Lessons Learned: Ádám Banai

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Yale Program on Financial Stability
Lessons Learned

Ádám Banai

By Matthew A. Lieber

During the Global Financial Crisis (GFC), Ádám Banai served first as an analyst in the National Bank of Hungary (Magyar Nemzeti Bank, or MNB), where he helped the bank develop and implement a macroprudential framework for financial stability. Since 2020, he has served as MNB’s executive director of monetary policy instruments, financial stability, and foreign reserve management. This Lessons Learned is based on an interview with Banai conducted on April 18, 2023. The full transcript can be accessed here.

To best manage financial stability, the central bank should have the authority to address systemic risks and vulnerabilities when identified.

According to Banai, the GFC exposed a dysfunctional division of labor in Hungary’s system of financial regulation. Before the crisis, the authority of Hungary’s central bank, MNB, was limited to macroeconomic analysis and monetary policy; it was one component of a tri-party system of bank regulation. The Ministry of Finance was responsible for regulations relating to the banking system, and prudential supervision over banks was the responsibility of another agency, the Financial Supervisory Authority. At the central bank, financial stability was a marginal concern of a small unit that produced an annual report.

Having completed his master’s thesis on the causes of the GFC, Banai joined the central bank in 2008. His first assignment was to analyze the role of the large US government-sponsored mortgage finance entities—Fannie Mae and Freddie Mac—and their potential effects on global markets. In 2007, Hungary’s traditional banking model and its separation from British and US investment banks and funding markets had initially insulated the country’s markets from toxic stress. But Hungary had its own toxic assets—many home mortgages were denominated in Swiss francs rather than local Hungarian forint. Banai explained:

The National Bank of Hungary was the one that made some warning that FX [foreign exchange] lending was not a riskless product. Already in its 2006 Financial Stability Report, the National Bank of Hungary analyzed in detail the potential steps against FX lending. The Supervisory Authority of Hungary joined the central bank in early 2008, when a new FX product, the Japanese yen-based product, started to be sold by banks. The two institutions jointly published a warning on the risk of Japanese yen lending and emphasized that Hungarian forint-Japanese yen is very volatile, which makes it a very risky product.

However, Banai clarified that, given the separation of powers in Hungary’s financial regulation system, the MNB lacked authority to have the banks change practices that it thought were contributing to instability; the central bank’s warning was toothless.

According to Banai, the GFC experience also changed the way the Hungarian central bank analyzed the banking sector, elevated its focus on financial stability, and spurred a stress
testing program of increasing sophistication. Banai discussed his experience leading the 2011 development of and subsequent implementation of Hungary’s stress testing program, which evolved over time to include among other components, liquidity tests, solvency tests, modeling internal and foreign shocks, and the effect of bank runs. “We cannot emphasize enough the usefulness of these types of exercises these days. It was an important step of our stress testing framework,” said Banai. He further commented:

Development of the stress test underlined the importance of data collection. In stress testing, it is 100% true that you have to collect as many data as it is possible and as granular as it is possible.

An advantage of our framework is that we made it possible to compare our stress test result in time. So, we not only have a number about the present state of the banking sector in a potential stress environment, but we made it possible to see over time how the stress-absorbing capacity of the banking sector changes.

The crisis experiences also made clear to Hungarian leaders the need to integrate regulatory and supervisory responsibilities for banks in the central bank. With the 2013 Central Bank Act, Hungary merged the Supervisory Authority and the National Bank of Hungary, and it added an explicit macroprudential mandate to the MNB’s mission. MNB has since developed these new responsibilities and actively applied its new authorities to adopt new lending and funding measures aimed at moderating the buildup of another outsize FX exposure.

For the central bank of a small open economy like Hungary’s, understanding the agency’s unique characteristics and position in the global economy is the best approach to crisis preparation and fighting crises when they occur.

Banai said the policies and practices of a central bank are impacted by its history, and its effectiveness should be based on a rational understanding of its position in the world. Hungary’s financial reforms make use of global best practices, Banai said, but are driven by and tailored to Hungarian conditions and needs.

My generation in the Hungarian banking industry will always have a very strong relation with FX lending. It really governs our thinking. That experience taught us the process of building up huge risks. Our own toxic asset was the retail FX loan. . . . So, our thinking of bank risk will be always driven by this experience.

Thus, when we got the macroprudential mandate as a central bank, we started to use it very specifically for the Hungarian banking sector based on this experience. So, at first, we made regulations to avoid this type of behavior.

I wouldn’t say that we followed the international best examples, because we understood our own risks and we gave answers for our own risk. The foreign exchange funding adequacy ratio, in 2011, was among the first real macroprudential policy steps globally. The basic idea for the structure of the regulation was based on the NSFR [net stable funding ratio] suggested in Basel.
III. But we applied a tailor-made version for specific Hungarian risk and introduced it much earlier than any other countries.

According to Banai, because of their GFC experiences, Hungarian financial leaders have come to understand the value of preventing the buildup of systemic risks rather than assuming the success of fighting their effects, which will often result from external forces:

I think what we understood better was that, as a small country, it is not in our hands what will happen in the world and how the environment will evolve. For this reason, we cannot afford to build up risks in the banking sector. We, as the central bank and macroprudential authority, have to ensure the health and safety of the banking system all the time. In two, three years’ time, [the] FX loan portfolio was built up, and for sure it was unfortunate that the Global Financial Crisis started just after. But this example reminds us that even two or three years of too loose environment can result [in] risks with which you have to work for 10 years or so.

We have to keep in mind that dealing with the negative effects of risks built up by the banks is much harder than avoiding them, and the overall real economic effect is negative. Importantly, the motivation of individual banks is very different from the interest of the whole system. A CEO of a commercial bank said bankers were pro-cyclical by nature. My answer was that it didn’t mean it was right. For the sake of the whole system, central banks have to limit them.

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