

## Wrap-up and Concluding Remarks\*

*Deepak Mohanty*

Governor Dr. Subbarao, governors of other South Asian Association for Regional Co-operation (SAARC) member countries, heads of country delegations, Dr. Reddy, Dr. Caruana, Mr. Ninan and distinguished participants from the SAARC central banks and friends,

It has been a long day of exciting and thought provoking discussions on the very important issue of financial stability. The backwaters of Kumarakom and the tranquil atmosphere of Zuri has provided the perfect setting for a free flow of ideas throughout the day.

The theme of this symposium – Financial Stability issues – is appropriate for four major reasons, from the stand point of global, regional and India-specific considerations:

**First**, financial stability has acquired the centre-stage of public policy debate since the global crisis, with animated discussions seeking clarity on the role of central banks, particularly monetary policy.

**Second**, financial stability was assigned specific attention in formulating RBI's monetary policy during the period when Dr. Reddy was the Governor of the Reserve Bank, and this was reinforced considerably by Governor Dr. Subbarao.

Thus, in India, the dimension of financial stability was given due attention in the conduct of monetary policy, even before the onset of global crisis.

**Third**, India had started using counter-cyclical provisioning norms and risk weights prior to the global crisis, and in the post-crisis period such measures – known widely as macro-prudential tools – have become the mainstream consensus.

**Fourth**, given the level of development of the financial systems in the SAARC countries, the debate

on financial stability and monetary policy interactions may be somewhat different from what we see in the advanced financial systems. The development of the financial system, thus, has to be seen as an additional consideration in this debate.

Going forward, the efforts should be to harness the true potential of finance in promoting growth and development. In that process, increasing globalisation would require dealing with external contagion and managing spillovers.

This symposium has provided us the opportunity to learn from each other in the SAARC region, and also revisit our country-specific perspectives on the emerging international standards.

Deputy Governor Dr. Subir Gokarn in his welcome remarks set the tone for discussions to follow. He noted how the global financial crisis had shaken our faith in some of the pre-crisis persuasive arguments – what he termed as near-truths. He highlighted that an increasing number of central banks had started including financial stability formally in their policy mandates along with price stability. But the definition of financial stability remains largely informal. He emphasised that the financial stability mandate and governance arrangements for central banks must be compatible with their monetary policy responsibilities. For the SAARC countries, given the levels of development, he underscored the point that financial literacy and financial inclusion goals should not get marginalised because of the overdrive for financial stability.

Governor Dr. Subbarao highlighted issues relating to the mandate of central banks for financial stability in the international and Indian context. Making a strong case for the central banks to play a key role in ensuring financial stability, Governor Subbarao outlined the challenges in managing the relative prioritisation across multiple objectives. He also talked about the difference between a central bank's role in

\* Wrap-up and Concluding Remarks by Shri Deepak Mohanty, Executive Director, the Reserve Bank of India at the SAARCFINANCE Governors' Symposium on the theme 'Financial Stability' in Kumarakom, Kerala during June 10-11, 2011.

ensuring financial stability in crisis times *vis-a-vis* during normal period. The recent trends in arrangements for financial stability, giving increased responsibility for both systemic oversight and prudential regulation to central banks and institutionalisation of collegial arrangements, are seen as important.

A similar move in India is reflected in the creation of the Financial Stability and Development Council (FSDC). In this context, Governor Dr. Subbarao emphasised particularly the 'D' in FSDC. This stands for the 'development' dimension of the financial sector. Irrespective of the type of new institutional arrangements, he stressed that co-ordination mechanisms, especially between the government and the regulators, must function in ways that do not compromise the autonomy of the regulators.

The conduct of monetary policy in a world with macro-prudential policies could pose both known and unknown challenges. The presentation from Mr. Caruana provided possible approaches to adoption of macro-prudential measures, with necessary caution. He noted that stable, resilient and less pro-cyclical financial systems improve the effectiveness of monetary policy transmission. He also viewed that macro-prudential policies should not be used to safeguard macroeconomic stability, since there is no substitute to monetary and fiscal policies for attaining that goal. He cautioned that expectations from macro-prudential policies should not be ambitious, since without a range of reinforcing policies and instruments, the effectiveness of prudential measures could be limited. On the scope for conflicts between monetary policy and macro-prudential policies, he viewed that such concerns were overdone. He suggested that multiple objectives could be explicitly ranked, and that the timing of macro-prudential policy reviews could differ from monetary and fiscal policy cycles.

Dr. Y. V. Reddy emphasised in his address the potential 'crisis ahead of us' as a motivation for such debates that we had today. He viewed that the lessons from 'crisis behind us' could be extremely important in shaping the financial stability goal.

He outlined some of the key aspects of the pre-crisis stability-entrenching measures taken in India,

including explicit attention given to financial stability as an objective. His reference to the change from 'lazy banking' to 'crazy banking' as evidenced by significant pick-up in credit and money growth, exuberance in real estate and consumer credit needs to be seen in an important way, *i.e.*, the driving motivation behind use of macro-prudential measures in India for preserving financial stability. He emphasised fiscal consolidation and removing structural rigidities in the real economy to reinforce financial stability. He expressed reservations about the appropriateness of 2019 target date for new capital standards. He drew attention to the power of large conglomerates in diluting disciplining norms, with the potential to move to locations with less aggressive regulatory jurisdictions.

In the two technical sessions that followed, country presentations were made. It was indeed an honour and privilege to have the Governors of the central banks of Afghanistan, Bhutan, Nepal and Sri Lanka, and deputy governors of Bangladesh, Pakistan and Maldives to grace the symposium with their valuable contributions to the discussions. The country papers, besides reviewing financial sector developments brought to the fore the diversity that prevails across countries.

The Afghanistan paper drew attention to vulnerability to fluctuations in forex flows. It highlighted the challenges that could arise from the failure of systemically important banks.

The paper from Bangladesh highlighted the role of microfinance as also asset price pressures and balance of payments challenges arising out of volatility in remittance inflows.

The paper from Bhutan drew attention to legislative changes granting the central bank autonomy in monetary management as also in the oversight of the financial system.

Pakistan's paper noted how high fiscal deficit is crowding out private investment in a bank-dominated financial system.

The paper from Maldives underscored the importance of payments system for a sparsely populated country, particularly mobile phone payments system.

The paper from Nepal showed how its banking sector encountered liquidity shortage arising from the slowdown in deposit mobilisation and contraction in forex reserves, and how large flow of credit to real estate reduced the availability of financial resources for productive activities.

The paper from Sri Lanka highlighted the importance of principles-based corporate governance norms and consolidated supervision.

The paper from India presented the growing interconnected dimension of the financial system and highlighted the significance of systemic risk analysis.

The stimulating panel discussion that followed was anchored by Mr. T. N. Ninan, President, Editors' Guild of India. Financial stability in the post-crisis period has thrown several unanswered questions.

First, the issue of price stability *vis-à-vis* financial stability. Second, the post-crisis institutional arrangements for financial stability. Third, the challenge of implementing the international regulatory and supervisory reforms by SAARC countries with country-specific adaptations. This relates to the Basel III framework, regulation of Systemically Important Financial Institutions (SIFIs) and Over the Counter (OTC) derivatives markets. Fourth, the challenges of micro-prudential supervision in ensuring stability at the systemic level and the importance of macro-prudential policies. Fifth, the link between asset prices and financial stability.

These are issues on which, as the panel discussion revealed, the search for consensus is on. However, lack of consensus should not be a reason for national authorities not to take country-specific decisions. Preserving financial stability will continue to be a national priority.

During the panel discussion several important points emerged, which included:

- the role of confidence in shaping macro-financial conditions;
- post-crisis changes in regulatory architecture being driven largely by advanced economies;

- continued relevance of the role of the public sector in the financial sector of the region, particularly infrastructure financing;
- new arrangements on co-ordination between the Government and regulators are yet to be tested;

Mr. Ninan concluded the panel discussion by emphasising how the discussions helped in improving our understanding of complex issues.

Let me attempt some specific takeaways from this symposium:

First, irrespective of the nature of the mandate – *i.e.*, whether explicit or implicit – central banks will have to assume greater responsibility for financial stability, which in turn may mean multiple and not single objective to conduct of monetary policy.

Second, crisis prevention frameworks need to be strengthened in every country, but the approach to be adopted requires debate, consultations and co-ordination.

Third, given the level of economic development in the region, the usual suspects that could trigger a financial crisis must be avoided. This implies sustained emphasis on fiscal consolidation, low inflation, appropriate policies to manage volatile capital flows, and a sustainable balance of payments. The approach to reforms, going forward, must seek to balance the 'growth and efficiency gain' goals on the one hand with 'growth and equity goals' on the other.

Fourth, since national policies at times may not be adequate in a globalised world, voice of countries in the region in global governance may have to be collectively raised. Global safety nets and global surveillance would have to be seen as an integral part of financial stability initiatives.

Fifth, financial sector development would require a cautious approach but without stifling innovations, as the financial markets remain incomplete in the SAARC region.

Finally, I must thank now all involved in organising this symposium, having worked tirelessly for making this event a unique experience. I thank

Governor Dr. Subbarao for his guidance for the conduct of the event.

Our thanks to the distinguished guests from the SAARC region for making the discussions so lively. I thank the senior management of the Reserve Bank who are present in full strength.

The burden of organisation primarily fell on the Regional Director of Kerala and the staff from our Kochi and Trivandrum offices. Our deepest appreciation to all of them. Thanks are due to the organising teams from the Department of External Investment and

Operations (DEIO) and Department of Economic and Policy Research (DEPR) from the central office of the Reserve Bank.

I thank the Government of India and Government of Kerala for their support. I thank the Kerala Police for providing security coverage. Special thanks are due to the Hotel staff and management of Zuri resort and ERGO, the service provider for making excellent arrangements.

I once again thank all those who have been associated with this conference directly or indirectly.