Jan Frait: Twenty years of financial stability at the Czech National Bank

Opening remarks by Mr Jan Frait, Deputy Governor of the Czech National Bank, at the Czech National Bank Workshop on Financial Stability and Macroprudential Policy, Prague, 17 December 2024.

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We meet here today – first of all – to celebrate 20 years of financial stability at the Czech National Bank (CNB). In May 2004, the CNB Board endorsed the key features of our financial stability function: its mandate and objective, the definition of financial stability, the content of financial stability analyses and the meaning of macroprudential policy. It also announced the foundation of a financial stability team in the research department.

It is not easy to find traces of the original decision in the public domain. We were a bit secretive about it at the time. This was because there wasn't full support in the Board for this strange thing called "macroprudential". There was also limited support for it in the regulation and microprudential supervision departments back then.

As a matter of fact, I revealed that we had set up a financial stability function to a local audience in January 2005 at the earliest, in my presentation on the conclusions of the 2004 Financial Stability Report. This presentation was only published in Czech, as we did not think anyone would be interested – except for the Bank for International Settlements (BIS), which had the same idea on its agenda.

You may ask why the Board decided to establish a financial stability function anyway. One reason was a severe banking crisis that had occurred between 1997 and 2000, which had its roots in macroeconomic mismanagement, among other things. The other – and potentially more important – factor was the influence of certain BIS economists that some of us admired. The BIS chief economist William White had given an impressive lecture in this Congress Centre in 2003. That may have been the lucky breaking point.

Just as a matter of interest, in May 2004 the CNB adopted the following definition of financial stability: a situation in which the financial system (a) fulfils its functions without disturbances and negative effects on the present and future development of the economy, and (b) at the same time shows a high degree of resilience to adverse shocks. This definition is still in place after 20 years. Simply perfect right off the bat.

One more important thing happened 20 years ago. In May 2004, the government approved a plan to integrate the then fragmented supervision of the local financial market. At the time, the CNB was just the bank regulator and there were three other supervisory institutions. This government decision made us work hard to take over the others and bring them under the CNB's roof. This was actually not what the government had originally envisaged, but we were lucky and won the battle. Some think it was a kind of hostile takeover. No matter what it was, it took some time to complete – parliament did not approve the integration plan until the end of 2005. The CNB became the sole supervisor in April 2006.

There is one more important anniversary this year that no one speaks of. Ten years ago, at the end of November 2014, the Board decided to introduce a supervisory tool to address potential sovereign risk in the banking sector. As far as I know, we were the first and likely the last authority in Europe to establish any kind of sovereign risk instrument. Every year since 2015, the CNB has conducted a public finance stress test and informed banks whether sovereign exposures above a certain level could be subject to a Pillar II capital add-on.

To begin with, we were silent about the introduction of this tool as well. The decision was revealed in June 2015. At the time, it was viewed as a temporary solution before EU-wide regulation kicked in. With the benefit of hindsight, we were lucky to act early, before the window of opportunity was closed by the failure of the high-level working group of the European Economic and Financial Committee to agree on anything in this area. In summer 2015, the EU authorities recommended to "await the outcomes of the Basel Committee". We are still waiting. To be honest, the window of opportunity created by the sovereign debt crisis in the euro area was wide open back then – we even managed to convince the Ministry of Finance to support the introduction of the tool.

Looking at the state of public finances across a number of advanced economies today, one slogan inevitably comes to my mind as to the future: Never waste a good crisis!

For now, enjoy the conference.