KATEDRA HOSPODÁRSKEJ POLITIKY | CENTRUM PRE EKONÓMIU A FINANCIE | NÁRODNÁ BANKA SLOVENSKA EUROSYSTÉM

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Bailouts And Moral Hazard: How Implicit Government Guarantees Affect Financial Stability

Abstract

The recent crisis has shown that systemically relevant banks in distress are likely to benefit from governmental support. This reduces their downside risk and leads to moral hazard, i.e. to incentives for these banks to assume excessive risks. In this paper we show empirically that implicit guarantees lead to more leverage and to a lower quality of bank capital; furthermore, we investigate which institutional characteristics are associated with a reduction in moral hazard. Our analysis combines bank balance sheet information from 92 countries with Fitch Support Ratings and World Bank survey data on governance and regulation. We find that a higher likelihood of being bailed out is associated with higher leverage and with lower levels of common equity. We find that external auditing, regulating the range of banks' activities, and restricted access to Lender-of-Last-Resort facilities reduce moral hazard; financial sophistication, instead, appears to be conducive to risk-taking. We also find the moral hazard effect to be stronger after the Lehman default.

Venue: University of Economics in Bratislava, room C1_07
Dolnozemská cesta 1, Bratislava

Date: March 12, 2014

Program:
14:50 registration
15:00 Mike Mariathasan: Bailouts And Moral Hazard
16:30 coffee