DG EcFin Fellowship Initiative

Moving closer, rather than drifting apart (?)

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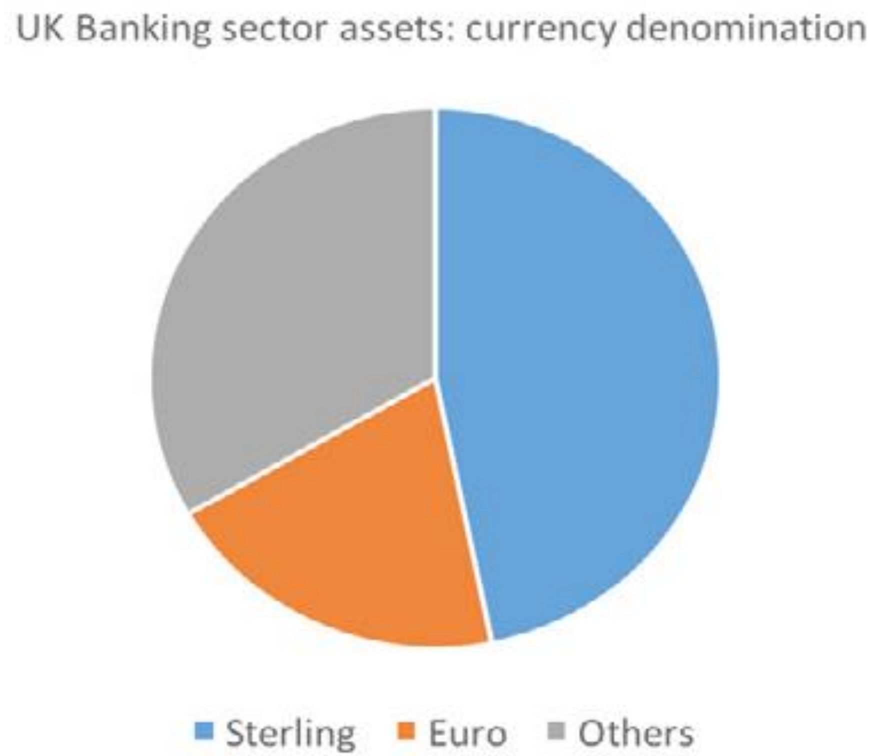
National Institute of Economic and Social Research

What has changed with Brexit?

- UK will no longer be under legal judgements of ECJ – but will try to maintain EFTA Court
- EU financial infrastructure mostly defined by EFTA and not Eurozone
- Central bank swap agreements do not require economic, political or monetary union
- Passporting: problems will start with BRRD but eventually extend to MIFID
- Politics

UK is the global financial centre

Figure 2: Currency denomination of banking assets (2015)



Source: Armstrong (2016)

The British Dilemma

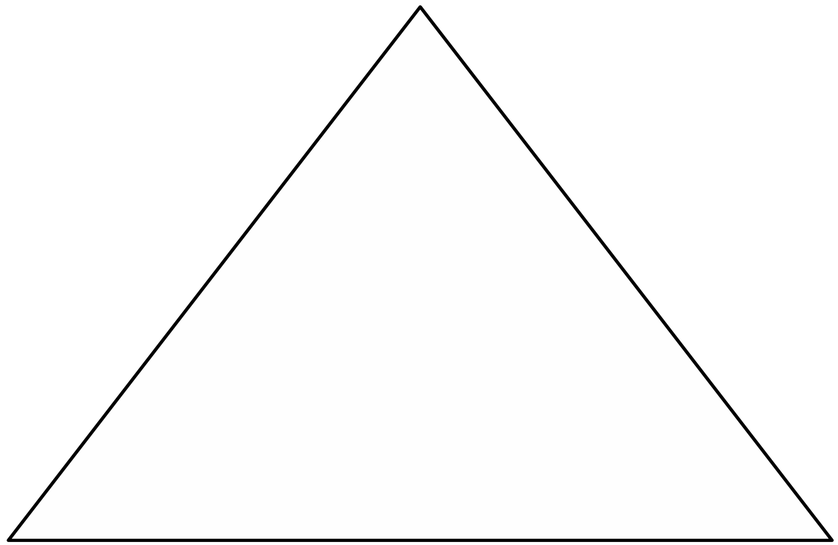
Table 1: UK financial sector by residency (2014)[7]

	£bn	% of GDP
UK banks	3,631	200%
Foreign banks	3,374	186%
Finance cos & SPVs	480	26%
Pension funds	1,430	79%
Insurance	1,830	101%
Unit, investment trusts & ETFs	880	48%
Hedge funds & private equity	760	42%
	12,385	682%

Source: Armstrong (2016)

GSIBs create a financial trilemma

1. Financial stability



2. Financial integration

3. National financial policies

Source: Schoenmaker (2011)

Advantages of having GSIBs in City

- Economies of scale from financial ‘eco-system’ – Eurozone companies use City
- Institutional alignment of supervision, tax authority and provider of LOLR
- Supervisory advantage of PRA

Dis-advantages of having GSIBs in Euro

- EBU is incomplete and unlikely to deliver effective risk sharing
- Germany is only logical centre (surpluses) but will worsen Euro imbalances
- LOLR remains a national competency
- Loss of economies of scale

Research question

- Economic rationale for GSIB risk sharing model is the coordination problem between states

(a) How much GSIB risk could be diversified <u>under different risk-sharing rules</u>?

- *Bank level data (branches & subs) available on a quarterly basis (BIS data by bank)*

(b) What is the cost of fragmenting banking in EU?

- *Are branches more efficient than subs? (E.g. Cerruti, IMF)*

Concluding thoughts

- Is allocative (Pareto) efficiency the appropriate metric for finance or we in third best world?
- Are GSIBs complements or substitutes for capital markets?
- What is economic rationale for free movement outside a single currency zone?

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