Discussion for ERCI Workshop on Financial Stability

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ADB HQ, 4 June 2018

Should we be worried?

- Risk and associated volatility are <u>not</u> bad. Stifle them, and you stifle growth. Instead, we need to guard against "excessive" risk-taking and volatility.
- But how to measure excess? High and/or rising indicators ≠ excessive
- Need to guard against "big ones." Assess both vulnerability, and potential triggers
- Vulnerability's two ingredients: (i) long expansion/stability (→ complacency and optimism, rising asset markets), and (ii) rise in debt/income (esp. "runnable liabilities")
- Are we vulnerable to another big one? Not yet in US, Europe. May be getting there in parts of Asia. China? Always hard to assess.
- Many potential triggers, but one very common one…

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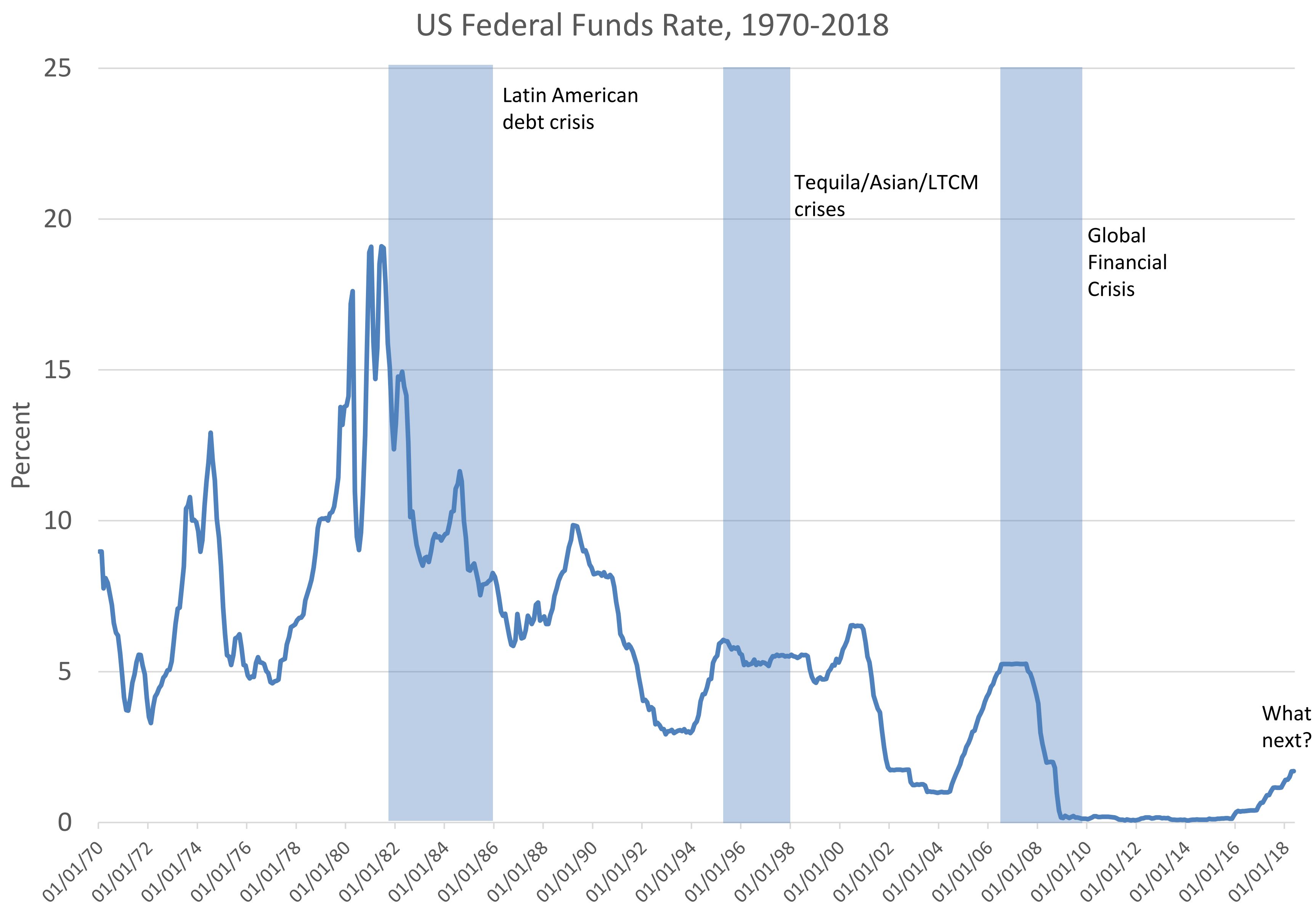

Are we ready?

- Running out of (conventional macro) ammunition in US, Europe; still have some powder left in Asia, but less than before

- Banking systems in better shape, flexible ER regimes, adequate reserves

- Measures to limit/control risk-taking are only as effective as our ability to prevent migration of risk-taking to beyond the regulatory perimeter