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Banking in Ireland: Back to the Future

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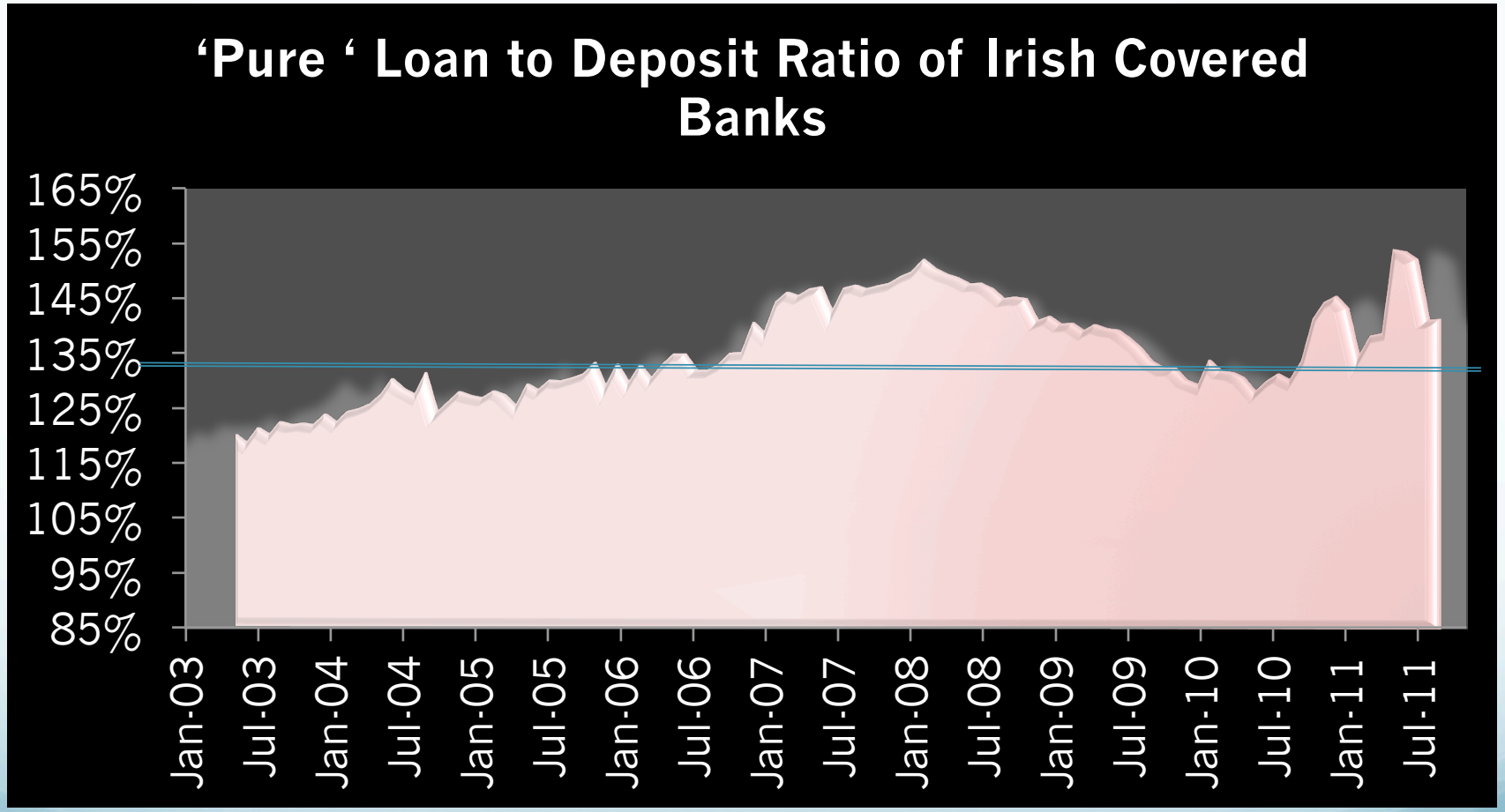
Emergent duopoly?

- Banking landscape transformed : Two Pillar Banks
- Significant job losses will ensure with branch closures inevitable
- CB estimates c €6-7b SME lending, €9b mortgage needed in 12-14, in face of deleveraging to 125%
- Banks still facing into rough waters

A long way to go...



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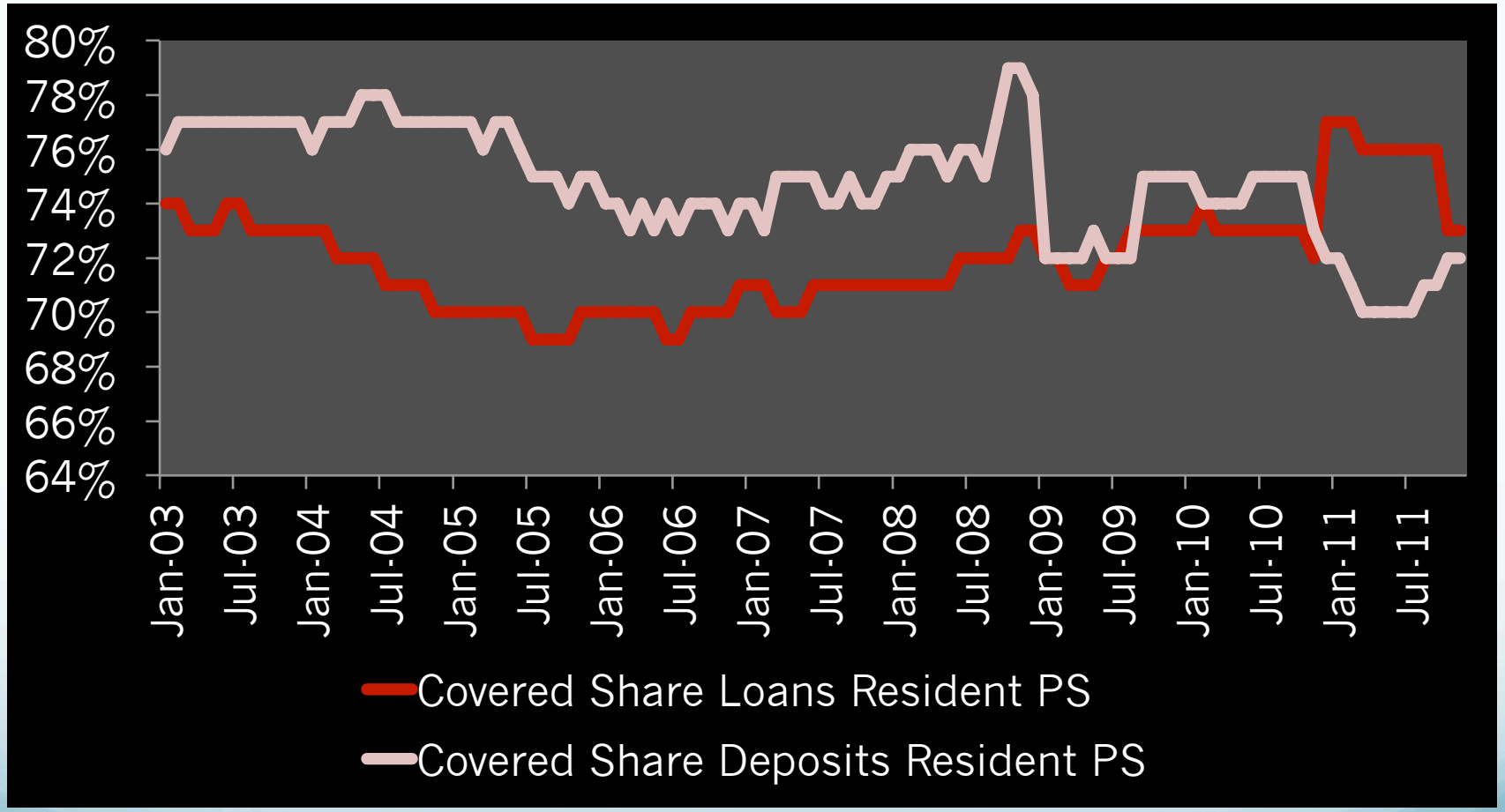
Covered banks gaining ground?



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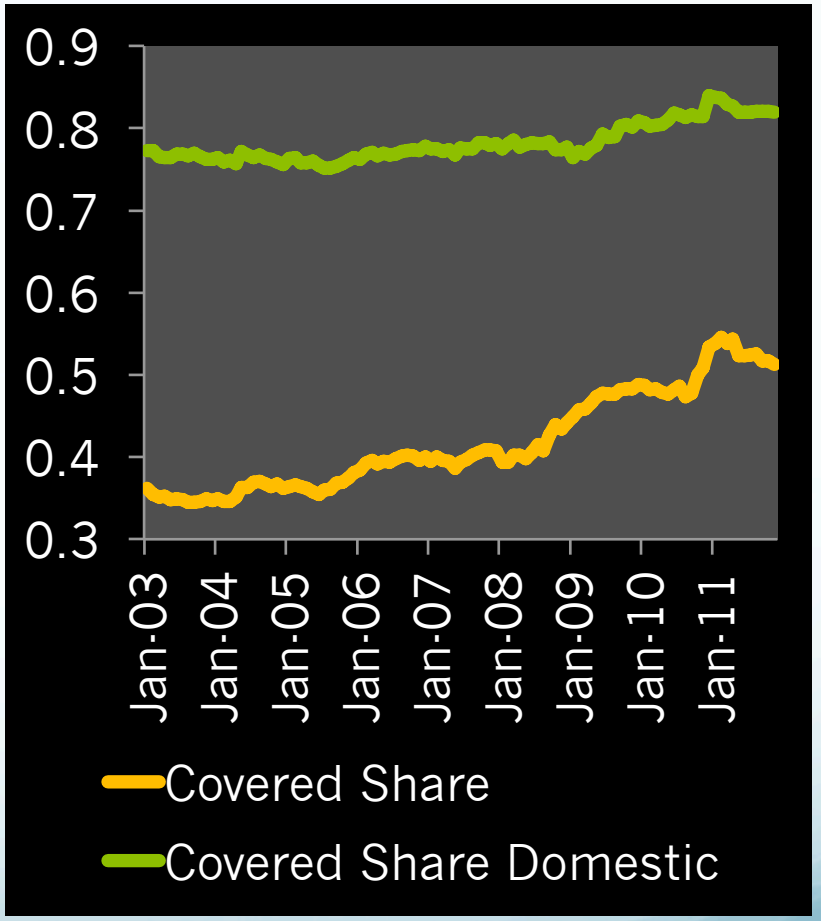
2008 : Why did we do it

What about guarantees

- (ongoing) Guarantee is a subsidy to those that get it
- Consequence is that those that don't are disadvantaged
- Choice then is
  - Exit the market
  - Chase more return (and risk)
  - Accept secular drag

Risk Embedding

- Industrial economics of banking (Gropp, et al, Haknes)
  - "**MSI (market share of insured) significantly increases** banks' risk-taking, and the estimated increase in risk is **substantial**. In contrast, we find no evidence for higher risk-taking at the protected banks themselves, **except for banks with outright public ownership**.
  - ...public disinvestment and the discontinuation of explicit guarantees may be insufficient to eliminate the distortionary effect of these guarantees: **As long as markets continue to expect banks to be bailed out in case of difficulties, the competitive distortions may persist** "



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Risk Embedding 2

- Recent research in USA suggests bailed out banks shift risk within Basle asset classes :
  - "**bailed banks approve riskier loans and shift investment portfolios toward riskier securities**. However, this shift in risk occurs mostly within the same asset class and, therefore, has little effect on the closely-monitored capitalization levels. Consequently**, bailed banks appear safer according to capitalization ratios**, but show a significant increase in measures of volatility and default risk"
- Might be useful to do similar for Irish situation

Competition not a bad thing

- more competitive banking systems are **less prone to experience a systemic crisis and exhibit increased time to crisis.** This result holds even when we control for banking system concentration, which is associated with higher probability of a crisis and shorter time to crisis. Our results indicate that competition and concentration capture different characteristics of banking systems, meaning that concentration is an inappropriate proxy for competition. The findings suggest that **policies promoting competition among banks, if well executed, have the potential to improve systemic stability** (Schaek et al 2009)

Banking crises are persistent

	Credit				
		Calm	Crisis	Calm	Crisis
Output	Calm	**87%**	4%	2%	7%
	Calm	**19%**	**72%**	2%	7%
	Crisis	38%	2%	52%	10%
	Crisis	7%	27%	14%	51%

Table shows transition probabilities from regime to regime, based on 103 banking crises episodes ; Explained Markov switching model Annual data, 4y window; crisis is where annual average growth rate < mean Implication is that where we are now only a 50% change
Source: Serwa 2012

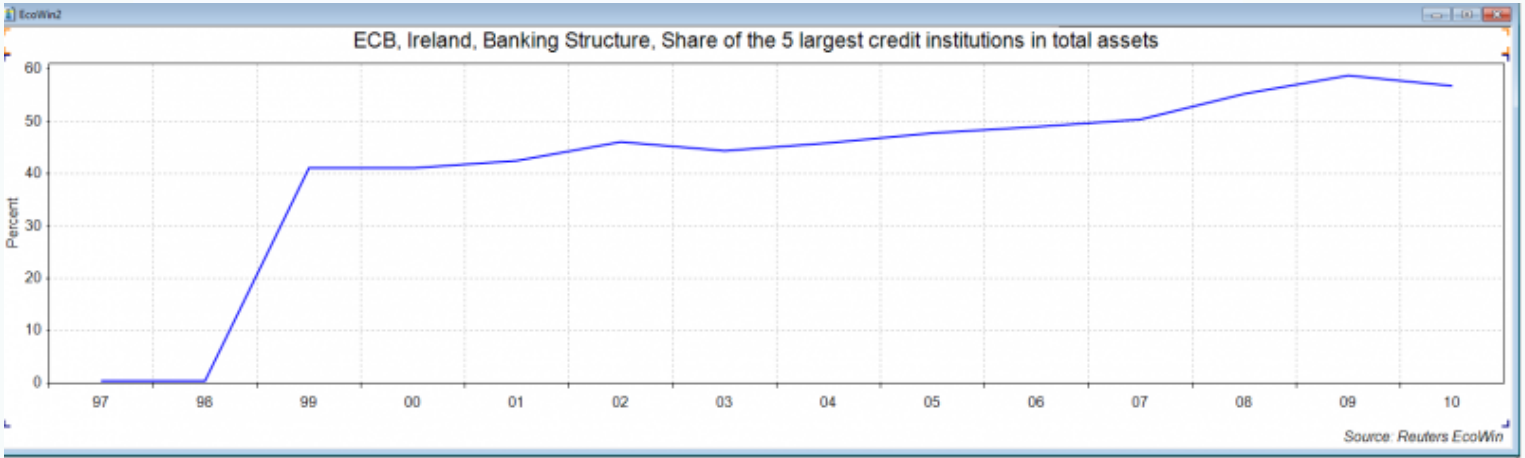
Some Suggestions

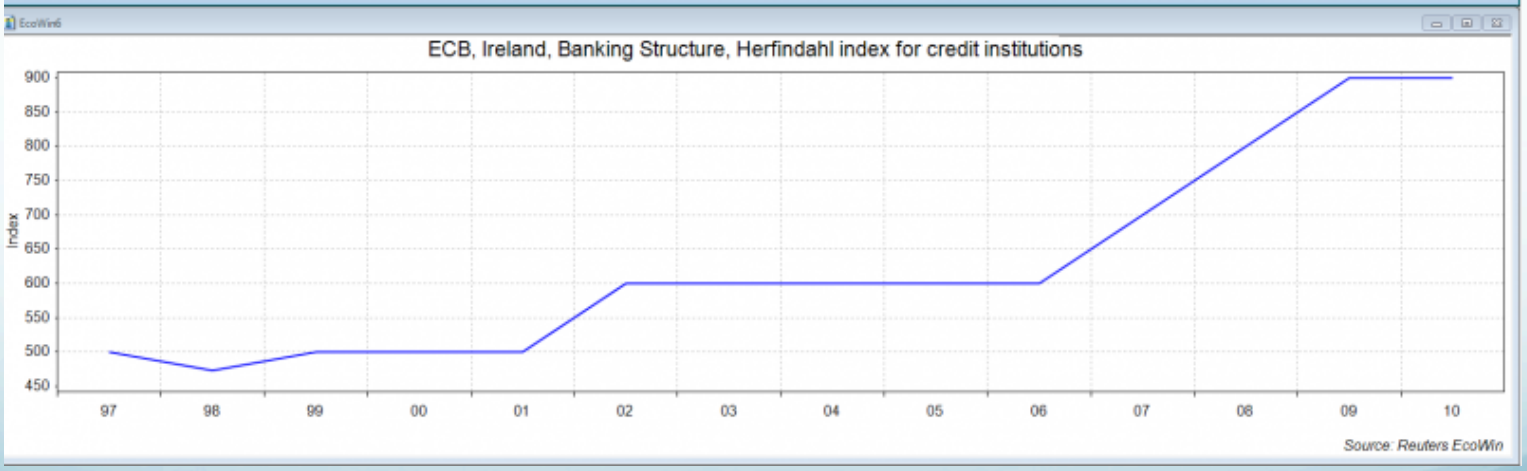
- Free up entry by banks leading to
  - Cooperative banks
  - New private banks
  - Foreign owned banks
  - Better regulated banks
  - Smaller banks (max. 30% Assets/GNP at group level)
  - more focused banks (separate mortgage, commercial and investment functions)
- Do we wind down or breakup existing banks in face of embedded moral hazard?

Didn't competition ruin us?

- Not hardly....at least not according to the evidence
- More specifically: there is relatively little evidence of significant competitive pressure during the credit boom
  - Caveat: survey data only as good as it is, nobody wants to be seen following a leader.

Competitive Forces?





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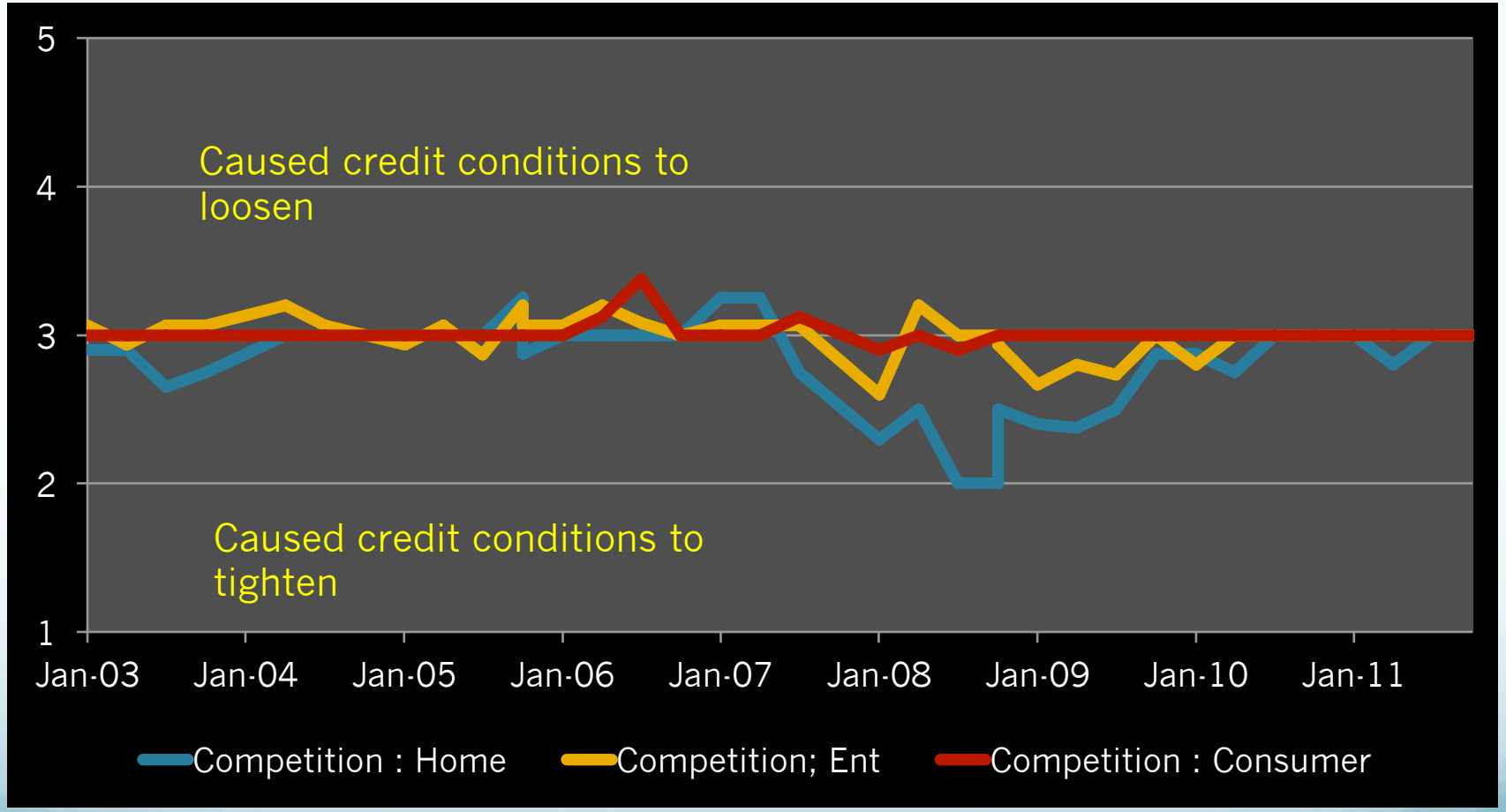
Lead or Follow in Lending?



Quarterly Survey of Banking Conditions: Central Bank

Sure Co-ops are inefficient?

- Conception is that mutual/cooperative banks are inherently inefficient.
- Care needed on what efficiency is being measured…
- Evidence on CU and Cooperative banking is not fully supportive of this : Cebenoyan et al 1993 USA , Girardone et al 2009 Europe for coop and mutual banks gives reasonable evidence on mutuals efficiency – McKillop significant evidence that Irish CU's inefficient (but what of banks…)
- Roy notes bond rating processes similar for cooperative and commercial banks

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Arent they too small?

- European Association of Co-operative Banks data
- Coop banks account for
- Cooperative and related banks account for between 2% (UK) and 40% (Netherlands) of SME lending.

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Whataboutery....

Cajas

- Spanish savings banks : perhaps as bad as Ireland
- Deregulation at end of 80's allowed Cajas to go outside home area, in effect become commercial bank competitors but much less efficient and fragile (IMF Country Report No. 11/216)

S&L Debacle

- Massive failures in the 80's, series of mistakes, problems and fraud:
  - Deregulation and poor supervision in a sleepy industry, allowing brokering of deposits and deposit chasing, onlent into a RE bubble, poor quality management and analytical capacity
  - Moral Hazard of federal insurance of troubled banks
  - Lax accounting signoffs
  - Persistent state and Fed delays in accepting crisis resulting in much worse at end

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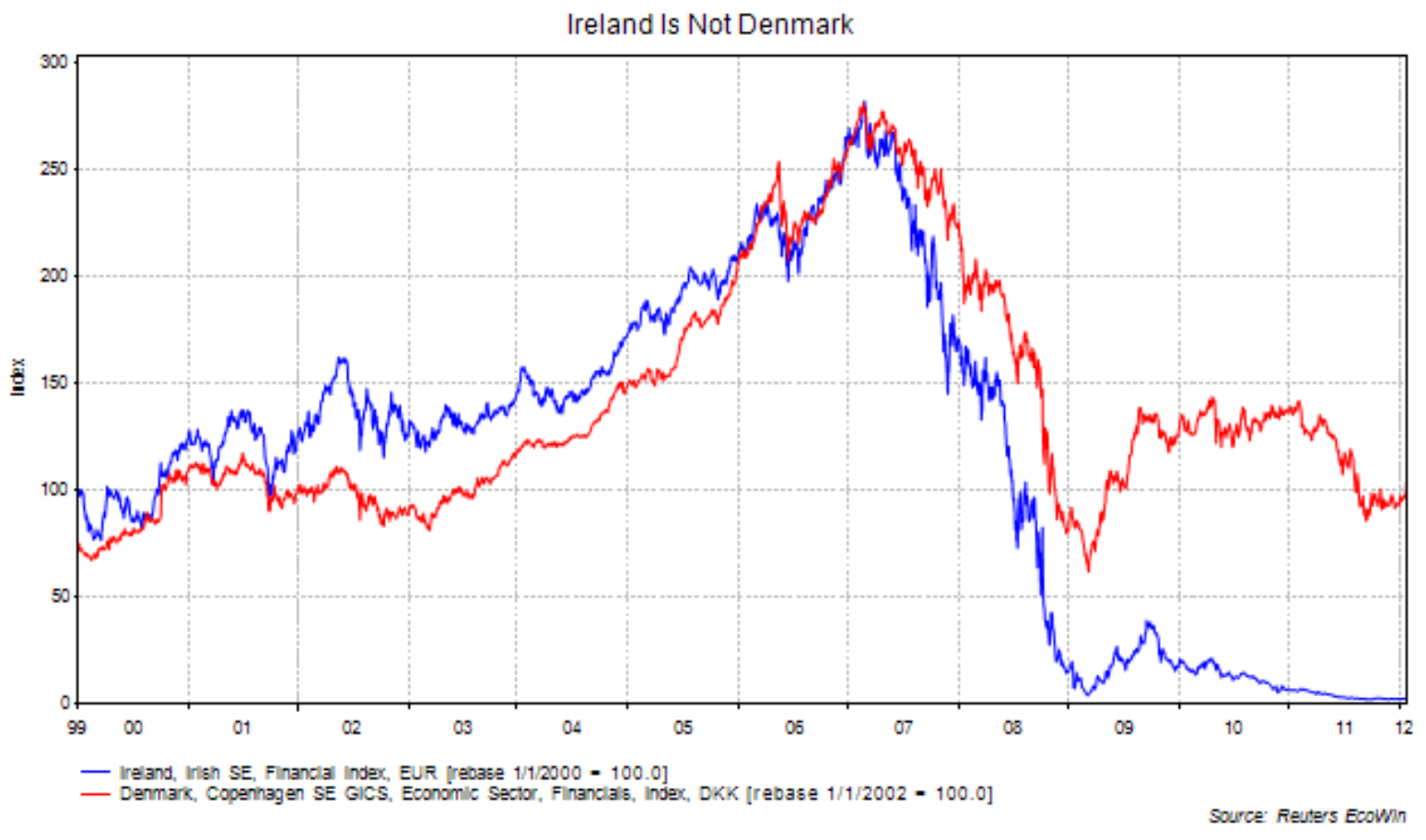
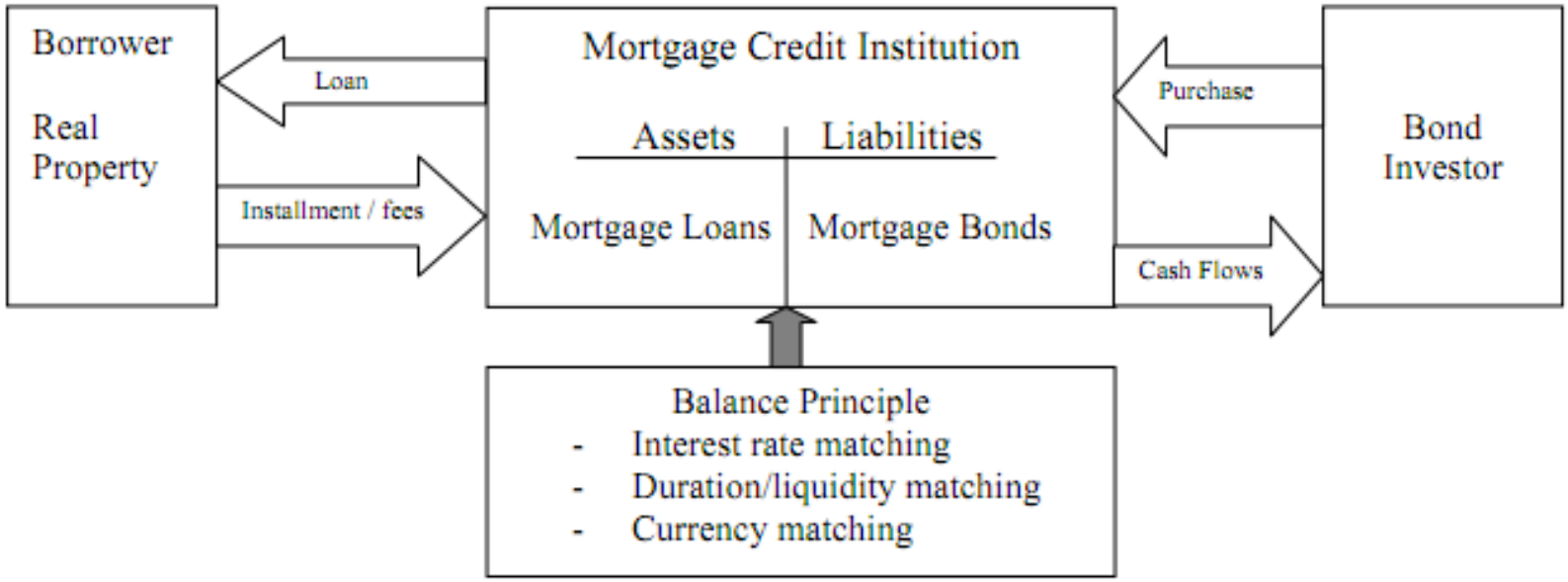
Look to the east?



Danish mortgages?

Figure 1. The Balance Principle



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Work in Denmark...

- Danish system works as they have
  - Good land registry and speedy resolution system
  - A very conservative LTV approach
  - Strict rules strictly enforced on LTV and income
  - Lots of law abiding nordic types.... ☺
- Danish mortgage market is quite concentrated resulting in a higher H index than ireland ... but stable.

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