

20100903 Bank for International Settlements: Strengthening the financial system - comparing costs and benefits (Stephen G Cecchetti Speech)

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Remarks by Mr Stephen G Cecchetti, Economic Adviser and Head of Monetary and Economic Department of the BIS, prepared for the Korea-FSB Financial Reform Conference, 3 September 2010

Abstract

The best way to prevent instability from spilling from one country to another is by preventing instability in the first place, which in turn calls for strong regulatory standards. Financial regulation is necessary because, left to their own devices, banks hold too little capital and liquidity. Stronger standards for both should provide benefits from the day they are announced. These benefits, and the associated costs, have recently been estimated by the BCBS long-term economic impact (LEI) working group and by the FSB/BCBS Macroeconomic Assessment Group. The LEI found that raising the capital ratio by one percentage point from its average pre-crisis level, while also strengthening liquidity standards, should cut the probability of financial crises roughly in half, producing an estimated benefit of 1.6% of GDP. As for the costs of such a measure, the MAG estimates that, for each percentage point increase in the target capital ratio implemented over a four-year horizon, the level of GDP relative to the baseline path declines by a maximum of about 0.19%. The associated rise in banks' lending rates would amount to about 15 basis points for each percentage point increase in capital. These costs will slowly dissipate during and after the phase-in, returning GDP to the path it would have followed in the absence of the changes. The impact of the new regulatory framework on specific national financial systems will depend on current levels of capital and liquidity in those systems, and on the consequences of changes to the definitions used in calculating the relevant regulatory ratios. Spillovers from the transitional impact of tighter standards should be modest, though they are likely to be higher for emerging economies than for advanced ones. These results imply that the reforms proposed by the Basel Committee are likely to have, at most, a modest impact on aggregate output, especially if the new standards are phased in over an appropriate transition period.

To view the full speech click [here](#).

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