About financial stability

Published: 1/1/2016

Financial stability is one of the key prerequisites for sustainable economic growth. As financial crises create considerable economic and social costs, the maintenance of financial stability has the character of a public good and is thus an important economic policy objective. Financial stability is primarily a subject of macroprudential policy, which includes measures, instruments and activities necessary to maintain the stability of the financial system as a whole by strengthening financial system resilience and preventing and mitigating systemic risks.

Financial stability is one of the key prerequisites for sustainable economic growth. It is characterised by the smooth functioning of all financial system segments in the resource allocation process, in risk assessment and management, payments execution, as well as in the resilience of the system to sudden shocks. The financial system consists of financial institutions, financial markets and financial infrastructures and it plays a key role in the allocation of resources, i.e. the process of transforming savings into investments, and therefore in economic growth and an increase in the overall level of social welfare.

Financial stability is based on the confidence of financial market participants and it largely depends on their perceptions and behaviour, which are subject to cyclical swings. A crisis episode is a situation where systemic disruptions arise in one or more segments of the financial system that may threaten overall financial stability, e.g. illiquidity or insolvency of financial entities, serious disruptions in payment and settlement systems, disruptions stemming from external financial markets or other disruptions that may lead to difficulties in the functioning of the financial system.

Costs of crisis episodes may amount to a two-digit share of annual GDP, and they most often relate to resolution of financial institutions. However, these costs are much broader than fiscal and quasi-fiscal outlays alone, particularly if one takes account of GDP loss and unproductive use of savings and resource allocation. According to IMF data, the median increase in public debt associated with banking crises amounted to 17% of GDP in the period from 1970 to 2011, while direct fiscal costs of crisis episodes stood at 7% of GDP. Therefore, the maintenance of financial stability has the character of a public good and is thus an important economic policy objective.

Financial stability is primarily a subject of macroprudential policy, which includes measures, instruments and activities necessary to maintain the stability of the financial system as a whole by strengthening financial system resilience and avoiding and mitigating systemic risks. Systemic risks are risks of disruption in the financial system with the potential to have serious negative consequences for the financial system and the real economy.

In addition to macroprudential policy, financial stability is directly and indirectly influenced by other policies, such as microprudential, monetary, fiscal and competition policies. As each of them influences financial and real developments and the financial system as a whole, their interrelations also affect the choice of macroprudential policy instruments.

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