# After the GFC

# “The System Worked” after the GFC (Drezner)

- The Fed and other central banks stepped in to support markets

- Governments provided short-term fiscal support

(Although there was a shift to austerity in Europe, in 2010, following Rogoff & Reinhart’s work on public debt and growth)

- A (re)newed drive to regulate finance

# … and is still working

- After massive financial market instability in March 2020
- The authorities stepped in… massively
- Monetary & fiscal support have been substantial
- In Europe (and UK) – an effort not to repeat mistakes of moving to austerity too quickly. Support for keeping workers in their jobs (Germany pursued this policy after the GFC)

# G20 and Basel III

- Apart from dealing immediately with the GFC, G20 initiated principles of re-regulation, including:

- Higher reserve ratios and liquidity requirements:
    - Stronger Common Equity Tier 1 (CET1) capital: *CET1/RWA ≥ 4.5%* l ratios of risk-weighted assets.
    - Plus "capital conservation buffer": mandatory 2.5% RWA
    - And "discretionary counter-cyclical buffer" (national regulators may require) 2.5%

- Leverage ratio *CET1/Total exposure ≥ 3%* (total exposure all consolidated assets, including non-balance sheet assets

- Liquidity coverage ratio (LCR):

$$LCR = \frac{\text{High quality liquid assets}}{\text{Total net liquidity outflows over 30 days}} \geq 100\%$$

# Bank balance sheets

**Traditional commercial bank**

| **Assets** | **Liabilities** |
|---|---|
| Reserves<br>Short-term loans<br>Long-term loans<br>Other investments | Deposits<br>Short-term debt<br>Long-term debt |
| | Shareholder equity |

**Large (multifunctional/universal) band**

| **Assets** | **Liabilities** |
|---|---|
| Cash | Deposits |
| Loans | Other debt<br>(mostly short-term) |
| Trading and other assets | Long-term debt |
| | Equity |

Source: Anat Admati & Martin Helwig, *The Bankers' New Clothes*, Princeton University Press, 2013.

# Risk-weighted assets

- **Banks have assets**, including central bank reserves, cash holdings, securities and loans. The riskiness of these loans varies, depending on collateral.
- Government bonds > mortgage backed securities > unsecured loans (like consumer credit)
- These are weighted to give an idea of banks' overall asset risks, and hence their capital requitements. See https://www.investopedia.com/terms/r/riskweightedassets.asp

- Liabilities: check (cheque) and deposit accounts, borrowings, bank capital (net worth, funds from selling equity, retained earnings)

# New regulatory structures

- Monitoring of 30 Globally-systemically important banks (G-SIBs)…

  … by the Financial Stability Board (FSB), the Basel Committee on Banking (BCBS) and national authorities.

  Involving stress-testing

- Macro-prudential regulation of finance

# Other post- GFC measures

- Bank resolution procedures (living wills) have been established, to bail-in private investors.

- Standardised derivatives are now traded on exchanges (central counter-parties).

- Stronger consumer protection for households.

# Potential weaknesses of post-GFC regime

- Much new regulation
- Little or no structural change in banking and finance
- Too-big-to-fail has become an even bigger problem
- Shadow banking activities – probably not regulated enough
- The essential nature of global finance seems unchanged

# Takeouts

- Significant regulation after GFC – through international cooperation
- No structural reform
- Resilient to Covid-19 shock – so far
- Macro-indicators (monetary policy and fiscal policy) are stretched – *is this a “fuite en avant”?*