Post-Crisis Areas of Research in Finance and Banking

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It’s difficult to state weather the global financial crisis that started after the fall of Lehman Brothers in 2008 is over or has just entered a new phase. The crisis has spilled over the international markets from the US financial system to financial systems in Europe and beyond. The hectic anti-crisis measures taken to save the financial system resulted in high costs for taxpayers and many lessons have to be learned to not only how to reduce the probability of the next crisis, but also how to effectively apply crisis-management measures. Yet, this at the same time opens many new research fields, worthy of scientific exploration and the need to produce practical policy implications.

First, systemic risk gains in importance on the research agenda. We still have no consensus on what this term encompasses and how to define it [1]. A clear understanding of systemic risk is the key in measuring it, which remains a challenge. There are being proposed many new models and quantitative methods to capture this phenomenon [2], yet they remain at the nascent stage of development and are still untested on a wider sample of data. Developing early-warning systems that would signal the build-up of systemic risk and vulnerabilities in the financial system would be a promising area of scientific ventures. This can be tackled by “marrying” approaches from different fields of knowledge e.g. finance and physics or biology. A network analysis of contagion in banking ecosystems is just one of many bridges between sciences crossing which brings most interesting results [3].

Second, the crisis has resulted in an overhaul of financial system regulations. Already present regulations (especially in the banking sector e.g. Basel framework) are being strengthened and new regulations are being introduced very quickly. However, in the mist of “regulatory tsunami” it is necessary to conduct a thorough cost-benefit and regulatory impact analyses i.e. to what extent they achieve their goals (e.g. financial stability) and what are the unintended consequences? This is a task for economic analysis of law, a booming field of research that might be used to analyze the optimal shape of post-crisis regulations. As an example, the European Commission has started work on this issue i.e. to what extent the new regulatory framework affects the ability of the economy to finance it and grow and what are the interactions and inconsistencies between regulations.

Third, the period after the outbreak of financial crisis has seen the proliferation of new safety net institutions tasked with responsibility for safeguarding financial stability. As Borio from the BIS said “we are all macro prudentialists now” [4]. All over the world new macroprudential authorities are being established with the aim to monitor the health of the system as a whole, as opposed to macroprudential supervisors that are concerned with the condition of particular financial institutions. In the EU the next step in financial integration – the banking union – is taking shape. At the same time we still don’t know how to best conduct the macroprudential policy, how to use macroprudential tools and what their effectiveness is, and how to coordinate it with other economic policies. There are first attempts to provide a comprehensive framework for understanding macroprudential policy but there are still a lot outstanding issues [5].

Last but not least, as several years have already passed since the fall of Lehman, it is necessary to objectively take stock of the crisis-management methods and assess their effectiveness. The interest rate policy of central banks has reached the Zero Lower Bound. As this was not enough to spur economic growth, increasing number of central banks are now applying negative interest rates. The question remains open to what extent they are a blessing or a curse for the financial system, especially should they persist for a longer period of time. Other central bank actions which need to be evaluated include non-standard monetary policy measures, specifically quantitative easing programmes implemented by the world-leading central banks and their impact (or lack thereof) on the financial markets and the economy. Further, it is also time to reflect on the best way to deal with failing banks and conduct resolution procedures. We need to know that types of state aid measures are the most effective in a given case, what their costs are and how to best minimise the contagion of banks’ default [6].

Summing up, these are only a few streams of research worth of scientific exploration which were “opened” by the global financial crisis. It is both the opportunity and the responsibility of researches to tackle those topics in order to contribute to the early identification of systemic risk, its measurement and mitigation, as well as containment of future financial crises.

References

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