

Executive summary

Macroprudential policy has gained increasing attention in Emerging Asia, particularly in the aftermath of the global financial crisis. *Strengthening Macroprudential Policy in Emerging Asia: Adapting to Green Goals and Fintech* provides a comprehensive overview of Emerging Asian countries' experience with macroprudential policy. It highlights various challenges, including the interlinkages with monetary policies, measurement of macroprudential stance and the implications of the COVID-19 crisis (Chapter 1). The analysis in this publication takes a forward-looking and holistic approach by considering the role of macroprudential policy amid emerging policy challenges, such as the transition to a low-carbon economy and the rise of Fintech firms. The report discusses a series of macroprudential policy options to support the transition to a low-carbon economy (Chapter 2). It concludes with an overview of the Fintech landscape in Emerging Asia and presents some macroprudential policy suggestions for tackling the systemic risk arising in the Fintech sector (Chapter 3).

Macroprudential policy in Emerging Asia at a glance: Recent developments and challenges

Monetary authorities in Emerging Asia enacted various prudential measures to ensure the stability of the financial system in the aftermath of two major financial crises that battered the region in the last decades. More recently, several countries transposed the Basel III reform package into their national legislation and overhauled their macroprudential institutional setup. Various types of macroprudential measures are in place across the region, the most widely used being capital requirements and measures targeted at bank borrowers. Measures targeting the leverage and liquidity of banks are also common tools aimed at ensuring the resilience of the financial system.

The report identifies several main challenges to the effective conduct of macroprudential policy. These challenges are interrelated and their magnitude varies across countries. First, measuring the macroprudential stance poses various challenges and calls for the development of a well-defined and stable framework. Second, macroprudential and monetary policy are interrelated, which makes the assessment of the former's effectiveness complex. Third, macroprudential policy frameworks must be further strengthened to better account for increased interconnections between bank and non-bank intermediaries. Fourth, macroprudential policy makers must give due consideration to the cross-border effects of domestic macroprudential policy and envisage greater co-operation to limit these spillovers. Fifth, macroprudential policy must be optimally targeted to avoid the moral hazard issue. Finally, the conduct of macroprudential policy must give due consideration to the legacy of the COVID-19 crisis.

Green goals and macroprudential policy in Emerging Asia: Promoting climate resilience and financial stability

The risks associated with climate change raise the spectre of a severe destabilisation of the financial system, and thus of the entire economy. The increased involvement of central banks and other macroprudential authorities in playing a co-ordinating role in the transition to a low-carbon economy could accelerate this process.

The transition to a low-carbon economy requires a major investment effort. The squeezing fiscal headroom in Emerging Asian countries due to the COVID-19 crisis, occurring in a context of already rising levels of government debt, makes it even more urgent to mobilise private capital for the transition to a low-carbon economy. However, the private sector alone may not have the capacity to contribute to this goal without support from policy makers. Furthermore, it has been argued that some of the macroprudential policies implemented in the aftermath of the global financial crisis, for instance, the liquidity and leverage requirements from the Basel III package, tend to promote short-term brown projects, to the detriment of longer-term, climate-friendly investments. These conflicts need to be identified and reviewed in order to ensure macroprudential policy does not hinder green goals.

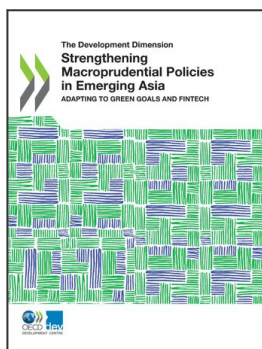
The existing macroprudential requirements could be amended to support the transition to a low-carbon economy. An important avenue is the integration of climate-related risks, both physical and transition risks, into macroprudential stress tests. Additionally, when considering how to use existing macroprudential policy instruments to address the risks of climate change, the most relevant instruments could be those that target credit growth directly, or indeed those that target the sectoral allocation of credit. Examples of the former include capital buffers for risk-weighted assets. Examples of the latter include large exposure rules that apply to potentially encumbered assets. Moreover, the Basel III countercyclical capital buffer could be particularly useful for promoting financial stability, while transitioning from a high-carbon to a low-carbon economy. Instruments targeting specific categories of loans, such as loan-to-value and debt service-to-income caps, could also be considered to reduce the amount of lending associated with brown assets and activities. In the same vein, specific requirements targeting leverage ratios could be envisaged as a macroprudential policy response to limit bank leverage with respect to brown assets and activities.

Fintech and macroprudential policy in Emerging Asia: Preparing for the digital age

The rise of financial technology (Fintech) is expected to provide significant benefits to consumers, however, Fintech is also likely to bring new challenges to achieving financial stability. In Emerging Asian countries, Fintech credit extension increased in the 2010s, although large disparities in usage of Fintech credit can be observed.

On one hand, Fintech offers several opportunities to reduce systemic risk within the financial sector, namely through increased decentralisation and diversification, and enhanced efficiency. On the other hand, there are also macro-financial risks associated with the rise of Fintech. Fintech intermediation could lead to changes in market structures, potentially leading to changes in the behaviour of traditional financial institutions, as well as to decentralisation and disintermediation. In addition, the rise of Fintech firms may lead to excessive risk-taking, owing to regulatory environments and consumers' increased access to complex financial products.

Macroprudential policy frameworks should be enhanced to address the systemic risks emanating from Fintech activities. As peer-to-peer lending platforms often fall outside of the regulatory perimeter, it is of utmost importance either to expand the regulatory coverage to these platforms or to develop new rules designed to limit financial risk arising from these platforms. Emerging Asian policy makers should further consider enhancing co-ordination among themselves but also with international partners to avoid creating room for regulatory arbitrage.



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