



Macroprudential Stress Testing as a Policy Tool: Communication

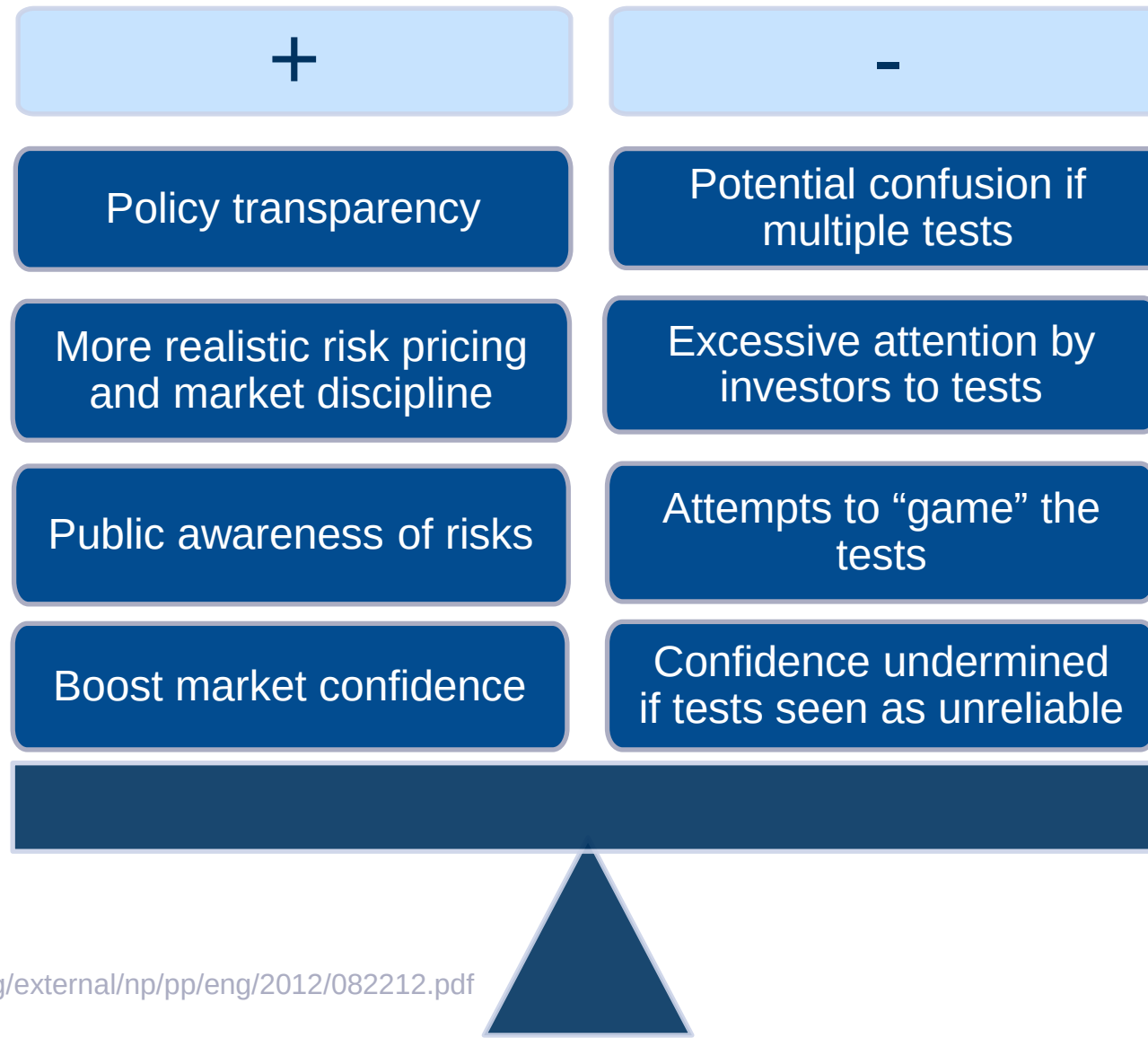
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**EUROPEAN CENTRAL BANK CONFERENCE
MACROPRUDENTIAL STRESS TESTING
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*Views expressed here do not necessarily
represent those of the IMF.*



To communicate or not to communicate?

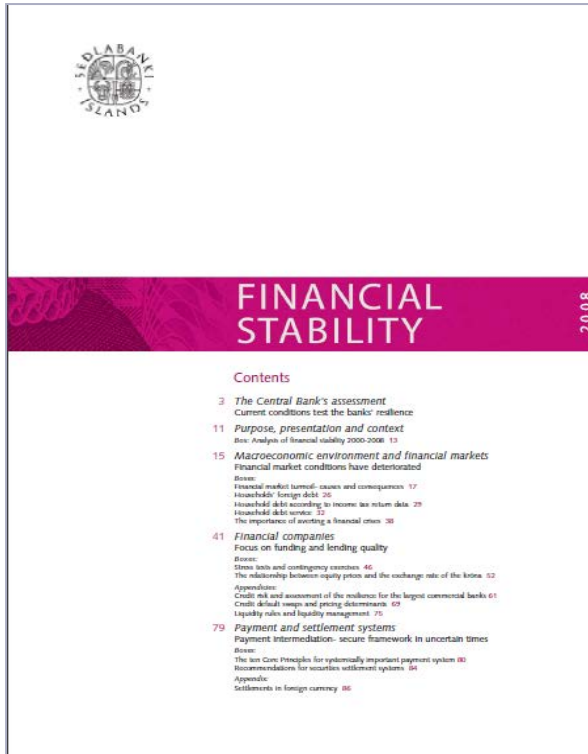


Trust is easy to break,
hard to rebuild.

If communications are
perceived as "spin,"
they further erode trust.

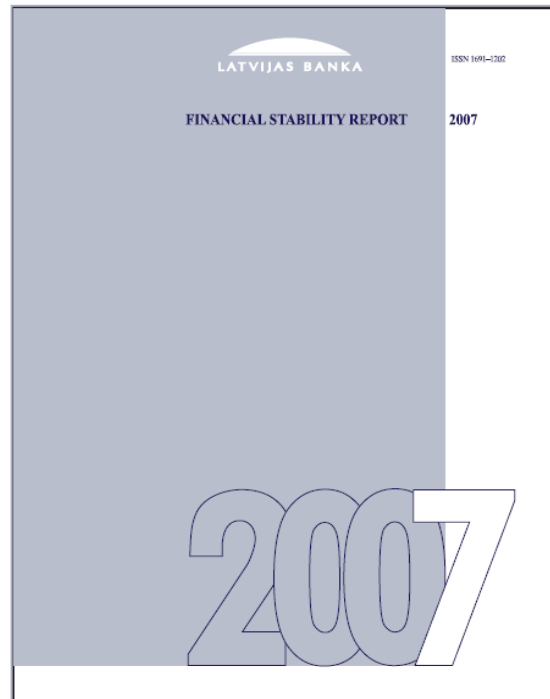
To be successful,
policies and
communications must be
trustworthy.

Communication breakdowns



“Banks are well prepared to withstand increased delinquency and loan losses, which have been extremely low to date...”

Iceland's Financial Stability Report (2008)



“Low probability that in 2008 existing risks might materialize to the extent that it will have an impact on bank performance...”

Latvia's Financial Stability Report (2007)

Measuring quality of communication

“Three Cs”				Key elements
	Clarity	Consistency	Coverage	
A. Aims				
B. Overall assessment				
C. Issues				
D. Data, assumptions, tools				
E. Structure, other features				

E.g.: Is it clear what data and assumptions were used to arrive at the presented results?

Source: “How Do Central Banks Write on Financial Stability?” IMF WP 06/163 (see also IMF WP 12/01 and IMF WP 17/73)

Note: Based on methodology used by Fracasso, Genberg, and Wyplosz (2003) to assess central banks’ inflation reports. They showed that for inflation reports, higher ‘quality’ measured this way was associated with lower dispersion in inflation expectations and lower inflation, on average.

Baseline model

(probit/panel with random effects)

$$FS_{i,t} = \beta_1 + \beta_2 FSR_{i,t} + \beta_3 MACRO_{i,t-1} + \beta_4 BANK_{i,t-1} + \beta_5 IQ_{i,t-1} + \mu_{i,t}$$

Dependent variable

- Probability of a banking crisis
- Moody's Banking Sector Financial Strength Rating
- Stock market volatility
- ICRG sovereign financial risk rating
- 1-year median banking system EDF

Independent variables

- Two alternative FSR specifications: (i) FSR publication dummy; and (ii) FSR quality index (CCC framework as in Čihák, 2006)
- MACRO: Macroeconomic controls
- BANK: Banking controls
- IQ: Institutional quality controls

To address endogeneity/selection bias, we estimate a two equation model:

$$FSR_{i,t} = \alpha_1 + \alpha_2 Crisis_{i,t-3} + \alpha_3 GDP_{i,t-1} + \alpha_4 Credit / GDP_{i,t-1} + \alpha_5 FSRN_{i,t-1} + \varepsilon_{i,t}$$

$$FS_{i,t} = \gamma_1 + \gamma_2 FSR_{i,t} + \gamma_3 MACRO_{i,t-1} + \gamma_4 BANK_{i,t-1} + \gamma_5 IQ_{i,t-1} + \lambda_t + \nu_{i,t}$$

- $FSR_{i,t}=1$ if country i published FSR at time t , =0 otherwise
- $Crisis_{i,t-3}=1$ if country i had banking crisis at $t-3$, =0 otherwise
- $GDP_{i,t-1}$ and $Credit/GDP_{i,t-1}$ are GDP per capita and credit over GDP at $t-1$
- $FSRN_{t-1}$ = total number of countries publishing FSRs at $t-1$
- λ_t = inverse of Mills ratio (probability density of prediction in first equation, divided by cumulative normal density)

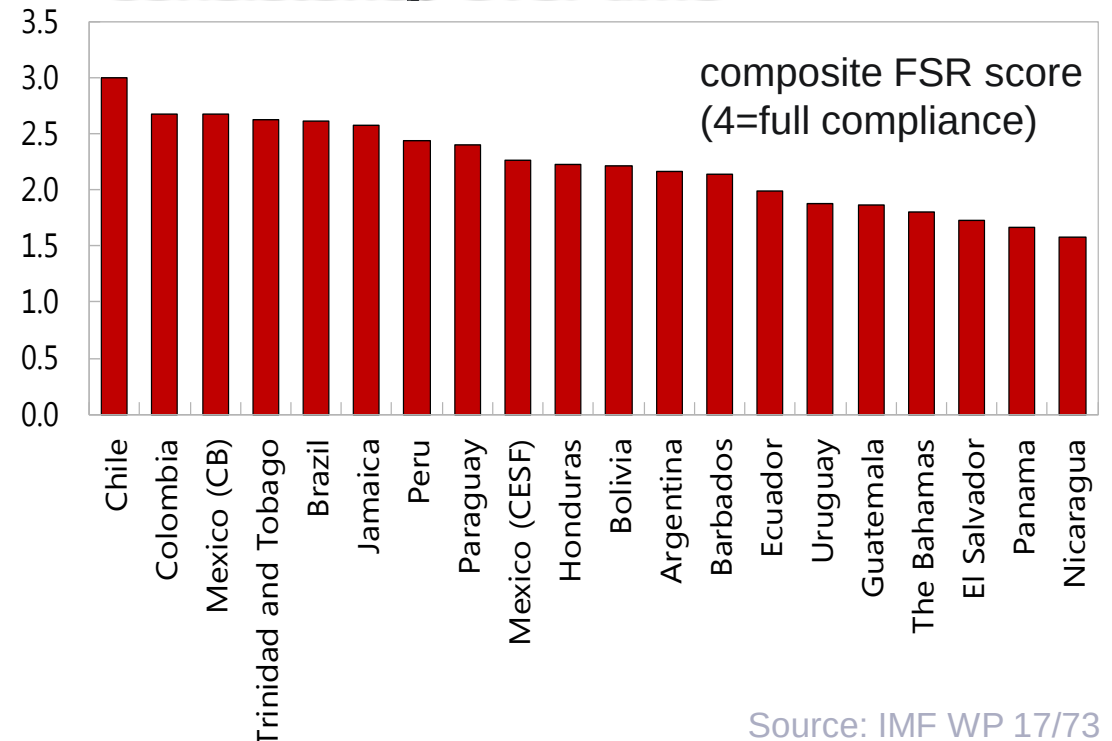
Effectiveness depends on the “three Cs”



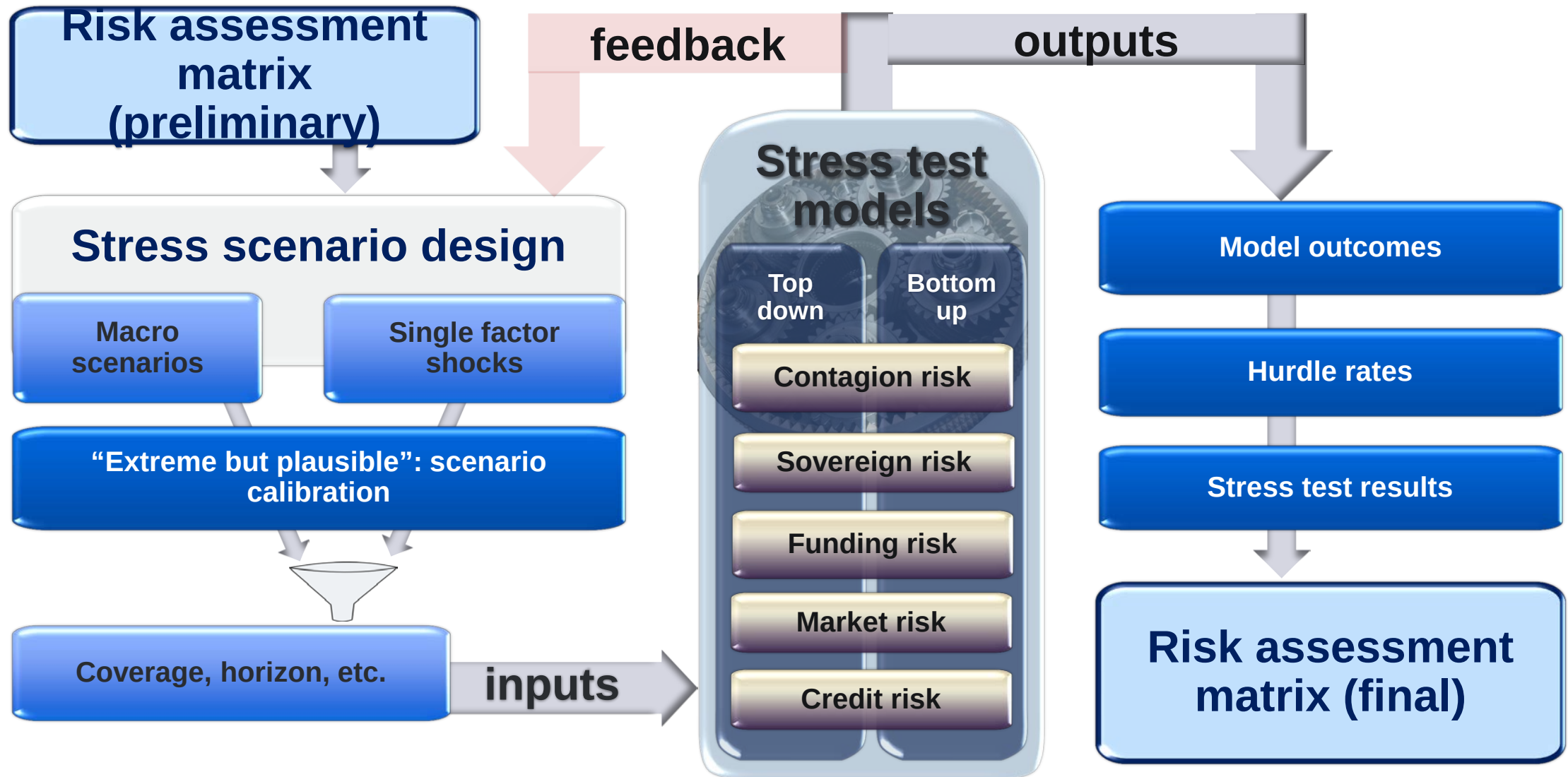
- Higher-quality reporting (clear, consistent, with good coverage) is associated with more stable financial environments, even controlling for macro, banking, and other factors.
- Publication itself has no robust empirical link to financial stability



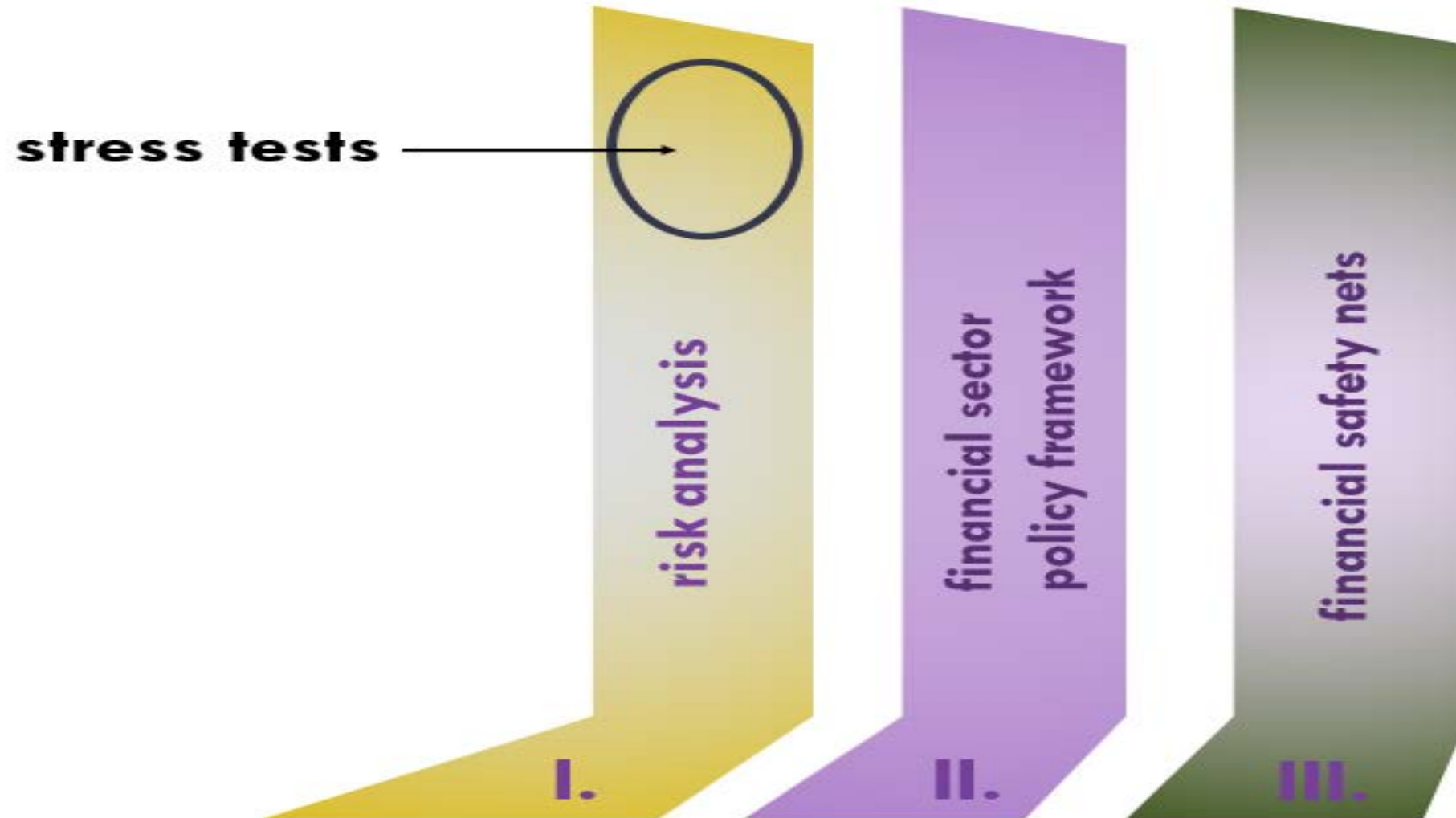
Despite improvements, reporting still leave much to be desired in terms of clarity, coverage, and consistency over time



Challenge: communicate this clearly!

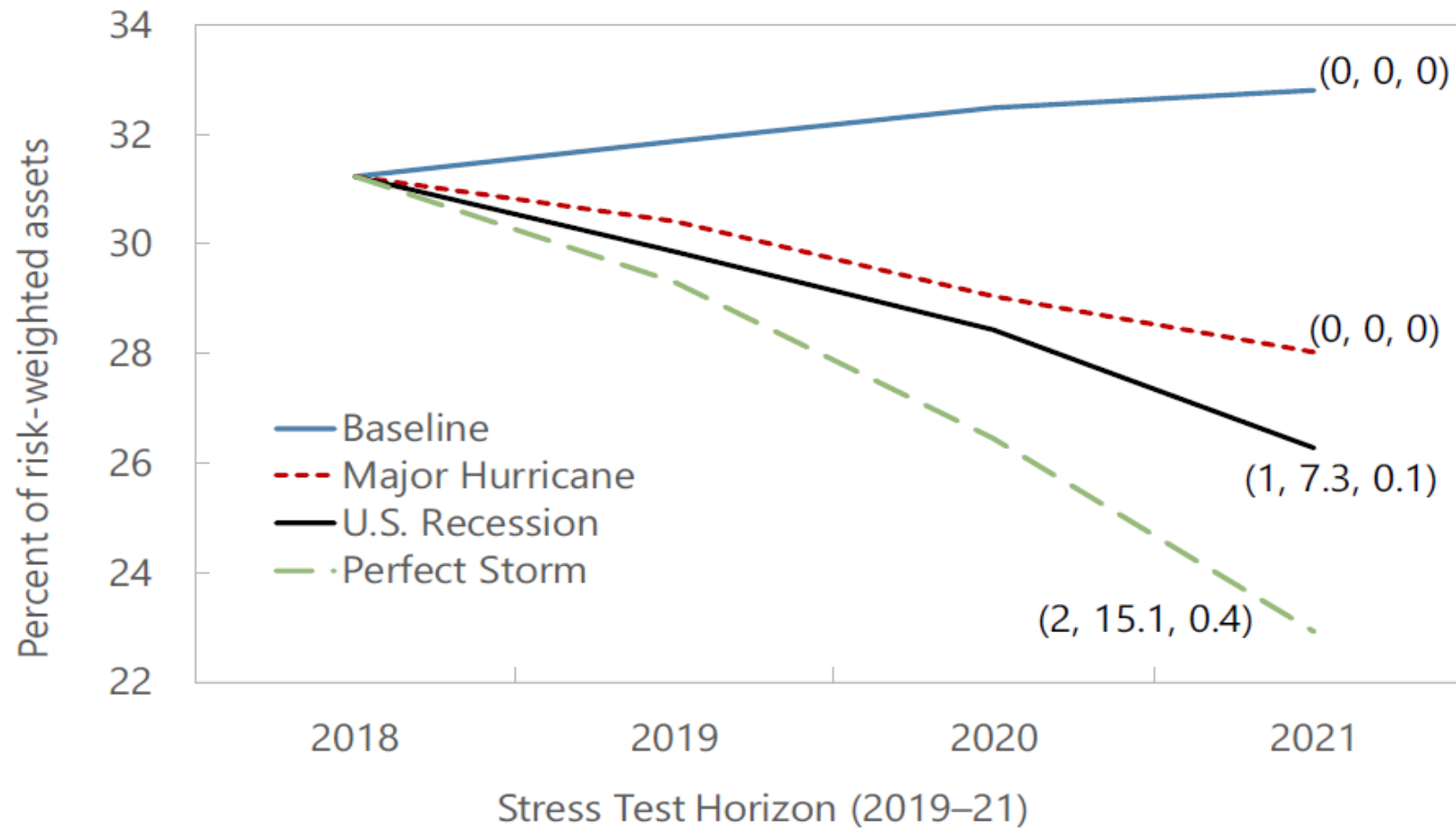


Pillars of financial stability assessment



Challenge: communicate this clearly!

System-wide CAR

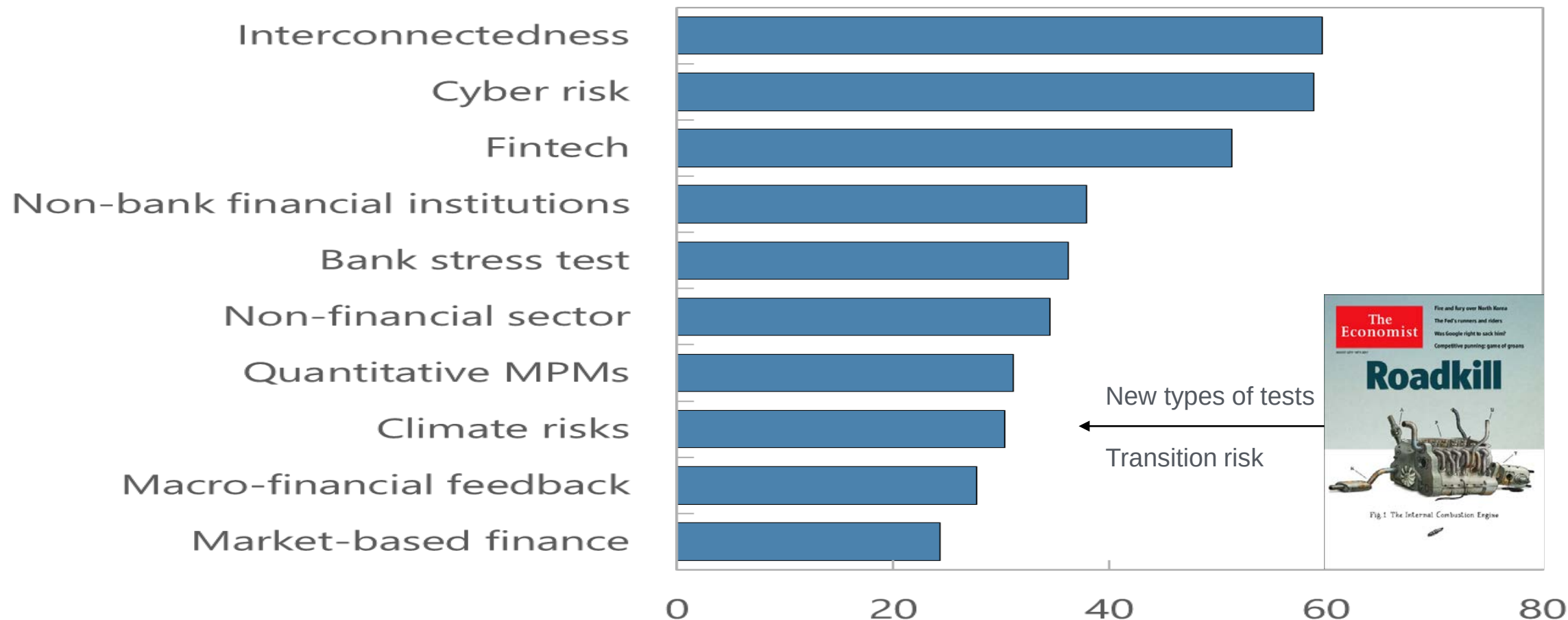


1/ Numbers in parenthesis show for 2021, respectively, the number of banks with stressed CARs below 14 percent, the percentage of the system's assets they represent, and the potential recapitalization needs in percent of nominal GDP.



FSAP: views from country officials on future topics

(Percent of responses; up to five choices; top-10 selections)



MPM = Macroprudential measures

Thank You

