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Perspective

Knowing the Measures of Banking Stability

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DESCRIPTION

Banks are closely connected with our everyday lives and activities. Drawing salaries, paying bills, shopping for homes, building up savings, and taking out loans all involve transactions with banks. Businesses also rely on the banking system for the settlement of their transactions and meeting other financial needs. Banks additionally interact among themselves in a global network to deliver financial services to their overseas as well as local customers. The links among banks and also the fact that banking stability is basically founded on public confidence mean that issues of one bank will easily spread to other banks and financial institutions. Any massive disruption of banking operations can have an effect on society as a whole. Banking stability is, therefore, crucial to minimizing the extensive economic and social impact that will arise from problems in the industry.

The recent financial crisis caused an enormous cost to the world economies and despite quite substantial research and analysis; there are diverging views about the exact genesis and causes of the crisis. Some of the research analysts have attributed the accommodative financial policy pursued in the USA as a significant reason behind the crisis. Lack of regulatory oversight of non-bank financial intermediaries, ascribed as shadow banking, is considered to be the main cause by another group of analysts. There are views that the lax lending standards in the sub-prime mortgage markets enabled the continuation and acceleration of the financial crisis. A number of economists have attributed the financial crisis as a consequence of huge global imbalances. Amongst all these various opinions and views, there is, however, unanimity that the real act of the financial crisis was enacted in the courtyard of the banking sector where the trigger of the financial crisis initially happened. It is perceived that fragile conditions prevailing in the banking sector were allowed to persist for a much longer period. In order to obviate the occurrence of such a crisis in the future, there are a lot of emphases to monitor the broad problems with financial stability as well as banking sector stability. There are combined efforts being made by the international organizations, like International Monetary Fund, BIS, World Bank, etc. and individual central banks, to evolve various leading indicators of the financial stability, including that of the banking sector, so as to make an informed judgment about the evolving risks to the financial system and initiate corrective policy measures a priori. As banks are the very important components of any financial system, the stability of the banking sector has become a paramount policy initiative worldwide.

The issue of financial stability is organically connected with banking stability. In fact, the historical evidence demonstrates that that financial crisis that had stronger involvement of the banking sector had a more devastating impact on the real sector in terms of fall in real output and reduction in employment level. The financial crisis of 2007-08 was no exception. The theoretical analysis of the events that preceded the financial crisis proves amply that whatsoever may the origin of the financial crisis be, its trigger took place in the banking sector. There is also evidence that the financial crisis persisted for a longer period because of drawbacks in the banking sector that went unnoticed for a longer period. In view of those developments, there is an additional emphasis to confirm the stability of the banking sector by strengthening regulatory norms, focusing on inquiry on the leading indicators of banking stability, and preparing a banking stability map and banking stability indicator.

Banking stability could be a yardstick to determine whether an economy is sufficiently strong enough to withstand both internal and external issues. On the other aspect, financial stability could be a by-product of stability conditions prevailing in the areas of banking, financial market, and also the real economy. Out of the three, banking stability conditions emerge as a significant ingredient to financial stability in a country. Banking stability in itself depends on the efficacies of the several parameters of individual banks, like asset quality, liquidity, capital, prices return on assets, etc. Though, the stability of the banking sector gets affected positively or negatively with the conditions prevailing in the financial market and the real economy; ultimately it determines as to what extent financial stability is ensured in the economy by its ability to absorb the issues. The stability of the banking sector may, therefore, be treated as a forerunner of financial stability in an economy.

In view of these developments, in the recent period, central banks and other superior authorities have started frequently assessing things in the banking sector with a focus on how the sector will evolve in the medium term. Initially, the issue of banking stability was covered under the arena of the banking crisis, which was based on the binary variables, signaling whether a banking sector is in crisis or not.

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