BUFF/96/29

March 15, 1996

Summing Up by the Acting Chairman
Bank Soundness and Macroeconomic Policy
Executive Board Meeting 96/21 - March 11, 1996

Executive Directors welcomed the opportunity to consider the relationship between banking system soundness and macroeconomic policy. Directors noted with concern the large proportion of Fund member countries that had experienced banking sector problems in recent years and the increasingly international nature of many bank failures. Given the fundamental role of banks in the economy, Directors stressed that awareness of the factors leading to banking sector problems, understanding of the impact of banking sector fragility on the macroeconomy, and the ability to design and implement measures to foster sound banking, deserved increased attention by the Fund.

Directors agreed that, in view of the linkages that exist between banking systems and macroeconomic policies, it was necessary to take into account the condition of the banking system in the formulation of economic policies, both as a key objective and as a constraint on policy. Directors generally accepted that stabilization program targets and instruments might need to be adjusted in the face of an unsound or potentially unsound banking system. However, several Directors stressed that this did not imply delayed adjustment, but rather showed the need for a realistic approach to design ambitious, yet achievable, policies. They urged that the design of stabilization policies should be complemented by structural reforms to foster banking system soundness, including strengthened supervision, and the advancement of financial sector development and liberalization. They stressed, in that context, the importance of a sound macroeconomic framework in underpinning an efficient banking system.

Directors agreed that the Fund should continue to encourage its members to adopt appropriate prudential standards. They also agreed that emphasis needed to be placed not only on external oversight of banks, but also on market discipline and internal bank governance, while the nature of oversight should evolve in line with the development of financial markets. Most Directors agreed that in developing, emerging market, and transition economies there was still a strong need for an independent and effective supervisory authority, which often might best be vested in the central bank. Directors observed that, in the industrial countries, market discipline must be supplemented by effective official oversight, and they noted that banking problems had occurred even in countries in which market discipline was reasonably strong.

Directors noted that a comprehensive mix of supervisory and regulatory policies could provide, in principle, for a sound banking environment, provided the macroeconomic framework was also sound; an inadequate mix of these policies had weakened market discipline in many countries and had increased the fiscal cost of banking problems.

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Directors emphasized the importance of contingent government liabilities that arise with respect to the banking sector. They agreed that more attention should be paid to the issue of contingent liabilities, and that national authorities should be encouraged to make such liabilities more transparent and to include them, with an appropriate degree of specificity, in fiscal projections.

Several speakers drew attention to the declining role of banking systems, particularly in industrial countries, vis-à-vis the rest of the financial sector. The implications of that development would need to be considered further at some point.

In addressing the Fund's role, Directors emphasized the need to coordinate closely with the World Bank and other international agencies so that each agency would concentrate on areas of core competence and complement each other. In the case of the Fund, that would include surveillance and advice regarding the linkages between macroeconomic policy and banking systems, as well as guidance in the areas of monetary and prudential policies in support of bank soundness. Most Directors agreed that the Fund should play a role in encouraging the strengthening of banking supervision and financial systems through the surveillance process, Fund-supported program design, and the supporting technical assistance. Although some Directors noted that member countries might be reluctant to discuss sensitive banking data with the Fund, most felt that Fund surveillance of financial sectors was critically important, and that the necessary data should be made available to Fund missions. It was observed that that would be consistent with the newly developed standards for dissemination of economic and financial statistics to the public.

A number of Directors suggested that international cooperation in banking systems was best left to the Basle Committee. Some noted, however, that the Basle standards were not necessarily applicable or useful for all member countries of the Fund, which faced widely differing situations. While somewhat downplaying the need for international cooperation and harmonization in banking supervision, they considered that the Fund should focus its own contribution on encouraging national authorities to strengthen their domestic systems and practices, and on supporting regional initiatives. The Fund should also encourage members to meet international standards for financial sector reporting, regulation, and supervision, while recognizing that harmonization would not necessarily lead to homogeneity of policies.

Directors encouraged the staff to devote greater attention to banking and financial sector issues in the context of the Fund's surveillance and program activities. Differing views were expressed on whether that could be achieved without a major redeployment of or increase in resources. Many Directors stressed the importance of continued technical assistance in the areas of bank supervision and financial sector development, and underlined that such technical assistance needed to be properly integrated into Fund-supported adjustment programs and the content of structural benchmarks.

Directors supported publication of the staff papers after revision to take into account the Board discussion. In that regard, comments on the paper should be communicated to the staff within two weeks; that is, by March 25.