2024 Geneva Report. Much Money, Little Capital, and Few Reforms: The 2023 Banking Turmoil

by

Ignazio Angeloni, Stijn Claessens, Amit Seru,
Sascha Steffen and Beatrice Weder di Mauro

Milan, 28 November 2024

By Sascha Steffen, Frankfurt School of Finance & Management

Overview of the report

Parts I will present

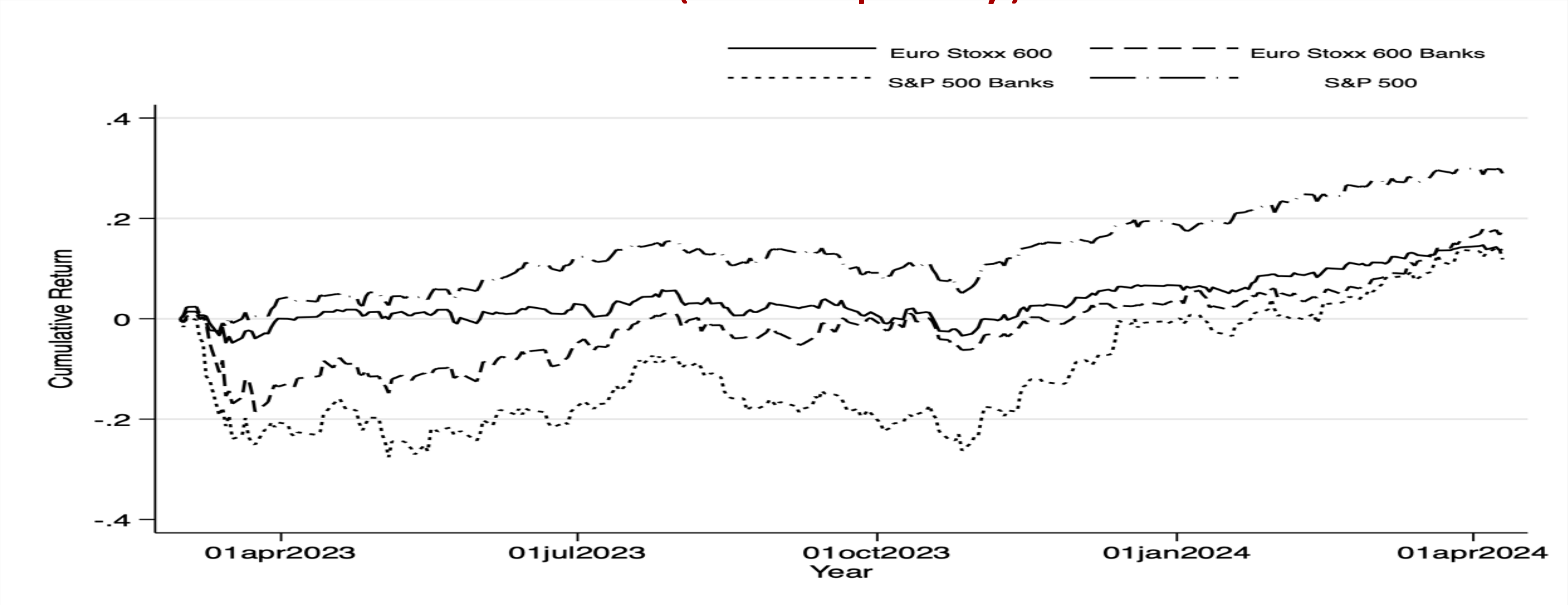
2. The March 2023 events, reforms to date, and current conditions
    2.1 Events last March in the United States and Switzerland
    2.2 Taking stock of the post-global financial crisis reforms

3. Weaknesses revealed by the March 2023 events and others known but hiding: Europe and the United States
    3.2 The US banking system: Lessons from SVB's collapse and beyond
    3.1 European banking systems: Strengths, weaknesses and lessons

Chapter 2: Reminder of key events in March 2023

- Speed of outflows was high, contagion in US was large
- Slow decline, yet sudden death of Credit Suisse =>
- Need for large scale interventions in both cases

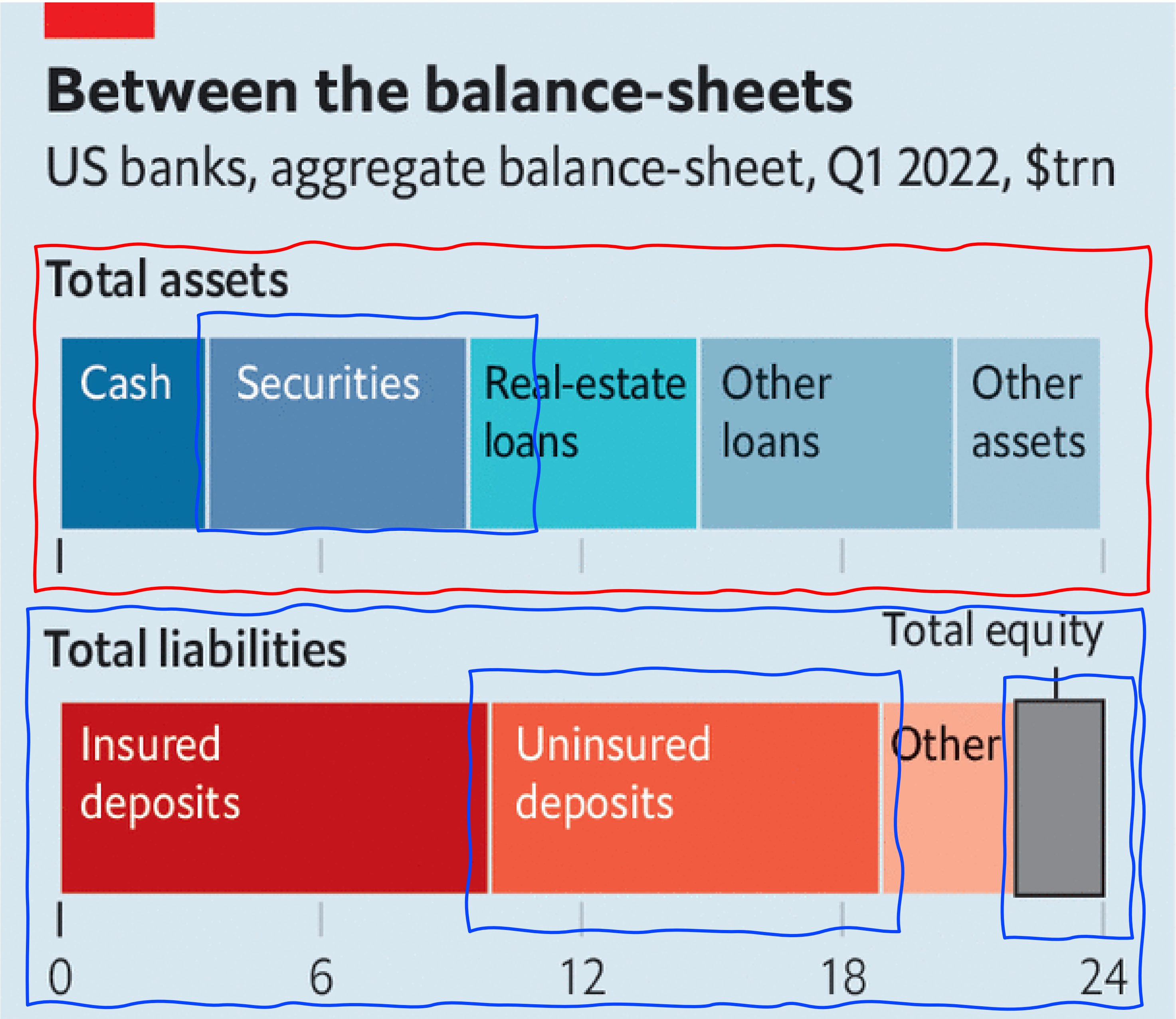
Market prices of banks fell most in US, but with large official support recovered in US and in Euro (more quickly). Low ST economic costs…



Banking reforms, while ahead of other areas, seen several delays and lagging in the US and Europe (EU, UK/GB, and CH)

Chapter 3:
US and European Banking Systems

Detailed Analyses of Vulnerabilities

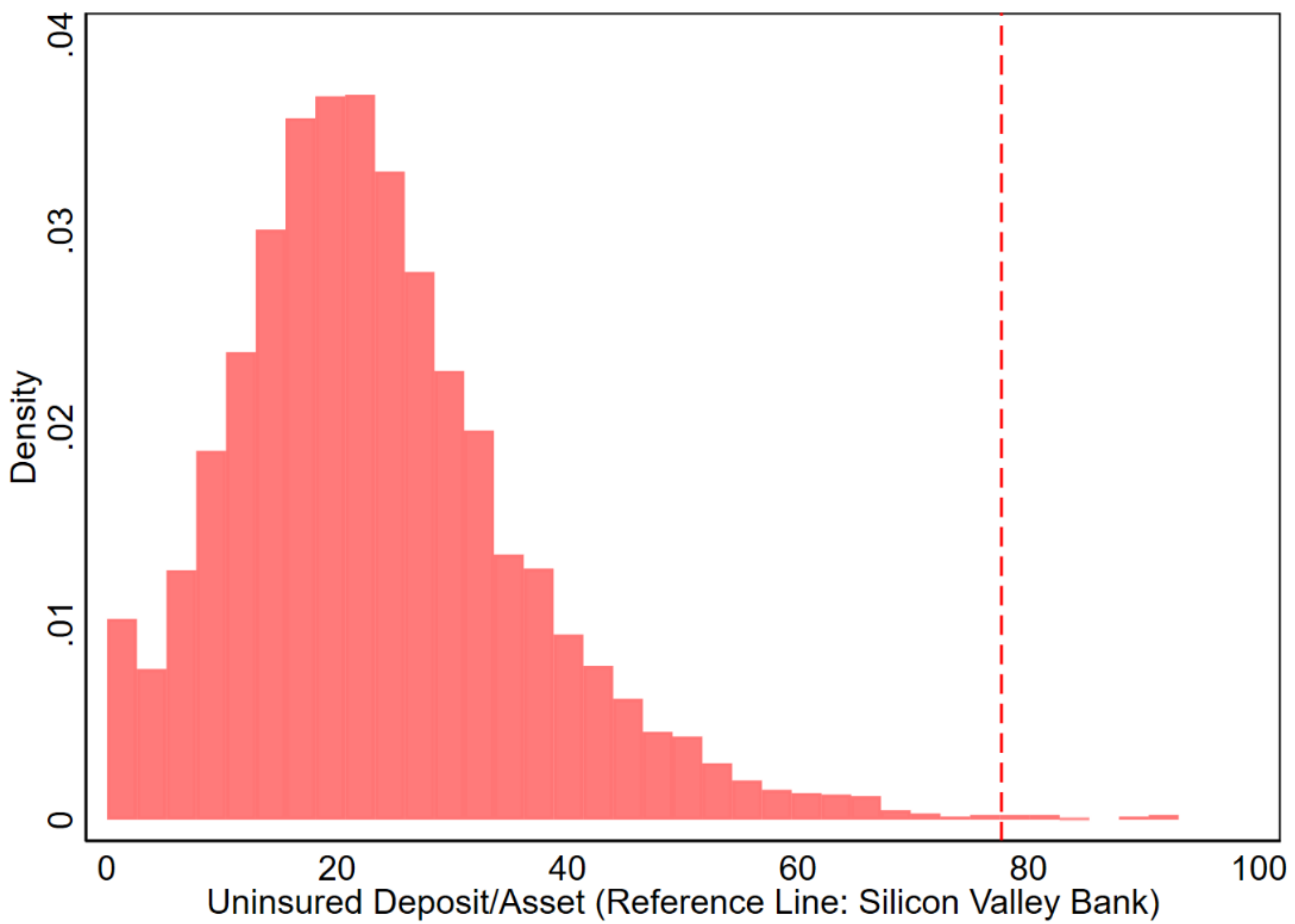


Source: Jiang, Matvos, Piskorski, Seru (2023): “Monetary Tightening, MTM losses”…

“Flight Risk”: Uninsured Leverage

Assets	Liabilities
Loans = 100	Uninsured Deposits = 90
	Insured Deposits = 5
	Equity = 5

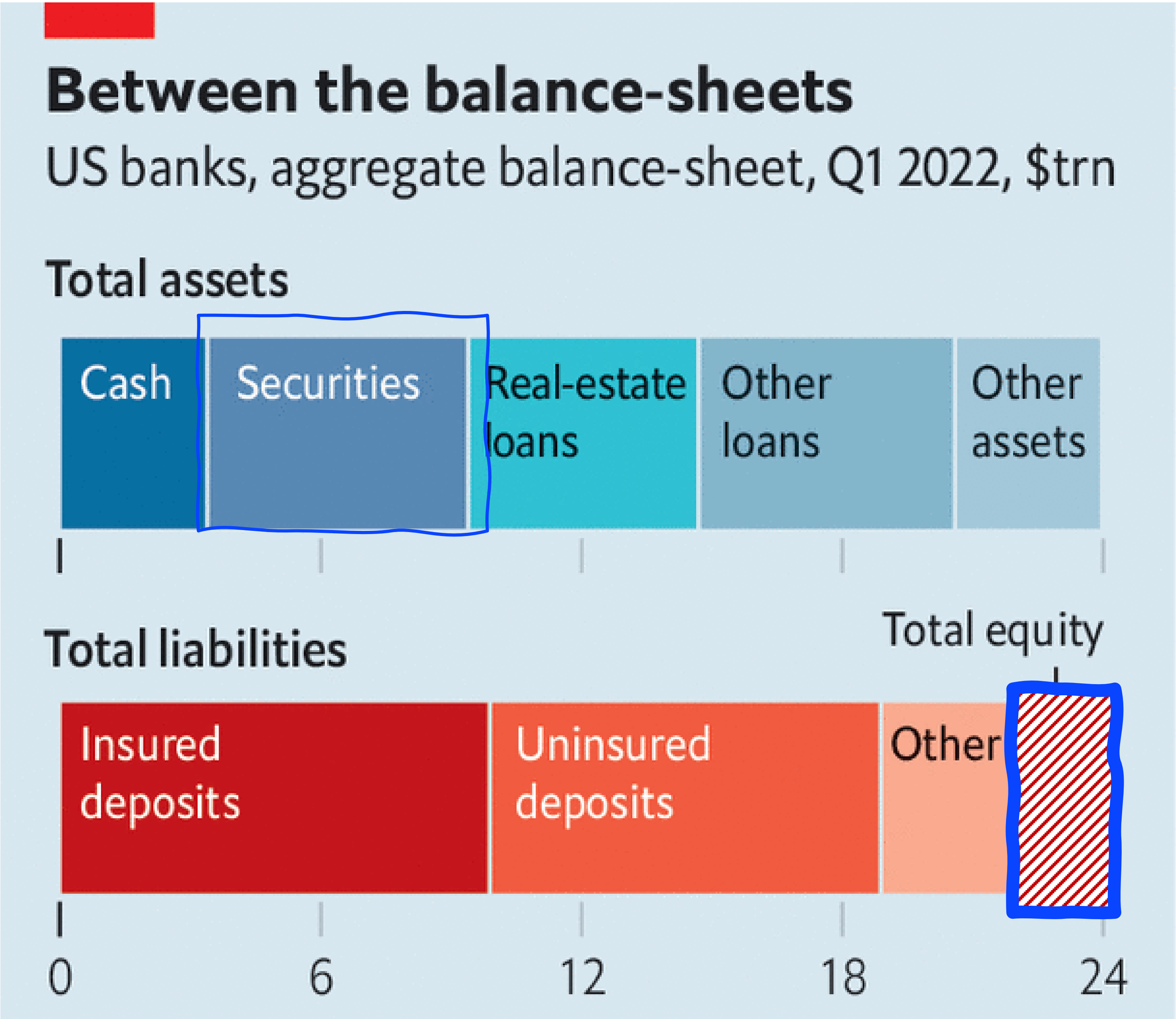
Uninsured Leverage = 90/100 = 90%



Source: Jiang, Matvos, Piskorski, Seru (2023): “Monetary Tightening, MTM losses”…

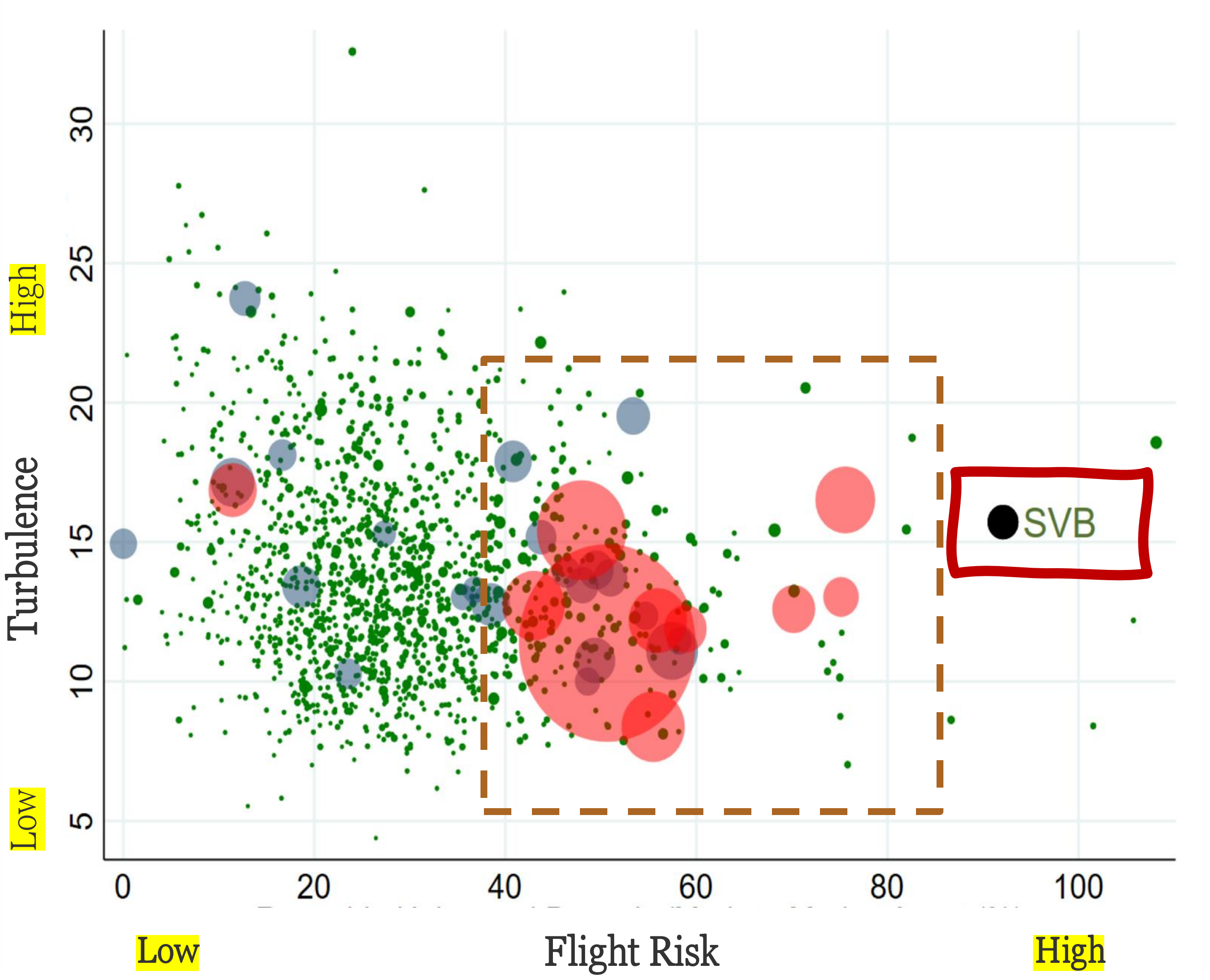
"Turbulence": Unrealized Mark to Market Losses as Interest Rate Rose

2Trillion+
(in March 2023)



Source: Jiang, Matvos, Piskorski, Seru (2023): "Monetary Tightening, MTM losses"…

Putting Flight Risk and Turbulence Together



Red are 10 largest US banks. Size of dot is asset size (1 > $1 trillion, 9 > $50 bill. SVB was $218 bill.
Source: Jiang, Matvos, Piskorski, Seru (2023): “Monetary Tightening, MTM losses”…

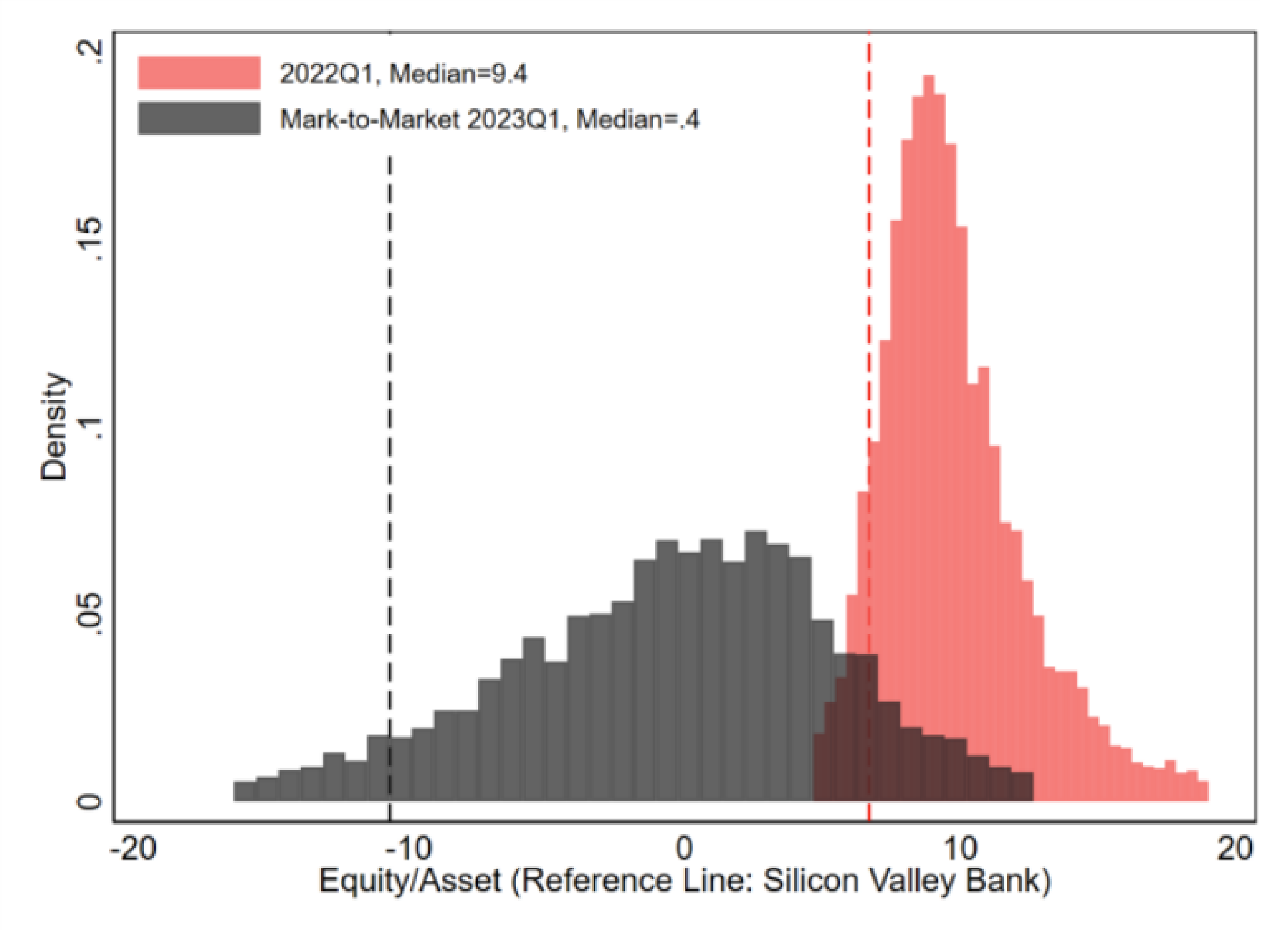
As of mid-2023: Mostly Stable. But at a Cost and Losses Remain

Insured Uninsured Depositors

Bank Term Funding Program

Mitigated short term risk…

But increased moral hazard



Now What? If a Shock Arises

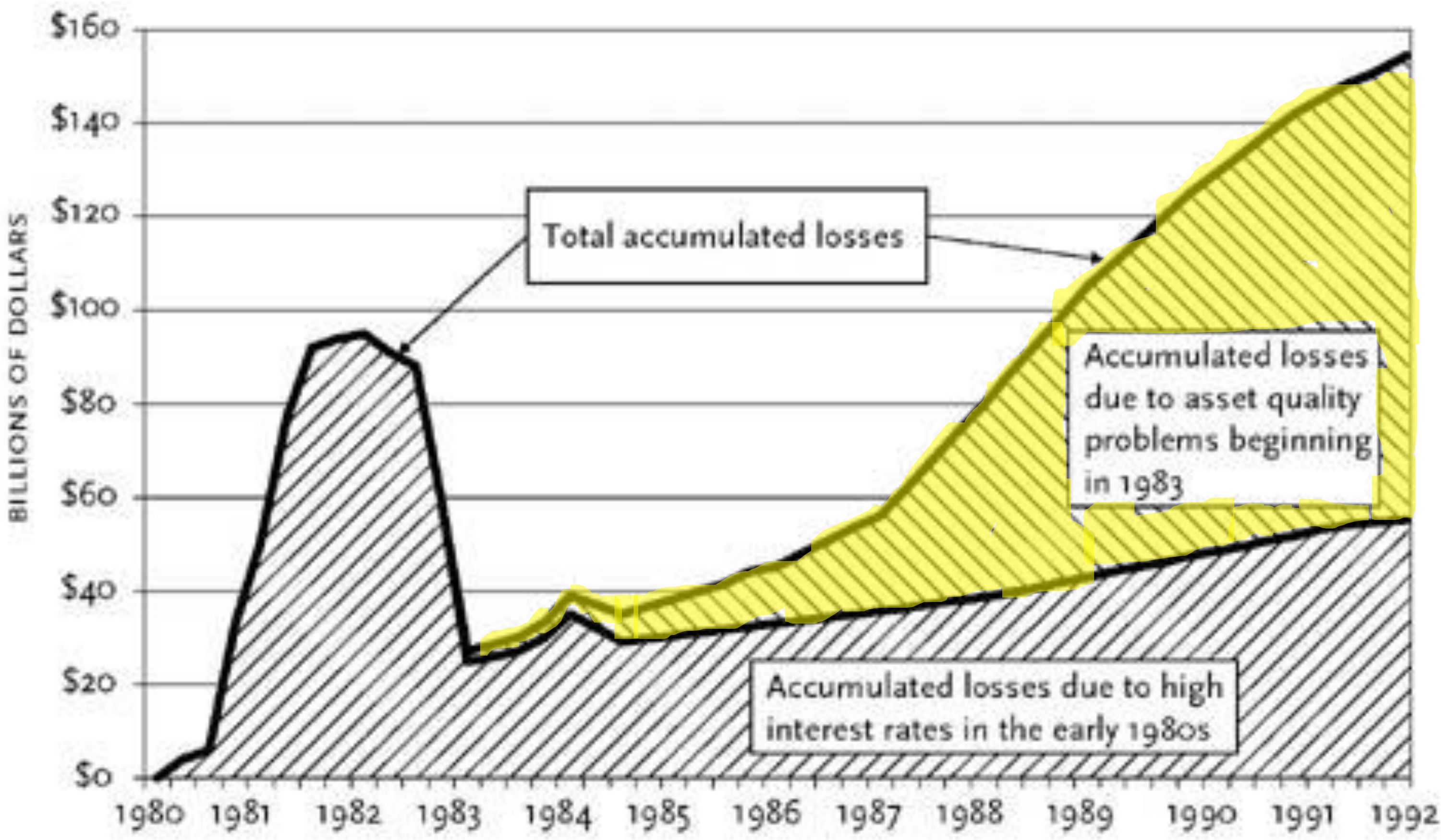
Bank Term Funding Program ≠

Insure more uninsured claims ?

Lower interest rate further to mitigate short term risk… ?

… But moral hazard and credit risks, e.g., CRE, all worsen

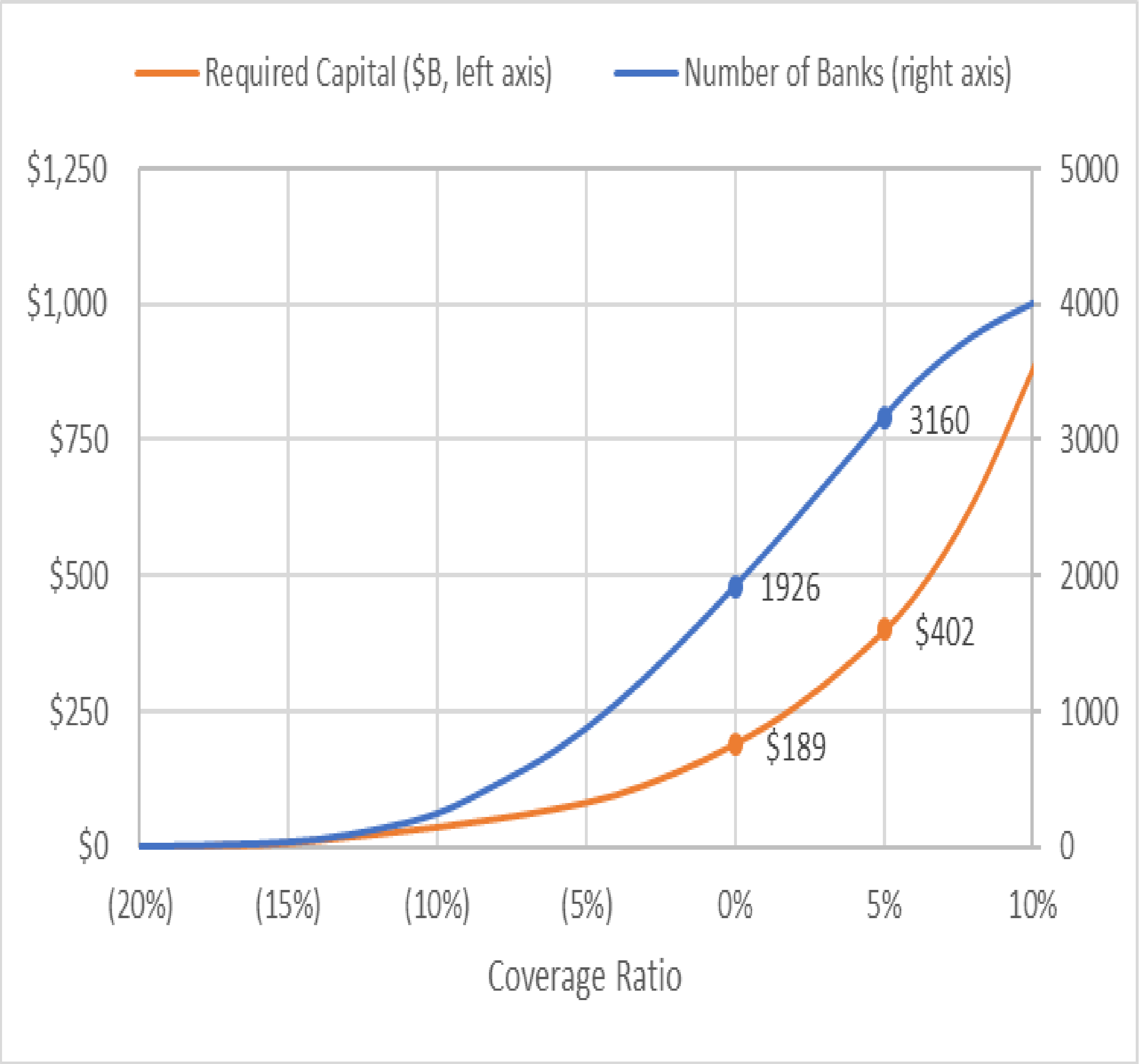
S&L Crisis (1980s)
“Gambling for Resurrection”



How to prevent another run?

"A market test"

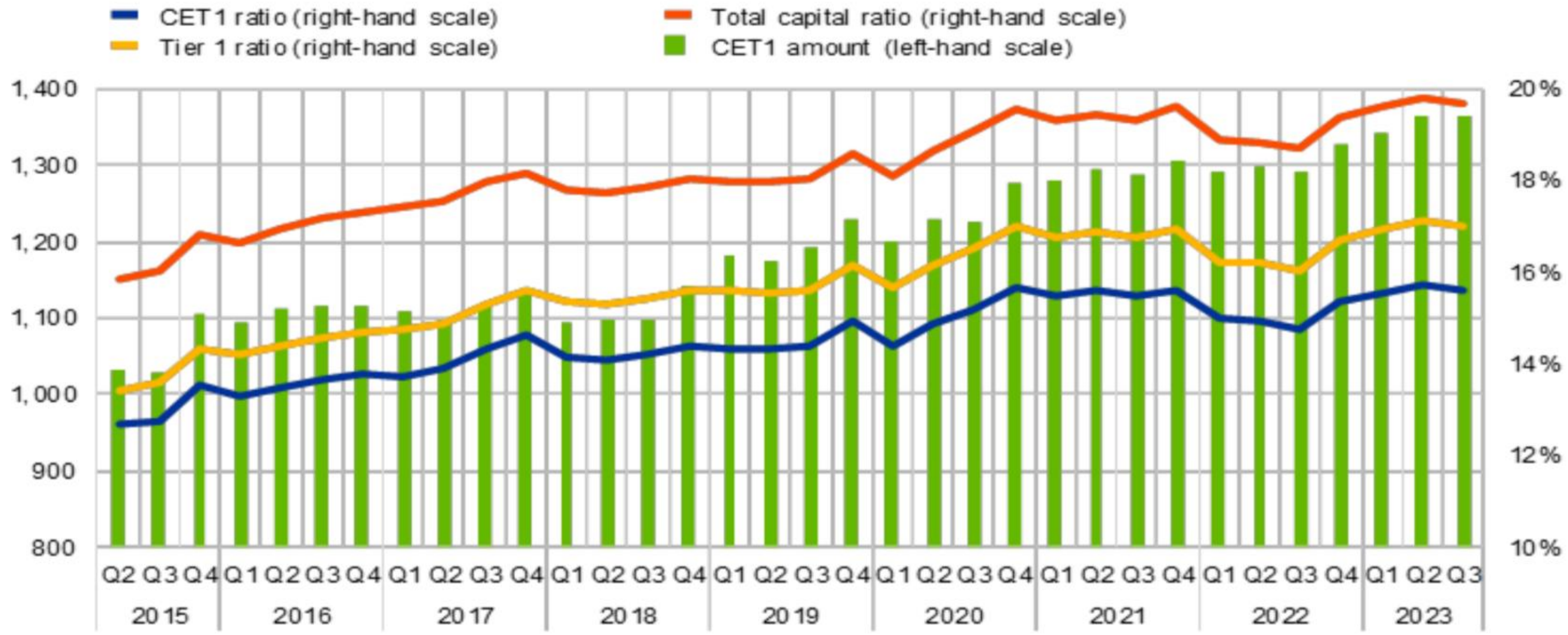
Public data suggests $190 billion to $400 billion in equity would effectively reduce risk of runs



European banks: balance sheets improved

Figure 3.1 Capital ratios and their components

(EUR billions; percentages)

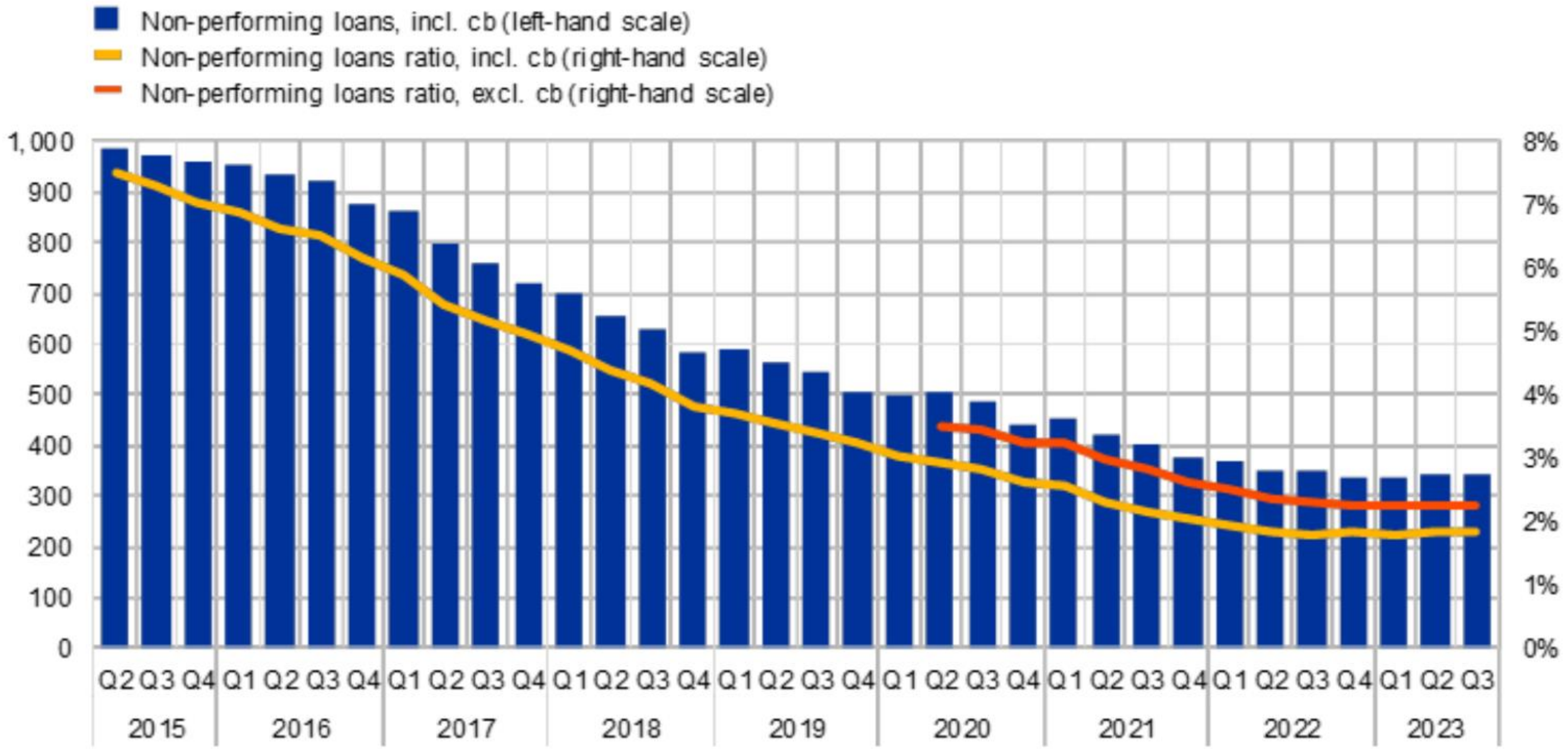


Source: ECB.

Non-performing loans declined

Figure 3.2. Non-performing loans

(EUR billions; percentages)

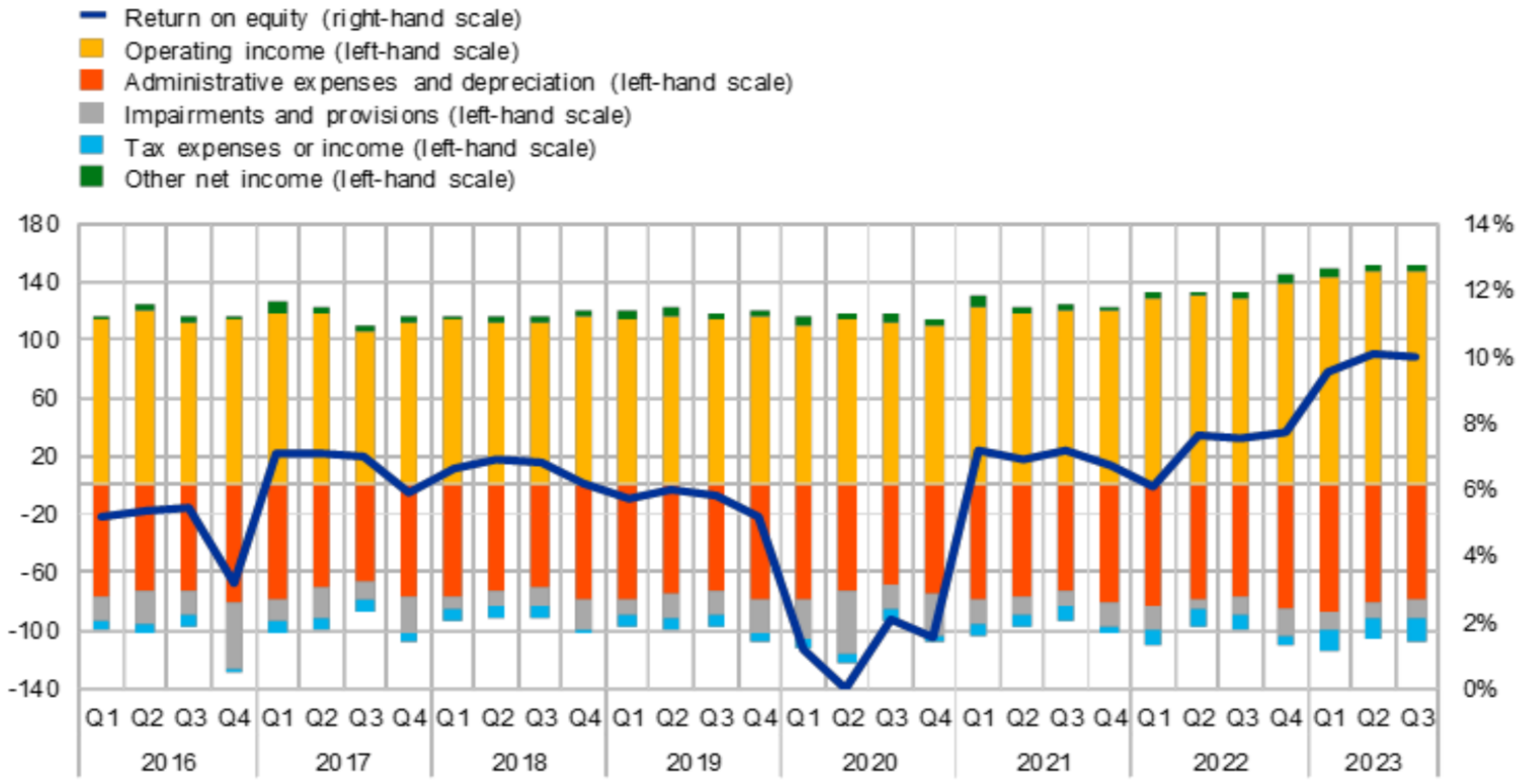


Source: ECB.

Return on equity was low, but with higher interest rates/margins, it and its composition improved over the last two years

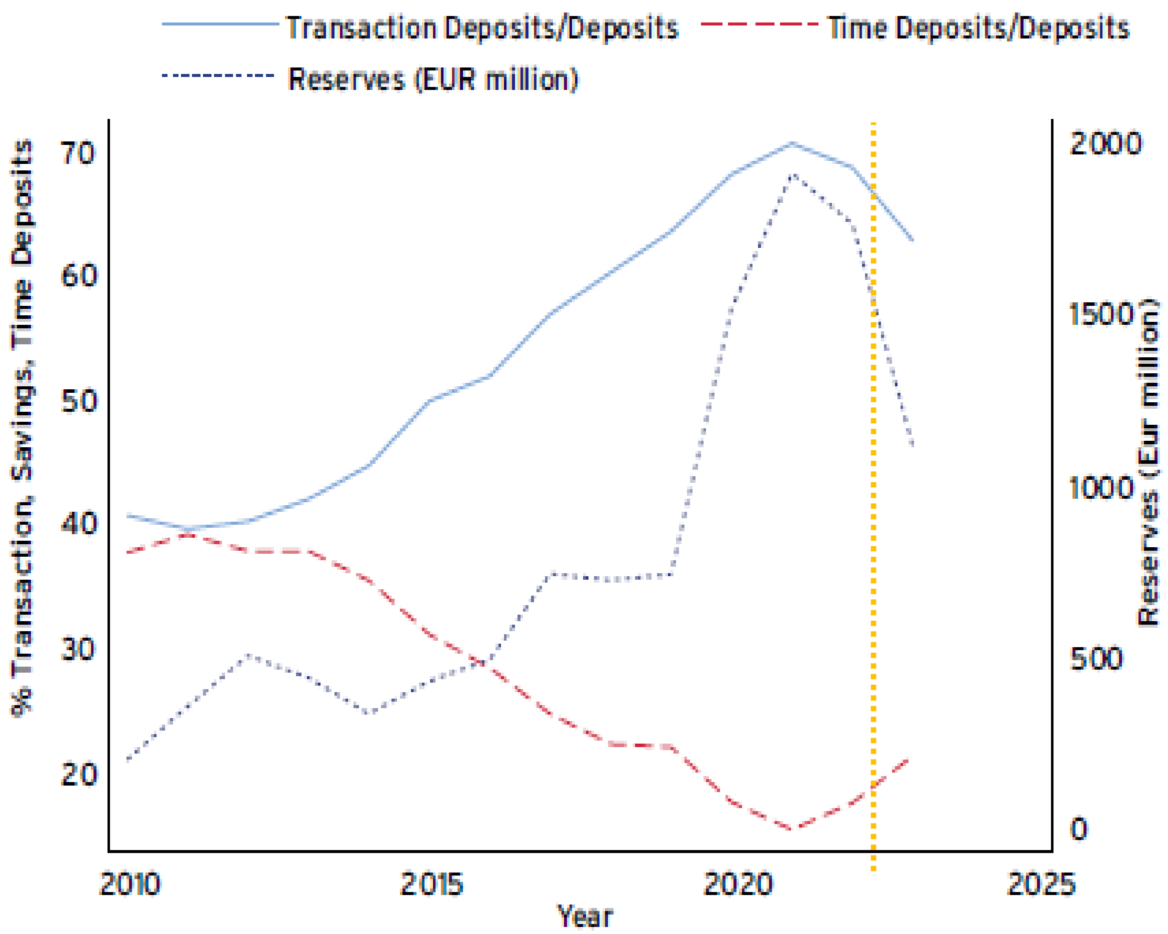
Figure 3.3. Return on equity and composition of net profit and loss

(EUR billions; percentages)



Source: ECB.

Like for US banks, transaction deposits increased after QE
But no runs, in part given limited losses due to interest rate rise

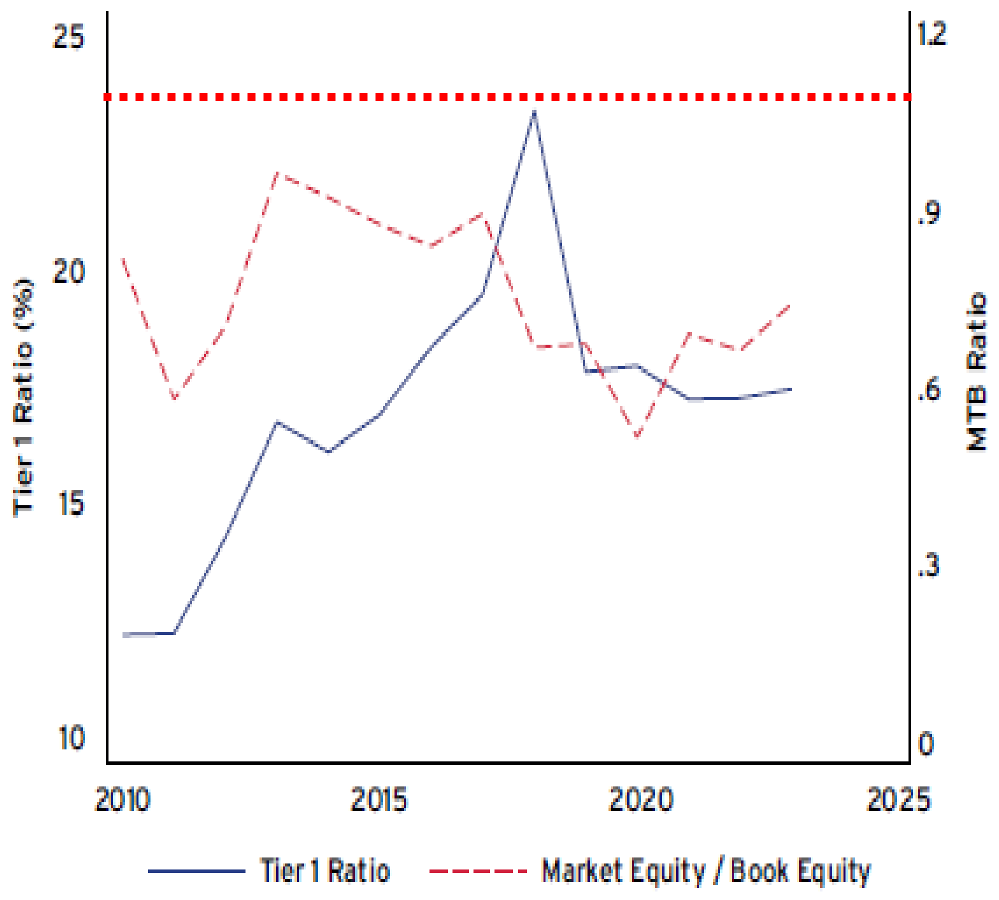


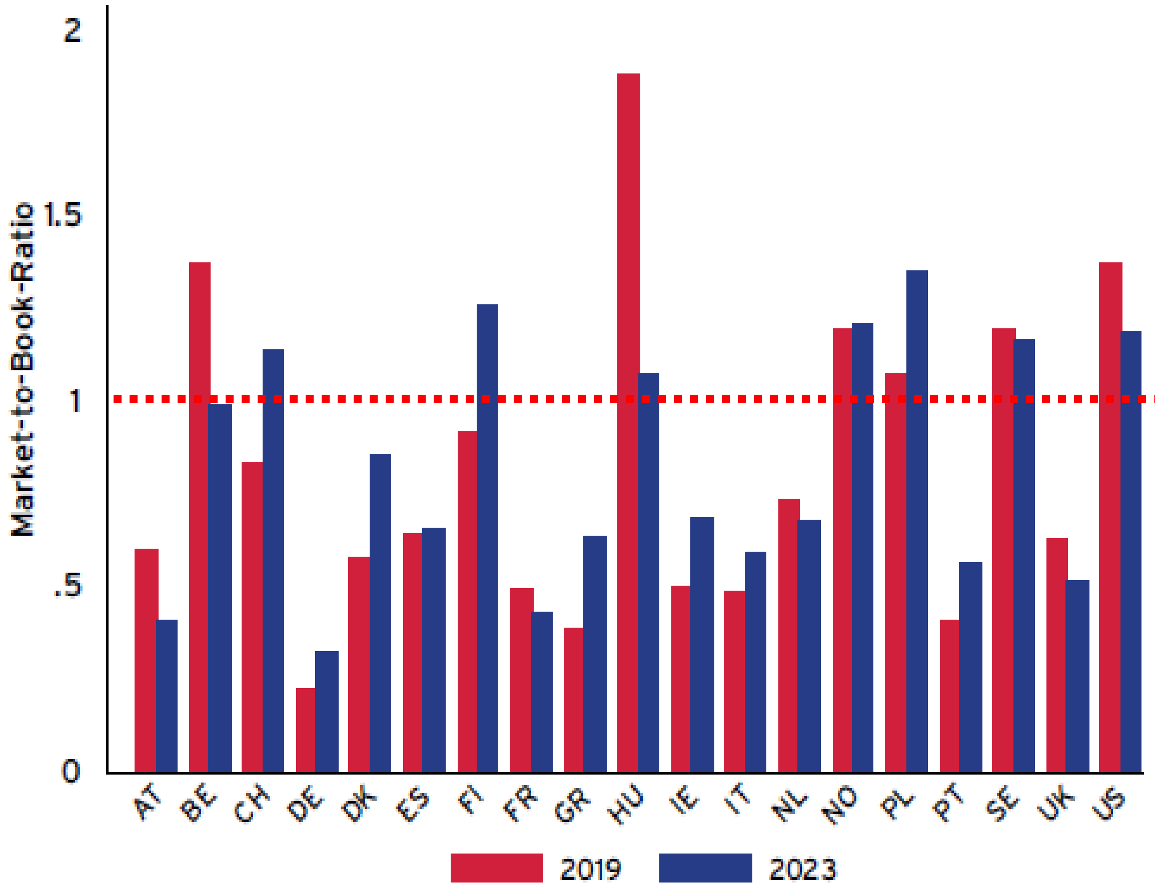
Source: Capital IQ, annual reports

Transaction vs Time Deposits

- Increase in deposits related to increase in reserves
- Shift from time to demand deposits, lowering maturity, higher run risks
- Financial stability risks increase with increase in runnable deposits
- But ample liquidity, limited interest rate risk, and good supervision prevented runs

But market-to-book-ratios still generally below one and less than US
Reflects risks, low profitability, inefficiencies, due to market structure
Credit Suisse shows low MTB <=> slow decline, yet sudden death…





Source: CapitalIQ, own calculations

Roadmap. Coordination and Institutional issues analyzed in chapter 4. Recommendations in chapter 5. Next in red.

Outstanding Issues: US 3.2 and Global
Unfinished reform agenda; Under-capitalization
Weak supervision 4b; Weak GSIBs resolution 4c

Outstanding Issues: euro area 3.1
Incomplete banking union; Sovereign risk & doom loop
Weak deposit insurance and resolution framework 4c

The Banking Turmoil

What role for monetary policy? 4d
Underemphasized links with financial stability

Fixing the eurozone's elusive banking market 4a
Missing a truly integrated banking union