Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

By: Emre Alkin

What Are Macroprudential Measures? Why Do They Fail?

Central Banks and Regulatory Authorities take certain steps within the framework of laws and regulations to achieve balanced economic growth while maintaining financial stability.

These steps are, by their nature, not simple and clear-cut. It would be better if they were, but I have never seen a clear explanation that a regular citizen could easily understand.

The language of explanations is not simple, and situations often arise where even the best-informed individuals have doubts. For this reason, Central Banks and Regulatory Institutions send implementation notices to banks and financial institutions regarding the decisions they take.

Banks and Financial Institutions evaluate the results of these measures based on their funding compositions, and they sometimes appear to try to comply.

However, there are moments when they continue their activities by saying, “If I do what you say, my costs will be higher.” As a matter of fact, where the market-making financial institutions behave this way, Central Banks and Regulatory Authorities will suffer a loss of credibility.

The disconnection of the precautionary measures from real life creates situations that often lead to confusion when new steps are taken to correct them. Therefore, it is important for Central Banks and other authorities not to continuously change rules like a “jigsaw puzzle.”

What falls under macroprudential measures

In developing countries, the appointment of politically supported individuals parachuted from outside rather than experienced insiders in the management of Central Banks and Regulatory Authorities is undoubtedly a primary cause of stubbornness and arbitrariness. Now, let’s briefly examine what falls under macroprudential measures:

1. Loan Growth Restrictions: Specific limits and targets may be set for banks to control loan growth.

2. Reserve Requirements: These are practices that require banks to hold a certain percentage of customer deposits at the Central Bank, which can restrict credit expansion.

3. Borrowing Limits: Limiting the amount of credit that commercial banks can extend to certain groups.

4. Interest Rate Regulations: Changes made by the Central Bank in policy interest rates can influence loan and deposit interest rates, thereby guiding economic activities.

5. Collateral and Percentage Rates: The rates and valuations regarding the collateralization of certain assets by banks can be set.

6. Selective Prudential Measures: Precautionary measures can be implemented to prevent excessive credit growth or market speculation in certain sectors.

7. Risk Management Practices: Some risk management standards and practices can be put into practice that banks must consider when lending.

8. Macroprudential Tools: Using tools such as foreign exchange transactions and swap operations, the Central Bank can manage exchange rates and liquidity.

9. Financial Stability Reports and Statements: Central Banks can utilize their verbal power by issuing reports periodically to monitor and report risks to financial stability.

The conditions for failure

All these measures and more are implemented to prevent imbalances in the markets, ensure financial stability, and sustain economic growth. The timing and scope of measures may vary depending on economic conditions.

However, it cannot be guaranteed that there will be 100% success. Often, these measures cannot be effective on their own; a unified and cohesive stance from the government is necessary to increase the chances of success.

I explored this situation in detail in one of my previous articles titled “When The Central Banks Are Left Alone Against Inflation.”

If you wish, let’s not discuss the conditions for success in this article. Let’s look at the matter from the opposite perspective and address the conditions for failure.

This way, we can also generate new excuses for the Central Bank managements that we constantly criticize. Joking aside, the following points indicate that ensuring the success of macroprudential measures is not an easy task:

1. Economic Environment: The economic conditions of the country can reduce the effectiveness of macroprudential measures. Particularly adverse situations, such as high inflation or economic stagnation, can limit the effects of the measures taken. (While not being a challenger, we mean that realistic targets should be set under existing conditions.)

2. Incentives in Financial Markets: Sometimes, the implemented macroprudential measures may not keep up with market dynamics. For example, banks and financial institutions may continue to take risks or find alternative ways to avoid the measures despite the restrictions. (We mentioned this above.)

3. Institutional Structure and Practices: Perceptions of the independence of Central Banks and political pressures can reduce the effectiveness of policy decisions. If the markets do not trust the decision-making processes of the Central Banks, the implemented measures may not be effective.

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4. Credit and Borrowing Behavior: Banks may continue to lend to meet the demands of savers despite limits on credit or reserve requirements. This may lead to exceeding the specified objectives. (This is often the case.)

5. Market Expectations: Economic expectations and the psychology of the markets affect the success of macroprudential measures. If the market believes that the measures taken will become stricter in the future, the risk-taking behavior may increase. (If individuals and institutions do not believe in the goals and forecasts of economic management, the measures will not work.)

6. Inadequate Coordination: The lack of sufficient coordination with other economic policies can reduce the effectiveness of the measures. For instance, when there is not enough alignment with fiscal policies and structural reforms, macroprudential measures may fail to create the desired effect. (It would not be incorrect to say this happens frequently.)

7. Insufficient Communication: If Central Banks do not communicate sufficiently well regarding policy changes and the objectives and results of macroprudential measures, it can create uncertainty in the markets and weaken the effectiveness of the measures. (Weak communication, even a condescending attitude toward citizens, is among the primary issues caused by managers appointed from

outside the Central Banks.)

8. External Shocks: External factors, such as global economic fluctuations, financial crises, or geopolitical risks, can negatively affect the targets for maintaining internal economic balances of Central Banks and Regulatory Authorities. Such situations can weaken the impact of macroprudential measures.

I believe I have approached the issue in a clear, comfortable, and understandable manner that should leave little room for interpretation.

What should be understood here is that it is not possible for Central Banks to succeed on their own; if they are left alone to combat economic problems, they need to recognize that insisting on the implementation and timeline of their own prescriptions creates side effects and complications.