



Banking Union and Financial Stability



But what is...?

Bank Regulations are meant to ensure that banks are safe and do not take on excessive risk. Many rules pertain to capital requirements, liquidity, lending standards and reporting.

Sovereign debt is debt issued in the form of bonds by a government to finance its budget. For regulatory purposes, sovereign debt is usually considered a risk-free asset.

Recapitalization is process of saving a troubled bank by the injecting new equity into the bank. Ideally, the private sector provides the money, but sometimes governments, and hence taxpayers, are called upon to contribute.

Banking Union refers to a set of policy reforms that will further integrate national banking sectors through more unified supervision, new rules governing bank resolution and a "single rulebook".

Moral hazard can occur when someone takes on more risk because someone else bears the burden of those risks.

A well-functioning banking system is crucial to the success of the economy. Banks handle payment systems, provide growing firms with credit and help people save money. But banks may make poor lending decisions and can pose risks to economic stability and government budgets. Given that economies are interconnected, problems in in one country's banks can spread to others. What can be done to ensure that banks help the economy grow without creating large risks for taxpayers?

- ① What are the core functions of a bank? How do banks help support economic growth and employment?
- ② What is a bank run? Why are banks vulnerable to a loss of confidence? What policy instruments are used to help prevent bank runs?
- ③ Who supervises banks in the euro area? What regulations are used to make banks safer and promote financial stability? What is meant by 'too big to fail?' What are 'safe assets?'
- ④ Describe the current state of the banking sector in your chosen country. Has the government needed to provide assistance to banks? How has this affected the country's fiscal situation and levels of outstanding sovereign debt?
- ⑤ What happens when a bank becomes insolvent? How can banks be resolved without hurting the broader economy? Should some creditors (like retail depositors) be protected? What circumstances might push governments to help recapitalize banks? What consequences might arise?
- ⑥ What is financial contagion? How have the single market and European monetary union transformed the European banking sector?
- ⑦ What are the major features of the EU Banking Union? How will Banking Union promote financial stability and prevent cross-border contagion?
- ⑧ What role does the banking sector play in transmitting monetary policy? How do low interest rates affect borrowing and the provision of credit?