



# MONETARY POLICY AND FINANCIAL STABILITY

**Pedro Duarte Neves**

Former Vice-Governor of Banco de Portugal

**Chair's opening remarks at the  
Central Banking Summer Meetings 2023**

**CENTRAL BANKING**

13 June 2023

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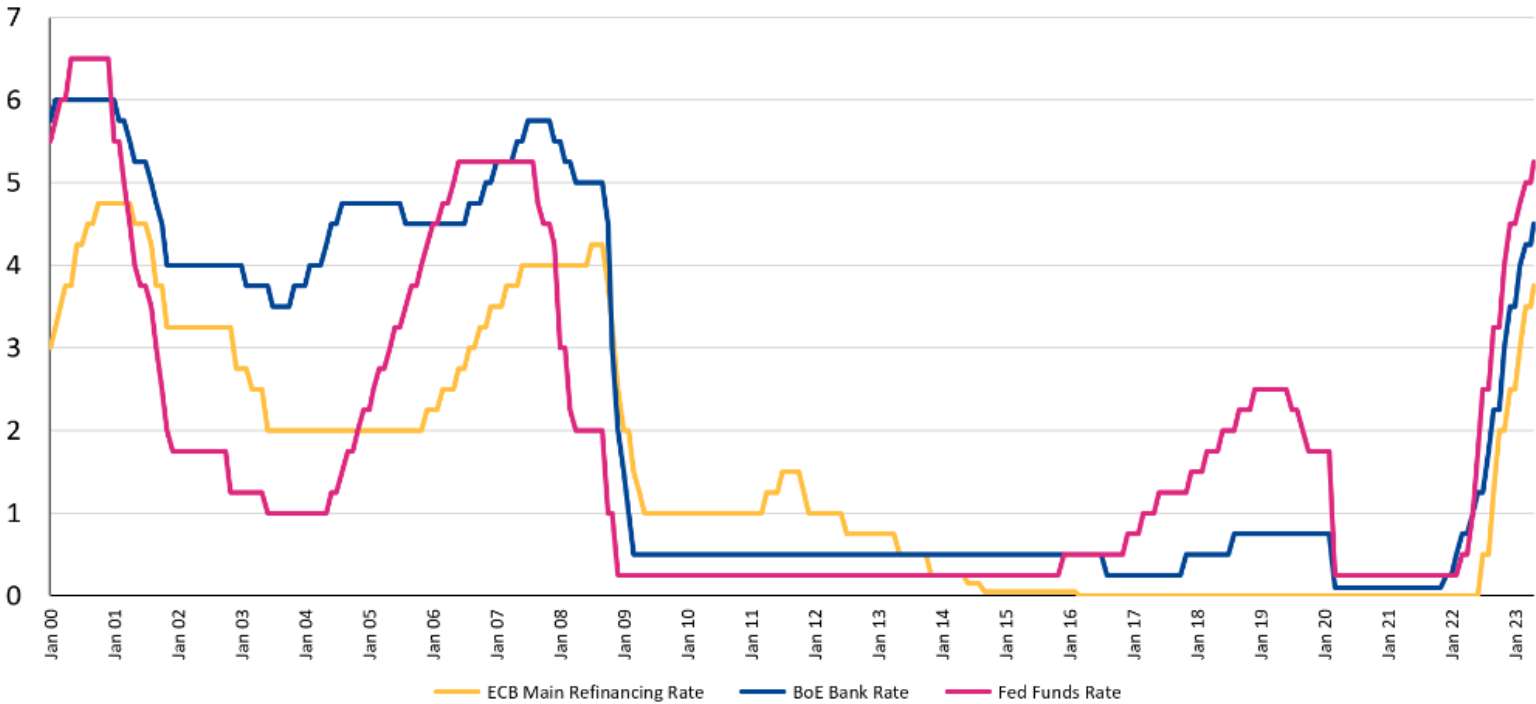
# The world economy one year ago...

... **unemployment** at all-time lows (40-50 years)...

... **inflation** at 40-year highs...

... public and private **debt** at all-time highs...

Figure 1: The fastest increase in interest rates since the birth of the euro  
(in %)



Source: Bloomberg

## The world economy one year ago...

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## The world economy today...

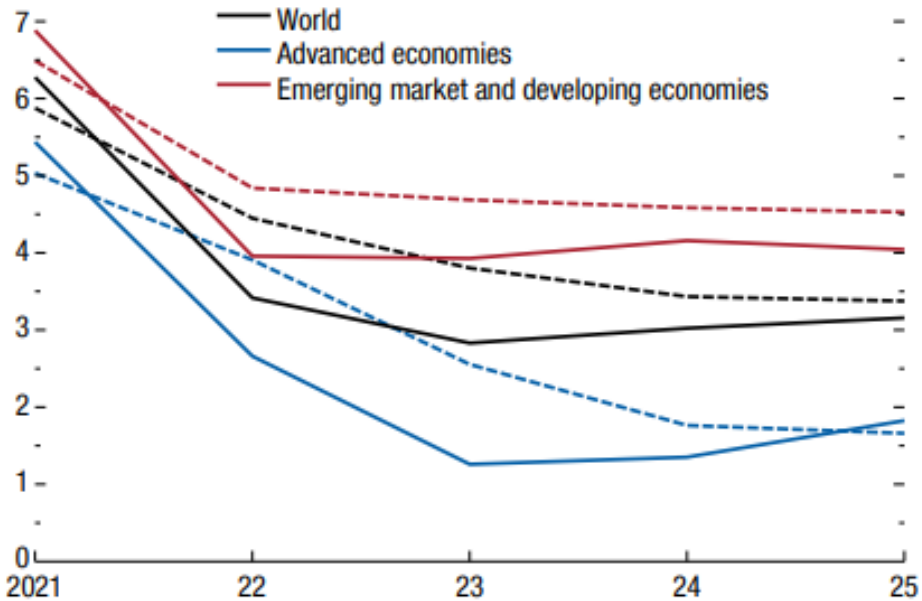
... **unemployment** at (or very close) to all-time lows...

... **inflation** declining fast, but far from price stability...

... **indebtedness** staying very high, but declining as GDP ratio...

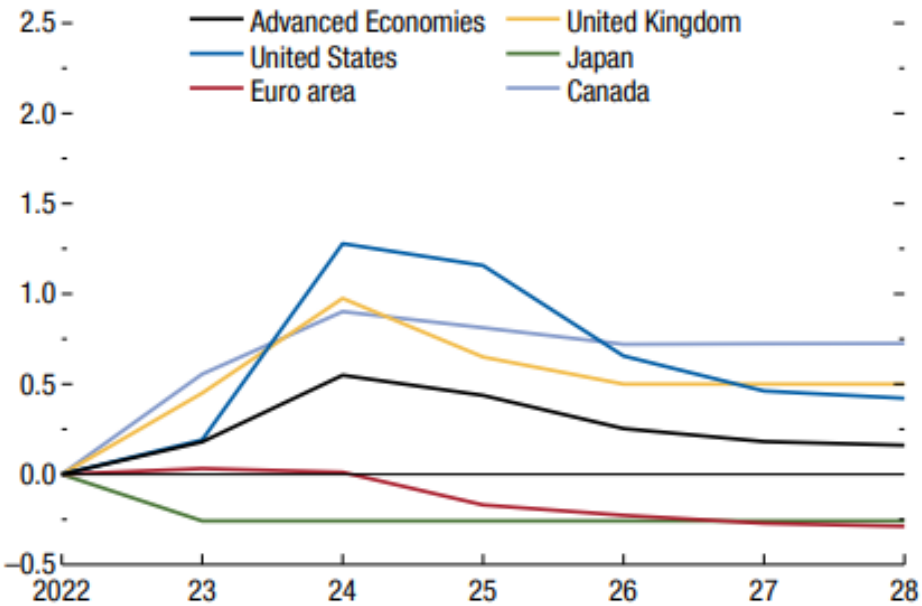
... “**economic growth** remains low by historical standards and **financial risks** have risen, yet **inflation** is stickier than anticipated” (IMF's GFSR, April 2023)

**Figure 1.13. Growth Outlook: Feeble and Uneven**  
 (Percent; dashed lines are from January 2022 WEO Update vintage)



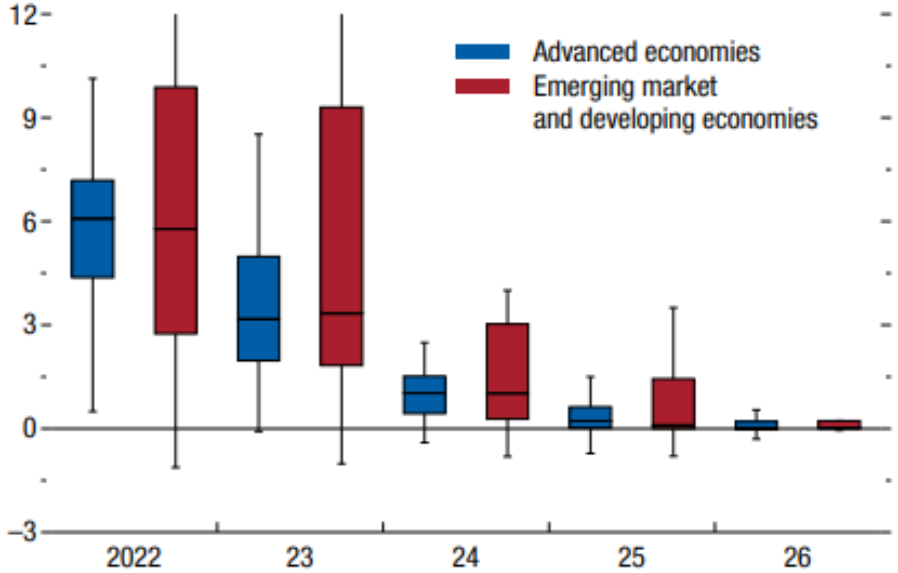
Source: IMF staff calculations.  
 Note: The figure shows the projected evolution of real GDP growth for the indicated economy groups. WEO = *World Economic Outlook*.

**Figure 1.14. Projected Unemployment Rate Rises in Advanced Economies**  
 (Percentage point difference from 2022 level)



Source: IMF staff calculations.

**Figure 1.17. Inflation Slowly Converging to Target**  
*(Percentage point, distribution of gap from inflation target)*



Sources: Central banks' websites; Haver Analytics; and IMF staff calculations.  
Note: The figure shows the distribution (box-whisker plot) for the indicated economy group by year. Line in the middle is the median, upper limit of the box is the third quartile, and lower limit of the box is the first quartile. Whiskers show the maximum and minimum within the boundary of 1.5 times the interquartile range from upper and lower quartiles respectively. The y-axis is cut at 12 percentage points.

## Very fast change in the economic environment...

- ... “effortless” **debt** reduction...
- ... tightening in **financial conditions**...
- ... sizeable adjustments in **relative prices**...
- ... very asymmetric effects

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- ... “effortless” **debt** reduction...
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- ... very asymmetric effects

## **Downside risks dominate... financial stability risks...**

- ... previous search-for-yield **accumulation of risk**...
- ... **interactions** between monetary tightening and existing vulnerabilities...
- ... **housing... real commercial real estate**...
- ... **banking stress**...
- ... **NBFI's** vulnerabilities (leverage, liquidity & credit risks, interconnectedness)..



### **Some facts on high indebtedness**

*Private credit booms culminate many times in either economic underperformance or financial crisis...*

*Public debt booms are also associated with financial crisis, more frequently so in EMDEs...*

*Fiscal space matters, as higher levels of public debt are associated with longer periods of economic underperformance and larger costs of financial crisis...*

*Total (public and private) indebtedness tend to increase sizably in the aftermath of global recessions...*

*Financial crisis recessions are costlier than normal recessions in terms of lost output...*

*High debt is a drag on growth...*

## QUESTIONS TO BE ADDRESSED TODAY:

- What are the implications of moving from the low-for-long interest rate environment to a regime in which the interest rate is again the main policy instrument?
- How to find the right balance between the promotion of price stability and the preservation of financial stability?
- How should we monitor asset markets (housing in particular) to build economic resilience and mitigating financial risks?
- How to calibrate macro-prudential policy?
- Which lessons should we draw from the recent banking stress?
- Which priorities should we have for regulation and supervision?



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## Implications for policies...

*...increase buffers...*

*...create fiscal space... build stronger counter-cyclical buffers... [Counter-cyclicity]*

*... be alert... need to be vigilant... monitoring risks, reacting promptly to market strains, strengthening oversight....*

## **Implications for economic policy...**

*...increase buffers...*

*...create fiscal space... build stronger counter-cyclical buffers... [Counter-cyclicality]*

*... be alert... need to be vigilant... monitoring risks, reacting promptly to market strains, strengthening oversight....*

## **Implications for economic agents...**

*... increase management buffers in banking...*

*... firms should aim efficiency gains, cost efficiency, debt reduction...*

*... NBFIs should focus on liquidity positions and reducing leverage...*

*... consumers should reinforce financial position...*

## AN OVERVIEW OF THE REGULATORY AGENDA

- Implement the Basel III finalization (level-playing field at global level)
- Increase macro-prudential 'space' in banking
- Develop a macro-prudential framework for non-banks
- Revisit insurance deposit systems
- Regulatory approach to Big Techs
- Address insurance protection gaps
- Climate change: reinforce coordination in policies

## THE REINFORCED ROLE OF SUPERVISION: PRIORITIES

- Business model assessment
- Credit risk assessment
- Supervisory approach to IT [outsourcing in IT, cyber risk, business model sustainability, digitalization, suptech, regtech]
- System-wide approach to stress testing: interconnectedness (banking, non-banking)
- Approach to climate change risks
- Conduct supervision [value-for money, misseling & detrimental practices of financial products, consumer disclosures, AML/CFT: **enforcement**]





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