Financial Stability Analysis

Paul Hiebert (IMF) / Dr. Reiner Martin (ECB)

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, 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. In addition to this 'entity-based' approach, the main activities of financial markets will be reviewed and feedback loops between the financial sector and the real economy will be illustrated.

The third part of the course presents indicators and models that are designed to detect vulnerabilities in the financial system and the economy at large. These models are designed to deal with the two dimensions of systemic risk – namely, attenuating procyclicality inherent to financial markets and institutions, and ensuring resilience of the financial system. Empirical approaches capturing this *time series* dimension of systemic risk (cycle estimation and early warning) and *cross sectional* dimension of systemic risk (interconnectedness and contagion) will be discussed.

The fourth part of the course looks at policies to prevent financial crisis. More specifically, (institution-specific) banking supervision as well as systemic (macroprudential) policy are covered. In addition, a framework for banking sector stress tests is introduced. This is a useful analytical tool for both banking supervision as well as macroprudential policy.

The final part of the course reviews important policy tools that are used to mitigate financial crisis and the negative impact on such crises on the real economy.. First, different approaches to deal with non-performing assets are presented. Second, options to restructure and 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

Financial stability analysis

1) Introduction and outline of the course (RM)

2) Structural features of financial markets (RM)

   - Financial activities and feedback loops between the financial sector and the real economy
     - Credit intermediation, and maturity transformation
     - The role for credit and asset prices (financing for firms, housing and mortgage markets, consumer credit)
   - Financial *entities*
     - Banks
     - Insurance companies and pension funds
     - Other financial institutions (so-called 'shadow banks')
     - Interlinkages between different types of fin entities

3) Financial stability *surveillance* (PH)

   - Concepts of systemic financial sector risks
   - Measurement of systemic financial sector risks: Systemic risk indicators
     - The *time series* dimension of systemic financial sector risk: Early warning indicators / models
     - The *cross sectional* dimension of systemic risk: Interconnection and network methods
   - A moving target? Tracking financial system innovation through *general* (market intelligence) and *specific* (Fintech) initiatives
   - Main current financial risks in the EA and globally

4) Preventing financial crises (RM / PH)

- Microprudential policy
- Macroprudential policy
- Stress testing as diagnostic tool
- Case Study: FSAP for the Russian Federation

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).