Macroprudential Policy: A Conceptual Framework[1]

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1. Introduction

Since the recent financial crisis the term "macroprudential" has become somewhat of a buzzword. In paraphrasing Milton Friedman, Borio (2010) has stated that "*we are all macroprudentialists now*". However, as much as a decade ago, many observers already alluded to a missing pillar in the overall regulatory and supervisory framework (e.g. Crockett 2000, Borio, Furfine and Lowe 2001 and Borio 2003), and the crisis provided new momentum to this 'missing policy pillar' view (Davies and Karim, 2009). Accordingly, on an international scale the need for a macroprudential policy framework has been made clear. In April 2009, for instance, the G-20 leaders recommended that "*regulatory frameworks be reinforced with a macro-prudential overlay that promotes a system-wide approach to financial regulation and oversight and mitigates the build-up of systemic risk*". They also called for "*all financial authorities to take account of financial stability and develop effective tools to address systemic risk*". Reiterating this, the G-20 *Seoul Summit Document (*November 12, 2010) tasked the IMF, BIS & FSB tripartite to advance their work on macroprudential policy frameworks and the leaders stated that they "*look forward to a joint report which should elaborate on the progress achieved in the identification of best practices, which will be the basis for establishing in the future international principles or guidelines on the design and implementation of the frameworks*."

Although "*we are all macroprudentialist now*", it does not mean to say everyone agrees on the meaning of or even need for macroprudential policy.[2] A recent report by the Committee on the Global Financial System found that although macroprudential policy had been applied quite widely among the countries forming part of their survey, most respondents had only a broad concept of what constitutes a macroprudential instrument. Overall the report finds that survey

[1] Draft of PhD chapter on macroprudential policy frameworks. **Please do not cite.**
[2] Not everyone agrees on the need for such an entirely new macroprudential policy framework, since many of its constituents are and has always been microprudential in nature and might only require some improvement rather than replacement (Ellis, 2012; Berntsson & Molin, 2012).

responses regarding conceptions of macroprudential policy aims and objectives are rather "*fuzzy*" (CGFS, 2010: 9). Other challenges inhibiting the process to develop a macroprudential policy framework includes our limited understanding of the macro-financial linkages as well as disagreement regarding the boundaries between microprudential and macroprudential policy (Galati and Moessner, 2011: 13).

It seems appropriate in the current environment in South Africa where development of a macroprudential policy framework is high on the SARB's agenda to provide clarification on some of the necessary elements required in a macroprudential policy framework. In a recent policy paper issued by National Treasury (Feb 2011) the Treasury admits the importance of the macroprudential policy framework and the role of the SARB by stating that, *"[.....this macroprudential approach will form the basis of our financial system regulation and broader financial sector policy reforms in the years ahead*." (SANT, 2011: 5). In response to this, the minister of finance and the SARB governor established a joint task team to, *inter alia*, "*formulate and implement an explicit financial stability mandate within an appropriate macro-prudential framework in the South African Reserve Bank*" (FRRSC, 2013: 14). This leaves the question as to what such a macroprudential policy framework should entail and what the role of the SARB will be in such a framework. This chapter makes a contribution in this regard in several aspects. First, the concept of macroprudential policy is described in order to clarify its importance within the overarching concept of financial stability. Thereafter the definition and elements of systemic risk are explored, mainly to make the case that much work remains to be done in order to more adequately define and understand the intricacies related to this concept. Subsequently the essential elements pertaining to a macroprudential policy framework will be explored, where it will become apparent that many challenges are facing the SARB (and most other central banks) in this regard. In particular the case will be presented that three sub-frameworks within the overall macroprudential policy framework will require equal attention, otherwise the overall framework will simply not work.