

# Economics of banking

## 1. Banks return risk

### Accounting based

Balance sheet

Income statement 32

Return Risk 45

### Market based

EU vs US

Bank performance 22

ROE (COE)

ROA

- ♦ NIM: Yield curve
- ♦ NONINT
- ♦ C/I
- ♦ NPL

Bank risks 84

How do financial markets assess bank health? 95

Stock market evolution, spread, CDS

P/E ratio

M/B ratio

### Stock market evidence

Determinants of bank stock returns

CAPM

- ♦ Market factor  $\beta$

Fama/French

- ♦ Market factor  $\beta$
- ♦ HML
- ♦ SMB

Risk decomposition: systematic and idiosyncratic 38

Capital, diversification, A/L, LLP, Business cycle

Cost of equity 61

King 2009

## 2. Regulatory

Banking crisis, Eurozone crisis, new regulatory framework, Eurozone Governance

Financial crisis

How to restore confidence 60

UMP

Bank recapitalization 77

Government bailouts & Bad bank

Policy implications 90

What has been done, is underway?

- ♦ Basel III: increased capital buffers and liquidity requirements
- ♦ tackling TBTF
- ♦ Banking Union: supervision (SSM, SRM, DGS,...)
- ♦ Recovery and resolution: bail in
- ♦ Liikanen
- ♦ Governance

Basel I, II, III

Bank capital requirements 3

Basel I

Basel II

- ♦ Pillar 1: Minimum capital requirements (Credit, operational and market risk)
- ♦ Pillar 2: Supervisory review process (SREP)
- ♦ Pillar 3: Market discipline (Risk report)

Basel III

- ♦ CET1
- ♦ CCyB
- ♦ G-SIFI
- ♦ Unweighted leverage ratio
- ♦ TLAC

Liquidity requirements 96

Liquidity ratios

- ♦ LCR: HQLA
- ♦ NSFR

Implications for banks 109

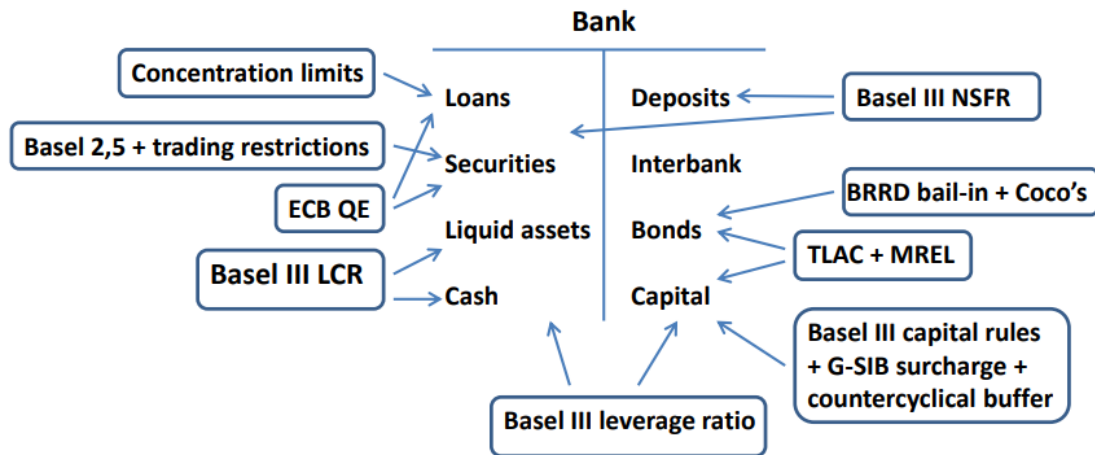
## Basel III: impact assessment

Capital requirement impact studies

BIS

Miles et al.: Modigliani Miller Theorem

IMF



## 3. Macroeconomic environment

Effect of (unconventional) monetary policy

Unconventional monetary policy

APP: Different channels

Bank profitability and risk 22

ECB: net ROA effect is neutral

- + lending, less NPL
- + market value of banks
- + non interest income
- NIM
- increase bank systemic risk
- excess liquidity charge (-0,40% deposit rate)

L4L

## Abbreviations

APP = Asset purchase programmes

BIS = Bank for International Settlements

BRRD = Bank recovery and resolution directive

DGS = Deposit guarantee scheme

EBA = European banking authority

ESM = European stability mechanism

ESRB = European systematic risk board

FSR = Financial stability review

IRB = Internal rating based approach

IRRBB = Interest rate risk in the banking book

PSPP = Private sector purchasing programme

SMP = Securities markets programme

SREP = The supervisory review and evaluation process

SRF = Single resolution fund

SRM = Single resolution mechanism = SRB

SSM = Single supervisory mechanism

WACC = Weighted average cost of capital