Political Economy of Systemic Risk (SRC, 17th November 2016)

STEPHEN BELL AND ANDREW HINDMOOR

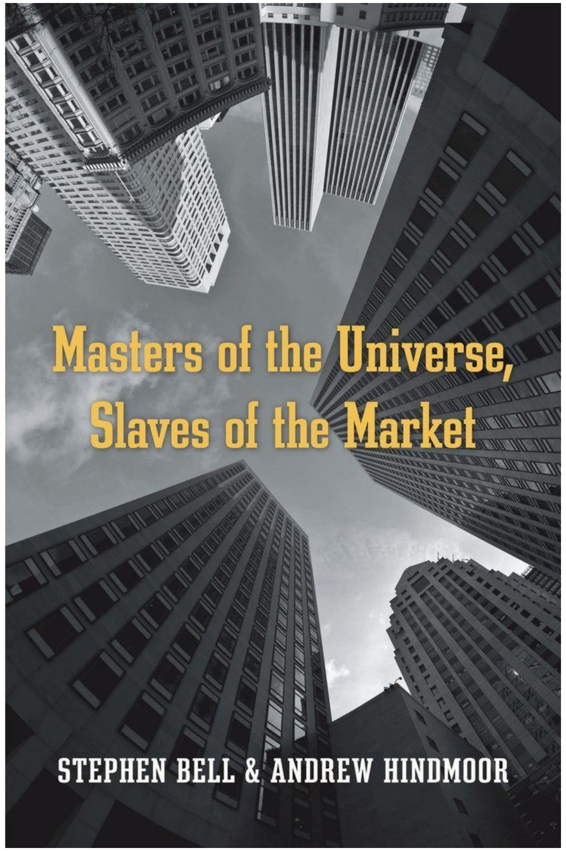
MARKET COMPETITION AND FINANCIAL STABILITY

A bank-centric perspective on systemic risk and financial stability.

* Australian Research Council Funded Project on the causes and impact of the financial crisis.

* Inter-country variation during the crisis – looking at the UK, USA, Australia and Canada

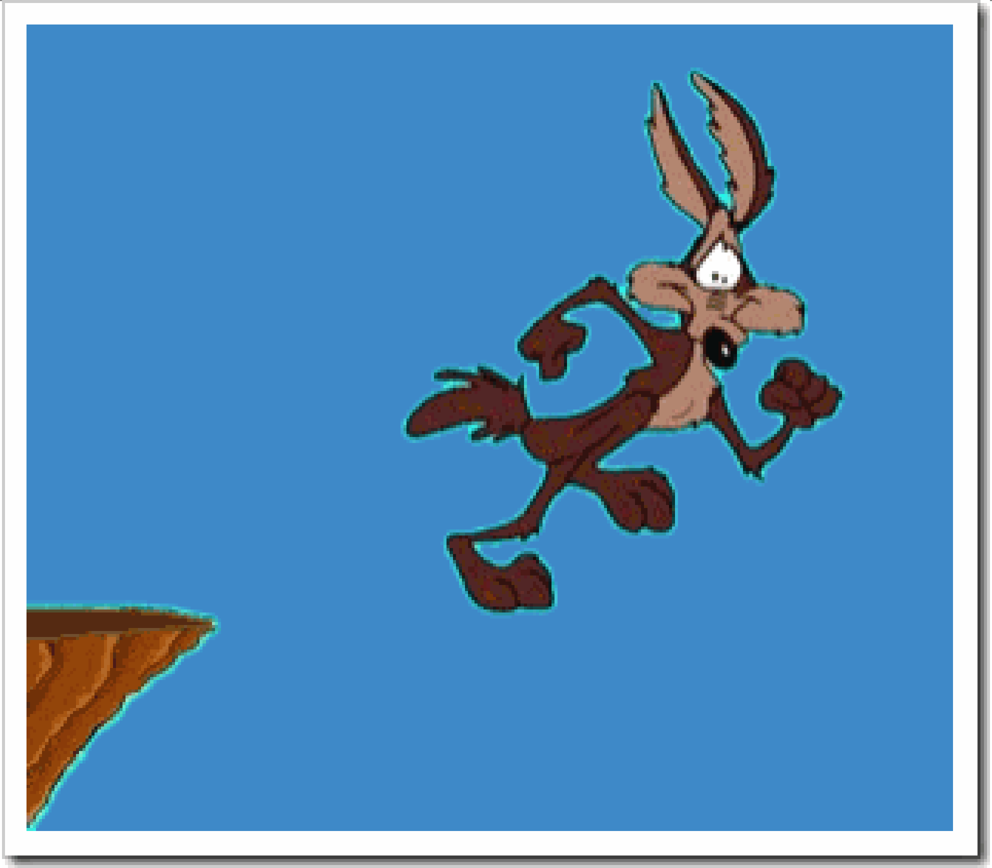
* Intra-country variation during the crisis – 'good' banks in 'bad' countries and 'bad bank's in 'good' countries.



institutional pressures as well as specific profit opportunities embodied in nationally specific banking markets were central in shaping banker behaviour

In the US and UK, financial markets imposed strong competitive pressures and placed bankers under intense pressure to reengineer their balance sheets in the search for additional profits.

Such pressures were strong in the US and UK, but weak in the Australian and Canadian markets; a key factor that explains the very different banking outcomes in these countries. National market conditions in banking thus emerge as a core variable that explains the origins or the trigger of the crisis



Andy Haldane (interview, May 2013)

Banks had no alternative but to:

juggle their own internal incentives because times were good and it was very difficult for any firm individually to step back - to step out of the party … was too much business being written? Absolutely. They'd say, well we've got a friend who stopped two years ago and they're not in a job any more. So there was this locomotive that was steaming ahead, it was impossible to step off this profitability merry-go-round. People were conscious that that meant running a bit more risk than they'd like but they couldn't stop themselves because their loss would have been someone else's gain. So I think externally there was, at least towards the end, a pretty strong sense of the risks that were being piled up… in a way that led, collectively, to everyone to pile over the cliff.

Current project (2016-18) to formally test the argument and assess post-crisis competition dynamics

Measuring competitive pressures:

1. We don’t think market share is a good indicator of the intensity of competitive pressures.
2. Interest-rate spreads
3. Management pressure and longevity
4. Take-over pressure – both actual and imagined.
5. Share price.