first steps in implementation of the new regulatory model have been made in many countries around the world the process will still be hampered by barriers of communication, political decision making and heterogeneity of financial systems.

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