Have the Regulatory Authorities Done Enough?

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Prelude to the Crisis

It is not possible to predict the exact timing of any crisis, but it *should* have been possible to appreciate the vulnerability of the financial system. Only a few did (Rajan). So self-flagellation amongst macro-economists.

But do not forget the NICE years, 1992-2007. Great Moderation.

What went wrong?

The three myths:

- Price stability → No general economic downturn, (but Minsky).
- Basel II plus no downturn → bank solvency, (but manipulation).
- Bank solvency → No need for own liquidity, (but market collapse).

Also: Reliance on US housing history

Mark-to-market, NB not ratings agencies (Ospina and Uhlig, NBER, April 2018).

What did we learn?

1) Banks need to be restrained from:-
   a) Excessive leverage
   b) Excessive reliance on wholesale markets. Own liquidity.

2) ZLB can be hit; use UMP. Concern about future recessions, especially since fiscal policy is constrained.

But, focus on levels, rather than dynamic process of adjustment to higher CARs.

Raising new equity lowers RoE, benefits debt holders. And how do it when profitability low?

USA, Geithner stress test and TARP vs. EU.

(NB: Liquidity issues resolved via QE and IOER.)

Political/public outcry over Bail-out, so move to Bail-in.

But bail-in is unlikely to reduce losses; just redirects to other, more concentrated, group of individuals, pensioners, etc.

Contagion is more likely, even if moral hazard is somewhat less. Section 13.3 and dollar swaps.

Other Issues

Procyclicality. Once again.

Regulations designed in silos, not holistically (Dimon and Bernanke). RWA, Leverage, Stress: LCR, NSFR.

Regulators also not structured efficiently in some cases, n.b. USA. EU, ECB vs. National (ALM). Balance between CB, MoF and Legislature.

Apply sanctions to bankers, not to banks.