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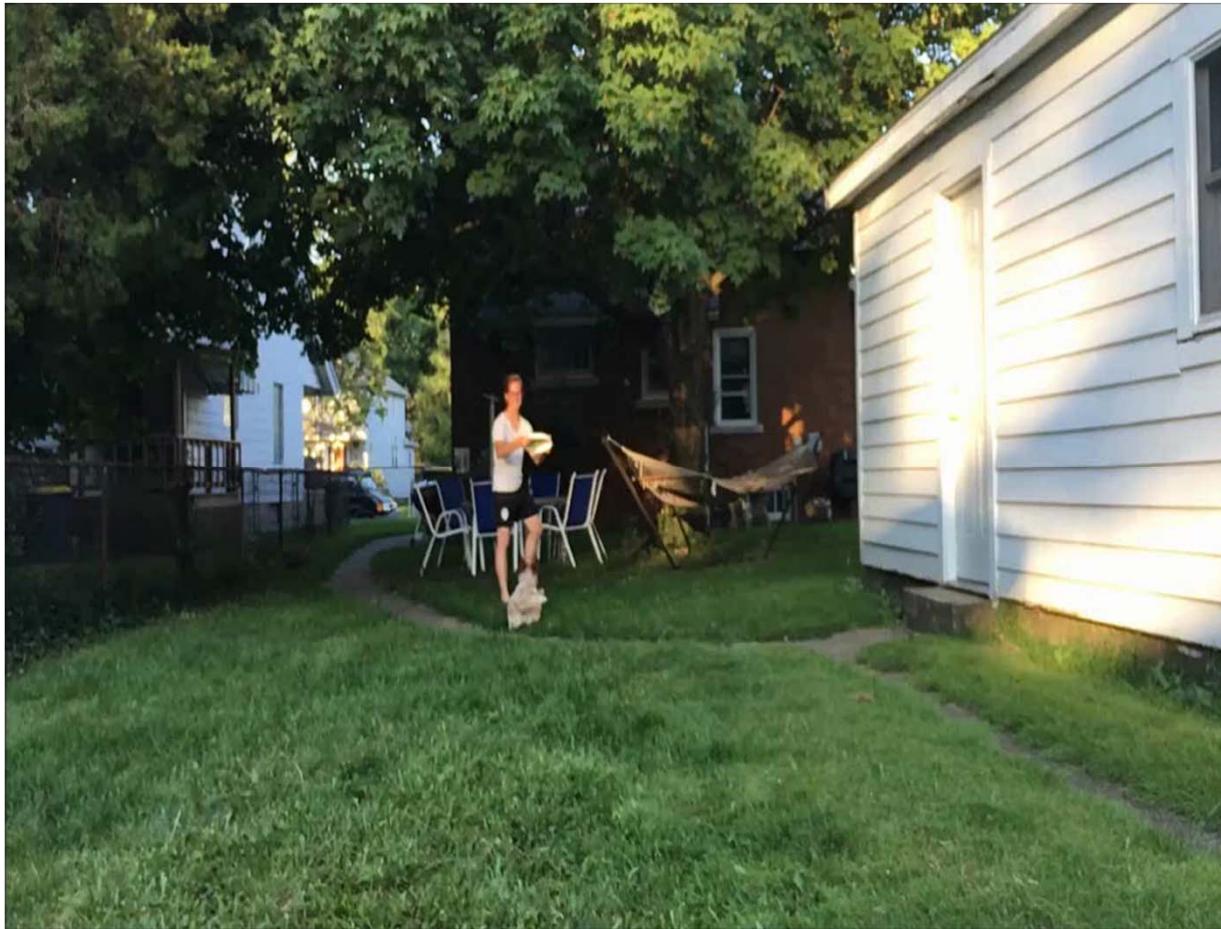
Rethinking Financial Stability

Andrew G Haldane

Rethinking Macroeconomic Policy IV

12 October 2017

The Dog and The Frisbee

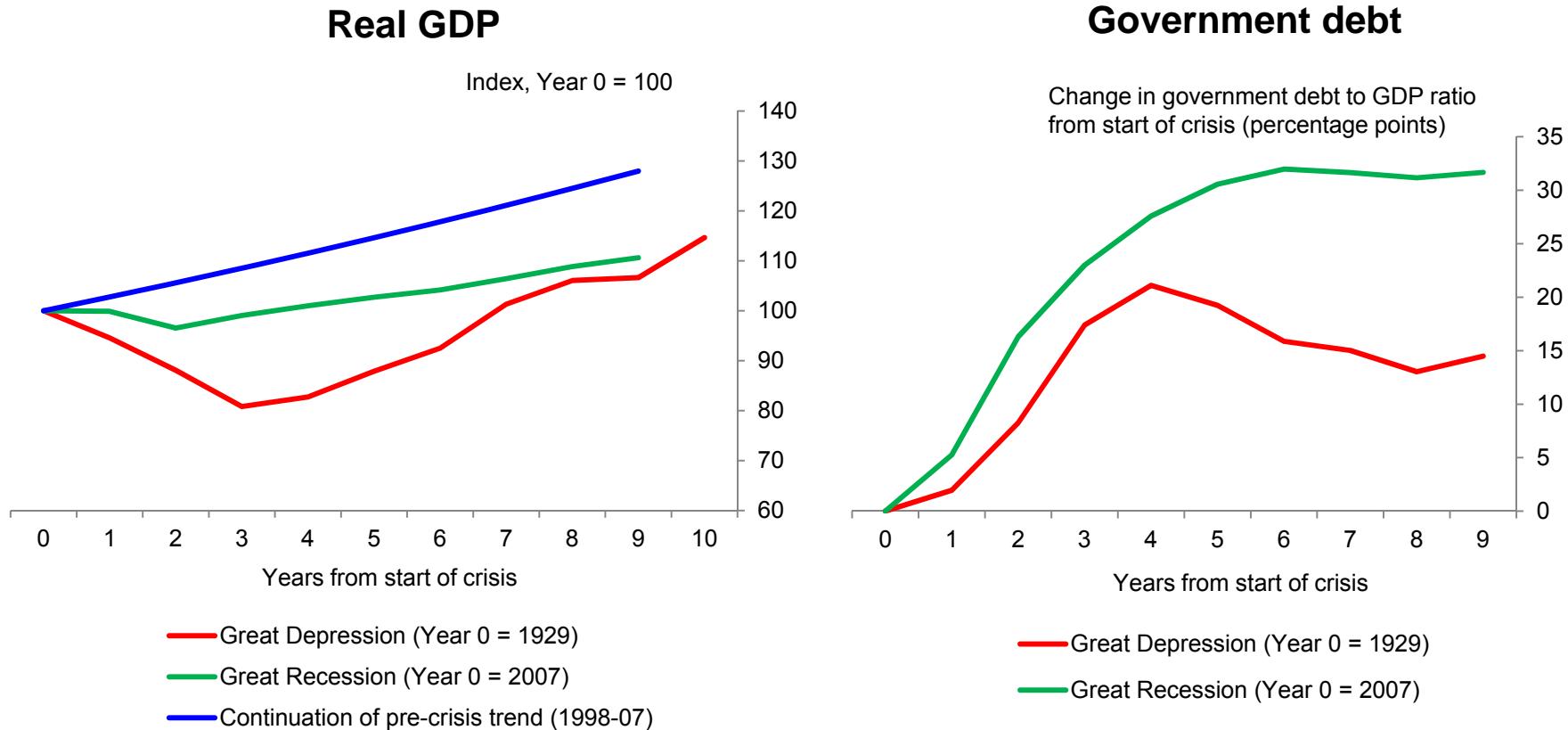


Source: YouTube



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Costs of Crisis – Recessions Compared



LHS chart shows PPP-weighted average for underlying indexed series for UK, US, France and Germany. RHS chart shows PPP-weighted average for UK, US and Germany for Great Depression and UK, US, France and Germany for Great Recession.



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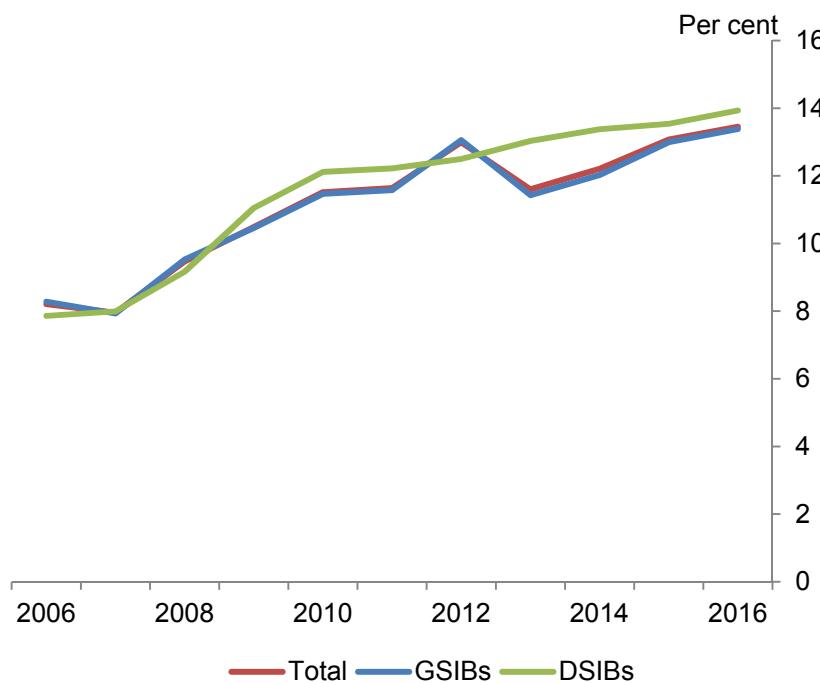
Rethinking Regulatory Reform

- **Micro-prudential**
 - Quantity and quality of risk-weighted capital requirements (RWCR)
 - Leverage Ratio (LR)
 - Liquidity Coverage Ratio (LCR)
 - Net Stable Funding Ratio (NSFR)
 - Resolution/Total Loss-Absorbing Capital (TLAC)
- **Macro-prudential**
 - Countercyclical Capital Buffer (CCyB)
 - Systemic capital requirements
 - Comprehensive stress-testing
 - Shadow-banking
- **Governance, pay, clearing, accounting, insurance**

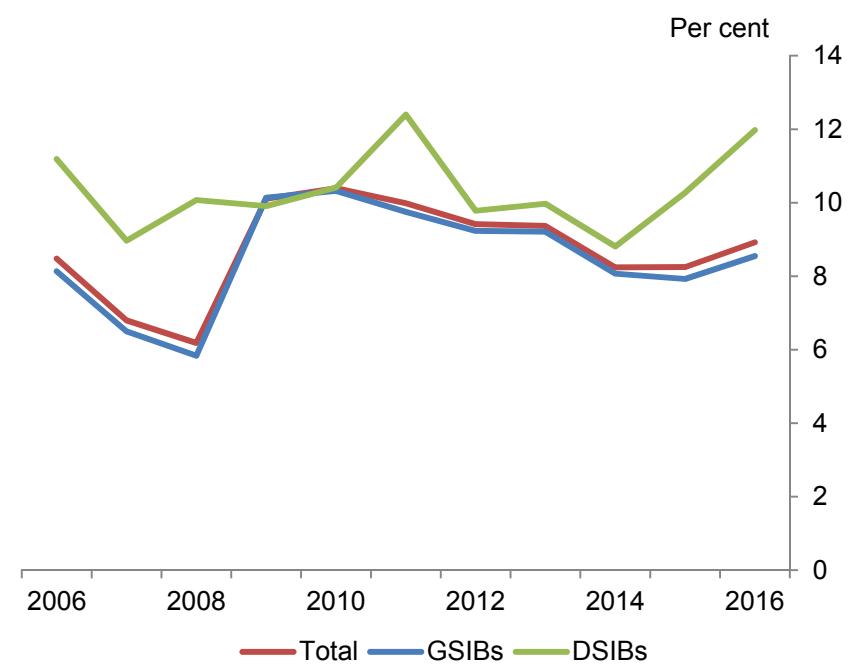


Higher Capital, Higher Liquidity

Tier 1 capital ratios

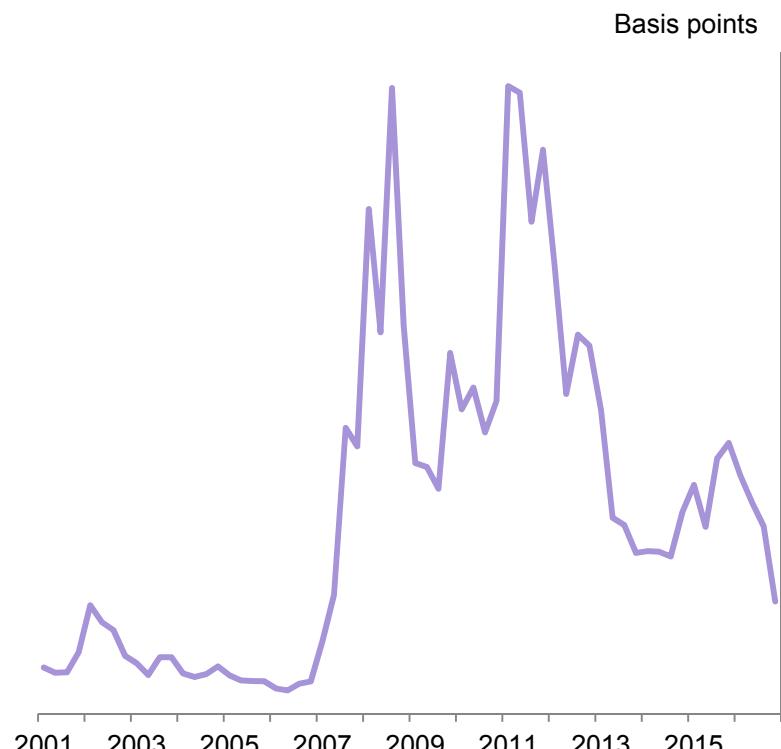


Liquid asset ratios

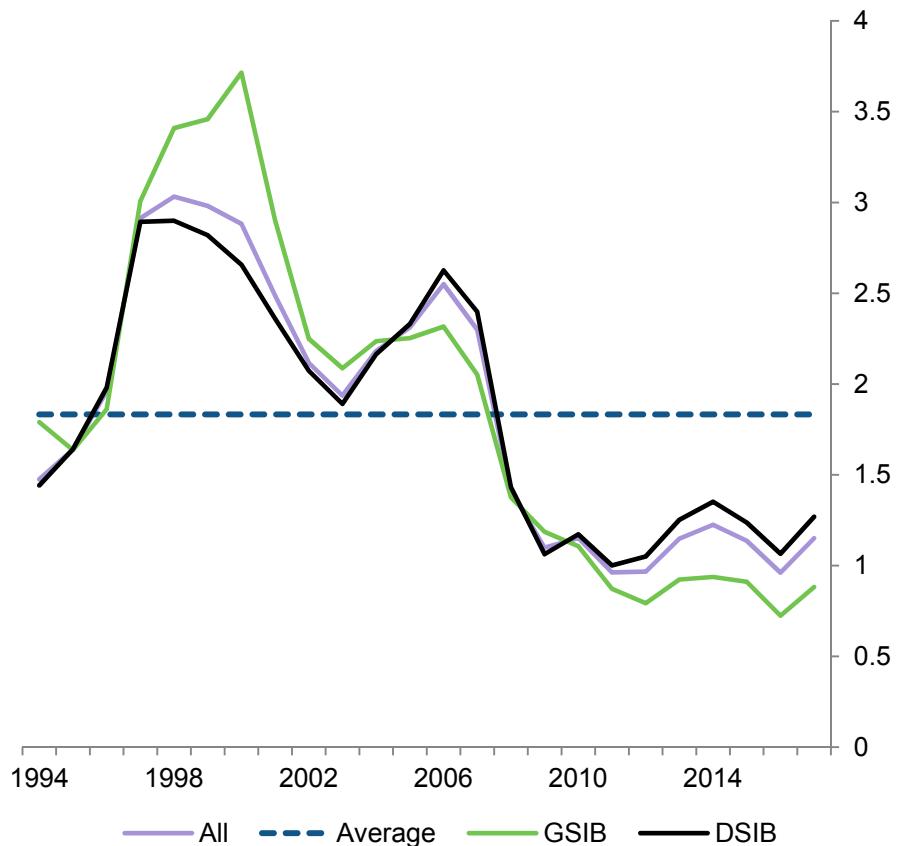


Lower Risk, Lower Profitability

CDS spreads for G-SIBs



Price-to-book ratios



High Enough?

- Equating marginal social costs and benefits of higher capital
- Basel Committee's Long-Term Impact (LEI) in 2010 study suggested "optimal" capital ratios of 16-19%
- Based on Tier 1 capital ratios, 20 of the 30 GSIBs fall short; 105 of the 169 DSIBs
- What have we learned since about marginal costs and benefits?



New Research on Costs and Benefits

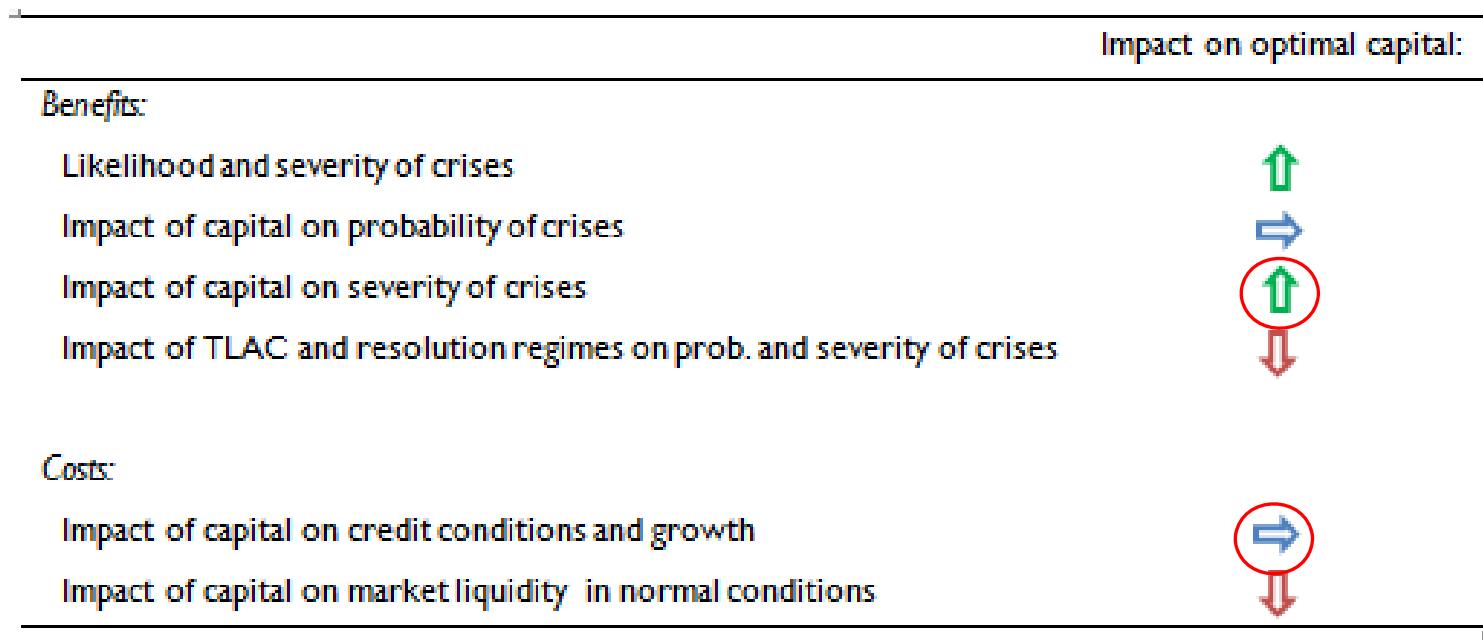
Impact on optimal capital:	
Benefits:	
Likelihood and severity of crises	↑
Impact of capital on probability of crises	↔
Impact of capital on severity of crises	↑
Impact of TLAC and resolution regimes on prob. and severity of crises	↓
Costs:	
Impact of capital on credit conditions and growth	↔
Impact of capital on market liquidity in normal conditions	↓

□

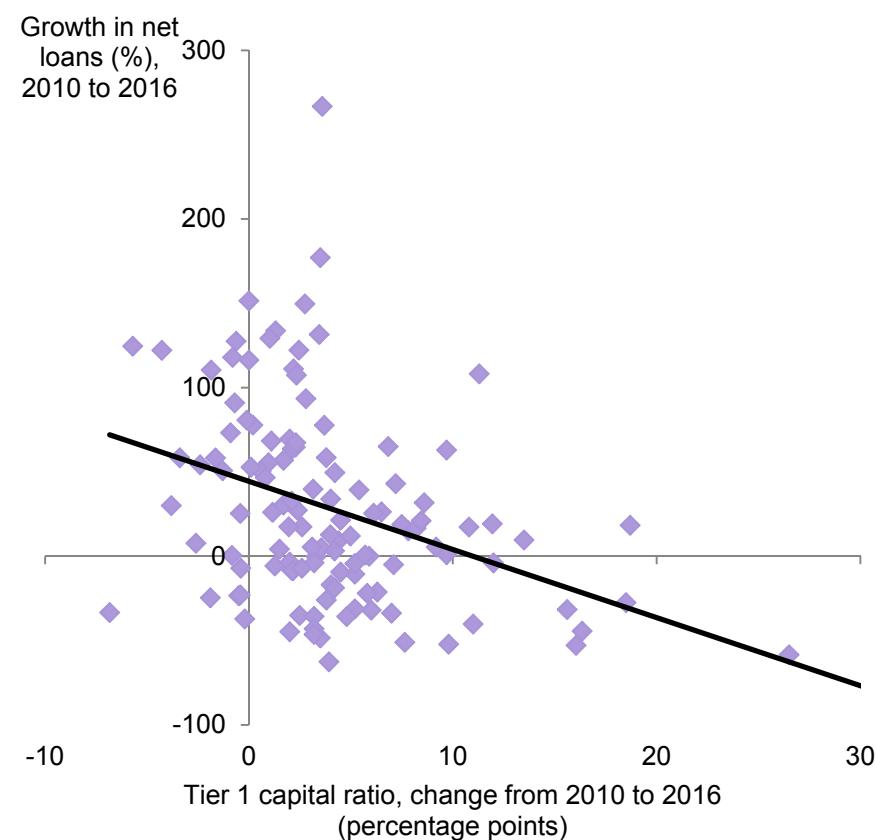
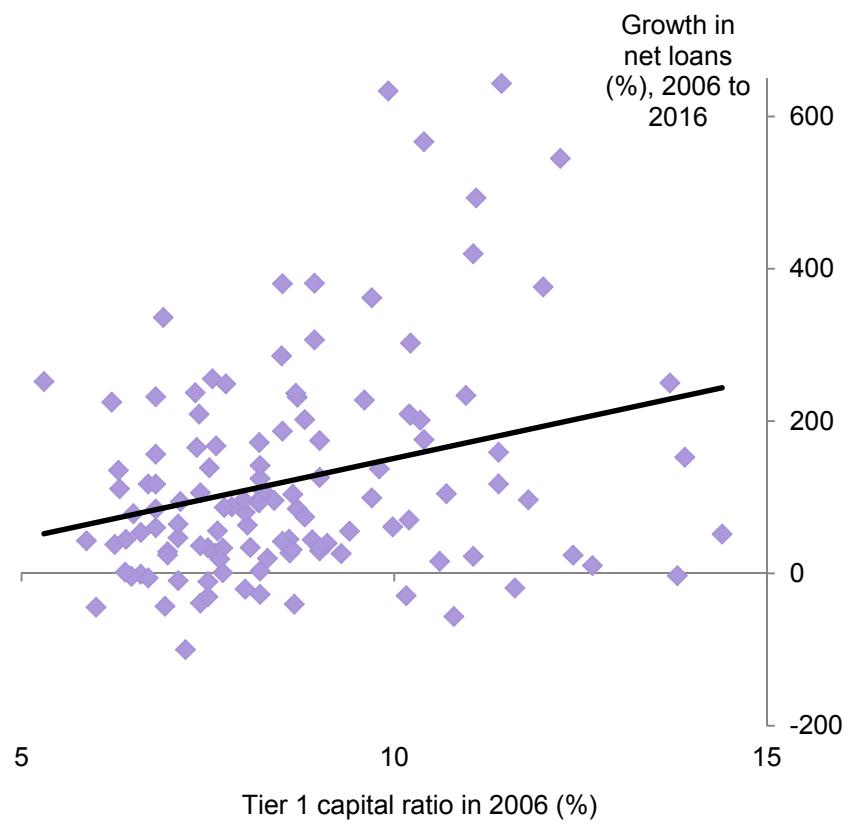


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New Research on Costs and Benefits

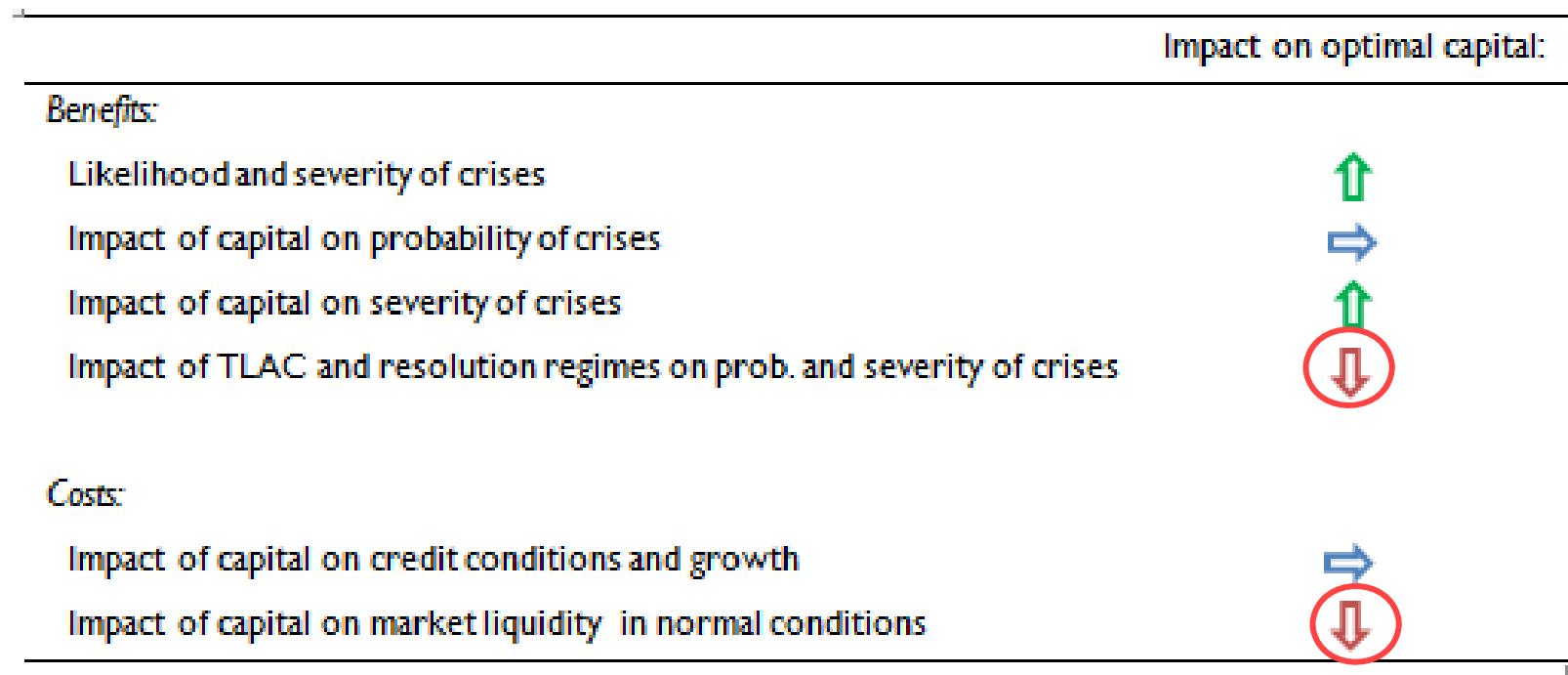


Capital ratios and lending



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New Research on Costs and Benefits



The System of Financial Regulation

- **New regulatory architecture**
 - *Multiple* versus singular constraints
 - (More) *complex* versus simpler metrics
 - Greater *discretion* versus rule-like regime
- **The multiple constraints problem**
 - Over-identified system – redundancy
 - Distortion of business models/behaviours
 - Cost and complexity



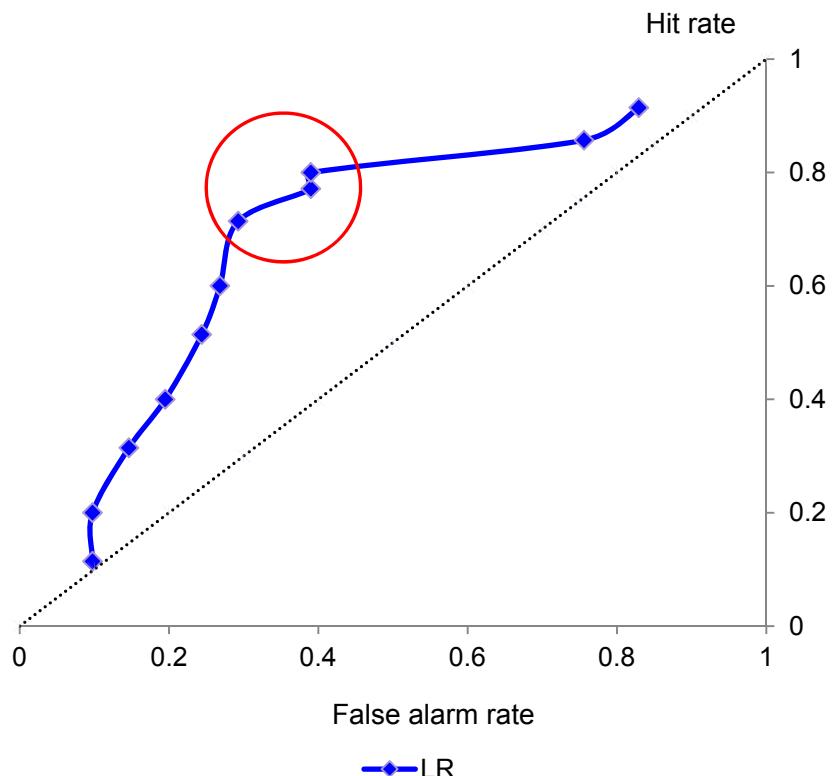
Benefits of Multiple Constraints

- **Multiple fault-lines, multiple instruments**
 - The Tinbergen principle
- **Uncertain risks, multiple instruments**
 - The Brainard principle
- **Avoidance and arbitrage, multiple instruments**
 - The First Law of Thermodynamics principle



Crisis Experience

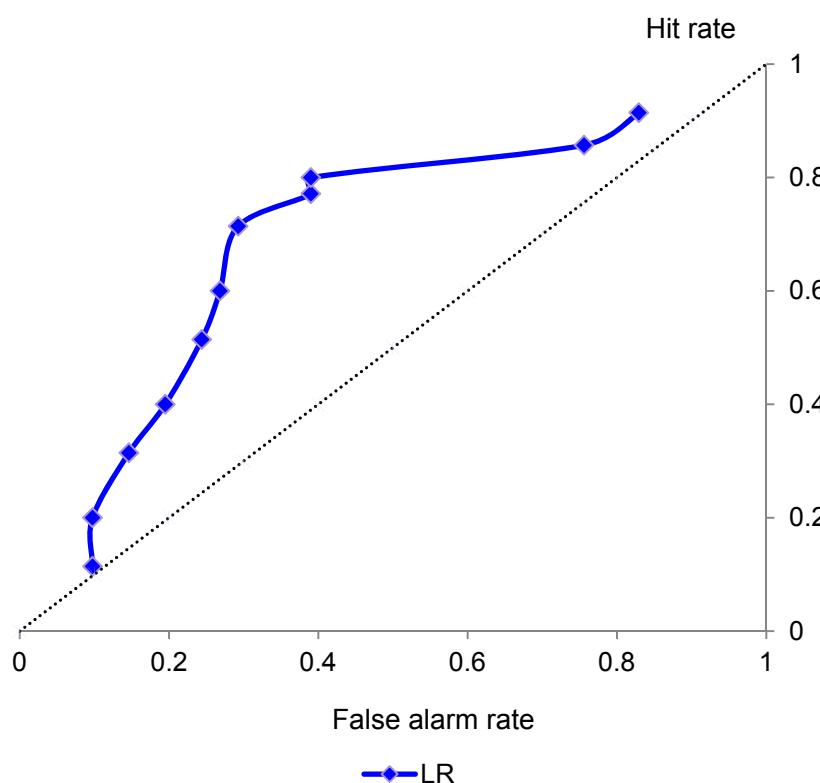
Single Leverage Ratio constraint



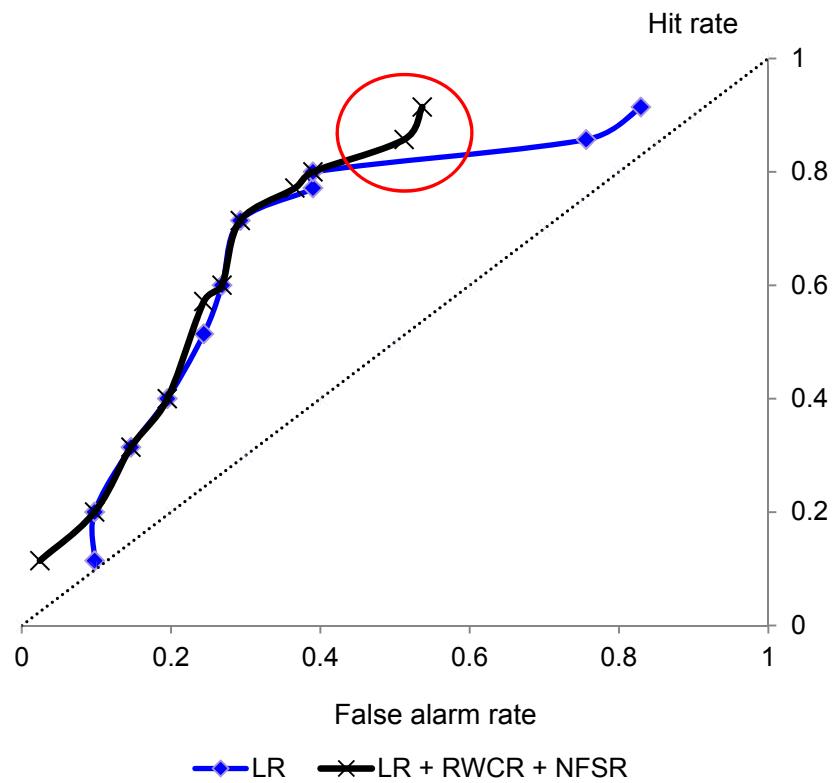
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Benefits of Multiple Constraints

Single Leverage Ratio constraint



Multiple constraints



Open Issues

- **Calibration** – is TLAC as credible as equity?
- **Multi-polarity** – what is a robust portfolio of instruments?
- **Stress-testing** – beyond banking, to market-based finance?
- **Macro-prudential** – defining/refining the reaction function?
- **Political economy** – predictability and accountability?
- **Meta-question**
 - is finance “too big”?
 - will “fintech” be disruptive?

