Financial Stability Analysis

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COURSE DESCRIPTION

This course provides a comprehensive overview of financial stability analysis as currently done by major central banks and international institutions. The course draws heavily on the situation in and experience of the European Union and the euro area. In addition, selected material relating to Russia and other developed and emerging economies will be presented.

Following a brief introduction of the concept of financial stability, Part 2 of the course will look at the key structural features of financial markets. Besides looking at banks, which still constitute in most economics the largest element of the financial sector, this part of the course looks also at insurance companies, pension funds, other financial institutions, often called 'shadow banks' and the interlinkages between these financial entities.

The third part of the course presents first the main concepts used to define systemic risk in the financial sector. This is followed up by a review of systemic risk indicators and models, differentiating between (1) time series and (2) cross-sectional approaches with the latter also covering contagion channels. This general overview of financial stability identification risks will be complemented with a more specific look at the risks posed by 'shadow banks' and 'fintech' and a case study, reviewing the origins of the Global Financial Crisis starting in 2007/08.

The fourth part of the course looks at policies to prevent financial crises. Both microprudential (institution-specific) banking supervision as well as systemic (macroprudential) supervision will be covered. In addition, a framework for banking sector stress tests is introduced and the main findings of the latest IMF FSAP for the Russian Federation will be discussed as a case study.

The final part of the course reviews important policy tools that are used to mitigate financial crises and the negative impact on such crises on the real economy. First, different approaches to deal with non-performing assets (NPL) are presented. Second, options to restructure and to resolve distressed banks will be shown.

The course is taught on the basis of Power Point Presentations. There is no single textbook available for this course but students will obtain a list of relevant documents.

COURSE INFORMATION

Course Title:	Financial Stability Analysis
Key words:	Financial Stability, Financial Markets, Macroprudential Policy, Early Warning, Stress Testing, European Monetary Union (EMU), Economic and Financial Crisis
Academic level:	Master
Duration:	20 hours

Language of instruction: English

SYLLABUS

1) Introduction – the concept of financial stability

2) The various parts of the financial markets

- Banks
- Insurance companies and pension funds
- Other financial institutions ('shadow banks')
- Interlinkages between different types of fin entities

3) Identifying financial stability risks

- Concepts of systemic financial sector risks
- Measurement of systemic financial sector risks: Systemic risk indicators
  - The *time series* dimension: Early warning indicators / models
  - The *cross sectional* dimension: Interconnection and network methods
- Risks associated with Shadow banks and Fintech
- Case Study: The origins of the Global Financial Crisis

4) Preventing financial crises (RM / PH)

- Microprudential policy
- Macroprudential policy
- Stress testing as diagnostic tool
- Case Study: The latest IMF FSAP for the Russian Federation – key findings

5) Mitigating financial crises (RM)

- NPL management
- Bank restructuring and resolution

LITERATURE & SOURCES

Main regular publications:

ECB, Report on Financial Structures, annual.

ECB, Financial Stability Review, biannual.

IMF, Global Financial Stability Report, biannual.

Selected textbooks, academic papers and publications (see also references on slides)

Crockett, A (2000) 'Marrying the micro- and macroprudential dimensions of financial stability', BIS Speeches, 21 September. Also, see Borio, C (2003) "Towards a macroprudential framework for financial supervision and regulation?", BIS Working Papers, No.128.

Fell J., M. Grodzicki, R. Martin and E. O'Brien (2016), Addressing market failures in the resolution of non- performing loans in the euro area, ECB Financial Stability Review November 2016: Special Feature B.

Fostel, A. and J. Geanakoplos (2008), "Leverage Cycles and the Anxious Economy", American Economic Review 98(4), September.

Henry J. and C. Kok (Eds) (2013), "A macro stress testing framework for assessing systemic risks in the banking sector", ECB Occasional Paper No. 152

Hiebert P., B. Klaus, T. Peltonen, Y. Schüler, and P. Welz (2014), "Capturing the financial cycle in the euro area", ECB Financial Stability Review: Special Feature B.

Hollo, D., M. Kremer, and M. Lo Duca (2012): "CISS - a composite indicator of systemic stress in the financial system," ECB Working Paper No. 1426.

Reinhart C. and K. Rogoff (2011), "This time is different: Eight centuries of financial folly", Princeton University Press.

Schularick M. and A. Taylor (2012), "Credit Booms Gone Bust: Monetary Policy, Leverage Cycles, and Financial Crises, 1870-2008", American Economic Review, Vol. 102, No. 2, pp. 1029-61.

Schüler Y., P. Hiebert, and T. Peltonen (2016), "Coherent financial cycles for G-7 countries: Why extending credit can be an asset" ECB Mimeo (see http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2539717).