



Varieties of Bank Based Systems: The interaction and intersection of banks, housing, and pensions in two small open European Economies, Ireland & Denmark

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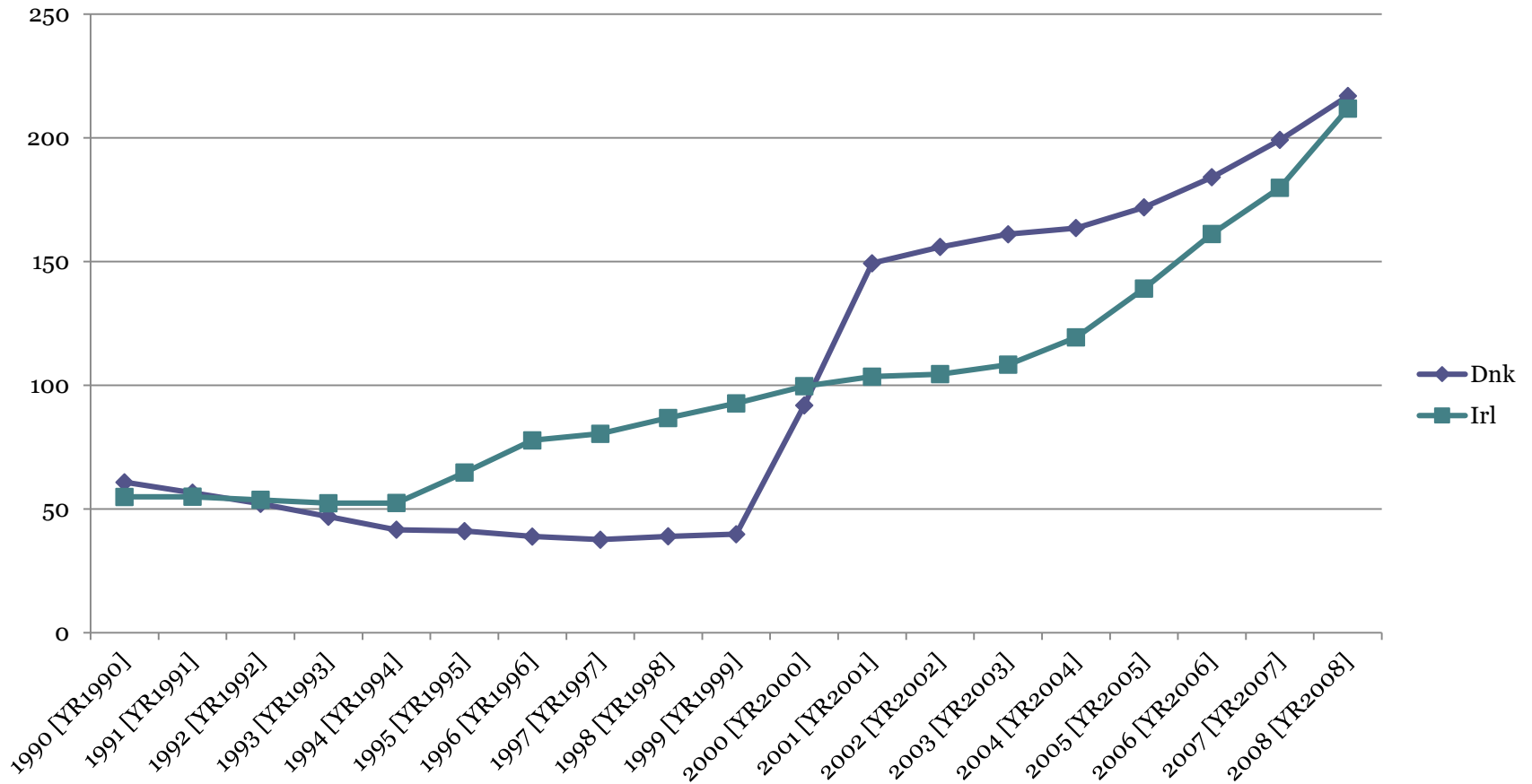


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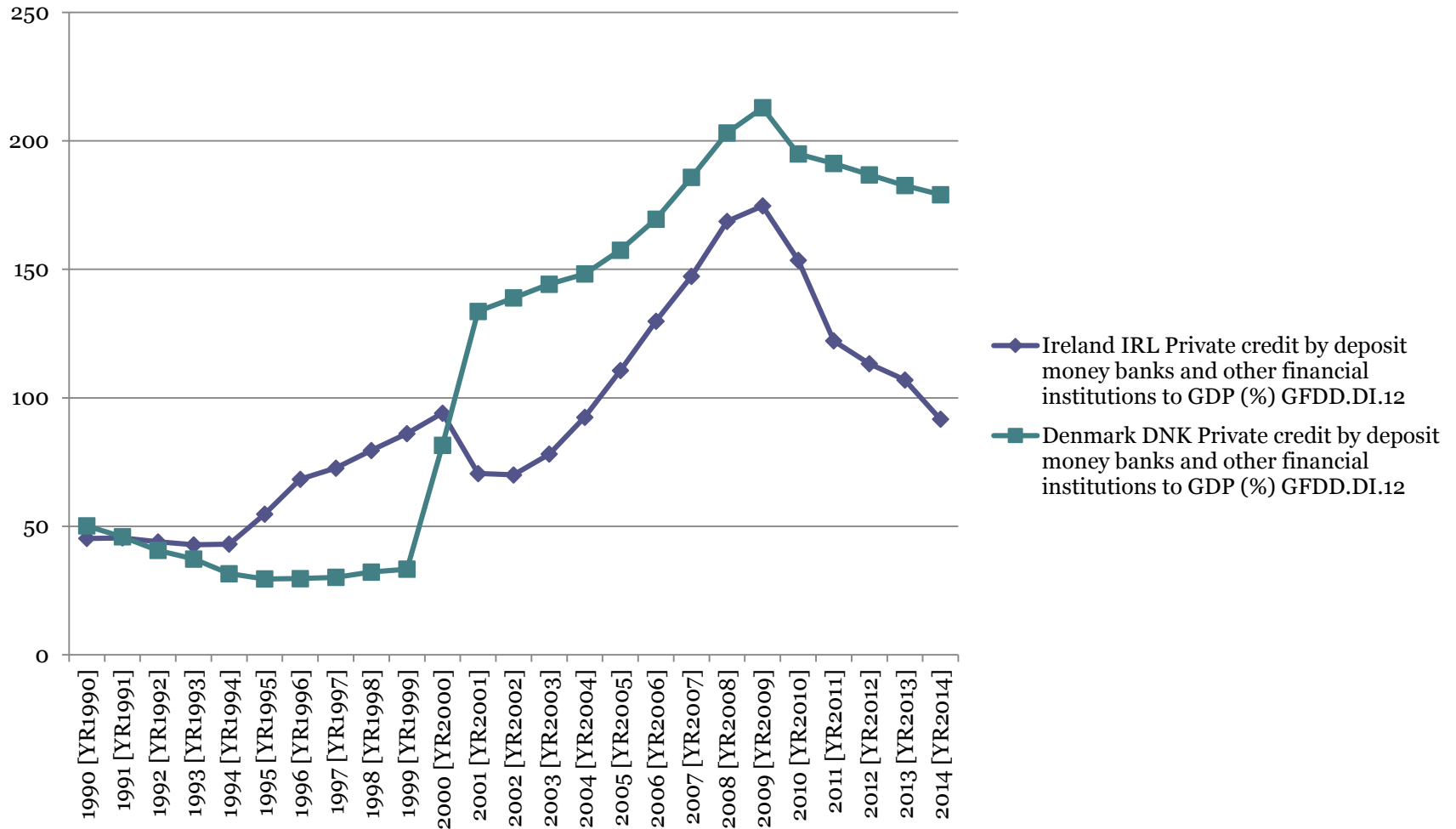
The Story of Two Financialisation That *LOOK* Very Similar

- Considerable Financial Development & Financial Liberalisation.
- Emergence of Market Based Banking (Financialised Banking) in Both Economies.
- Home Grown Housing Market Bubble.
- High Credit to GDP and Associated HH Debt levels.
- Severe Financial Crisis.

Growth of Two Large & Powerful Financial Sectors: *Bank Assets / GDP*



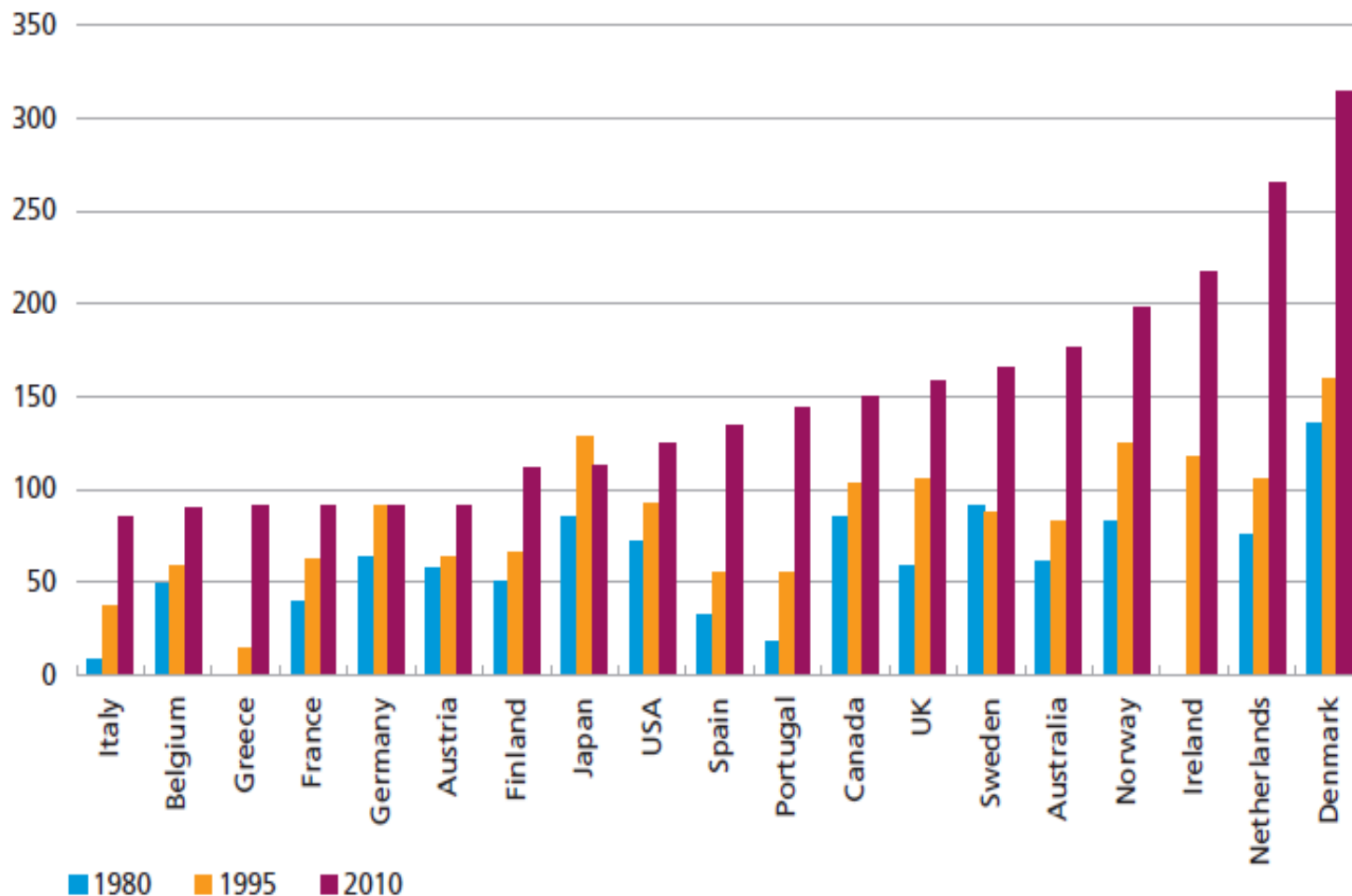
Credit / GDP



HOUSEHOLD GROSS DEBT

Chart 3

Per cent of disposable income



Note: For Germany 2010: The data refer to 2009. For Norway 1980: The data refer to 1987.

Source: OECD. Cecchetti et al. (2011) and national central banks.

Key Puzzles'

- National development, structure, and practices within the financial Sector.
- What drove the Growth in Lending on the Demand side?
- How have Banks Funded this Growth in Lending?
- Is the Debt in Ireland the same as the Debt in Denmark?
- Systemic crisis in Ireland, Crisis Limited to Commercial Sector in Denmark, Why?
- Credit Collapsed in Ireland, Whilst Credit Continued To Flow In Denmark, How?

Varieties of Bank Based Models

- This is not a case of bank Vs market forces, indeed if taken on traditional measures both systems have become more bank based.
- The model of Market based banking captures the new practices evident in both economies but how do we explain the key differences. (Hardie et al 2010)
- Change is captured by the Varieties of Market Based Banking which have emerged in both economies.

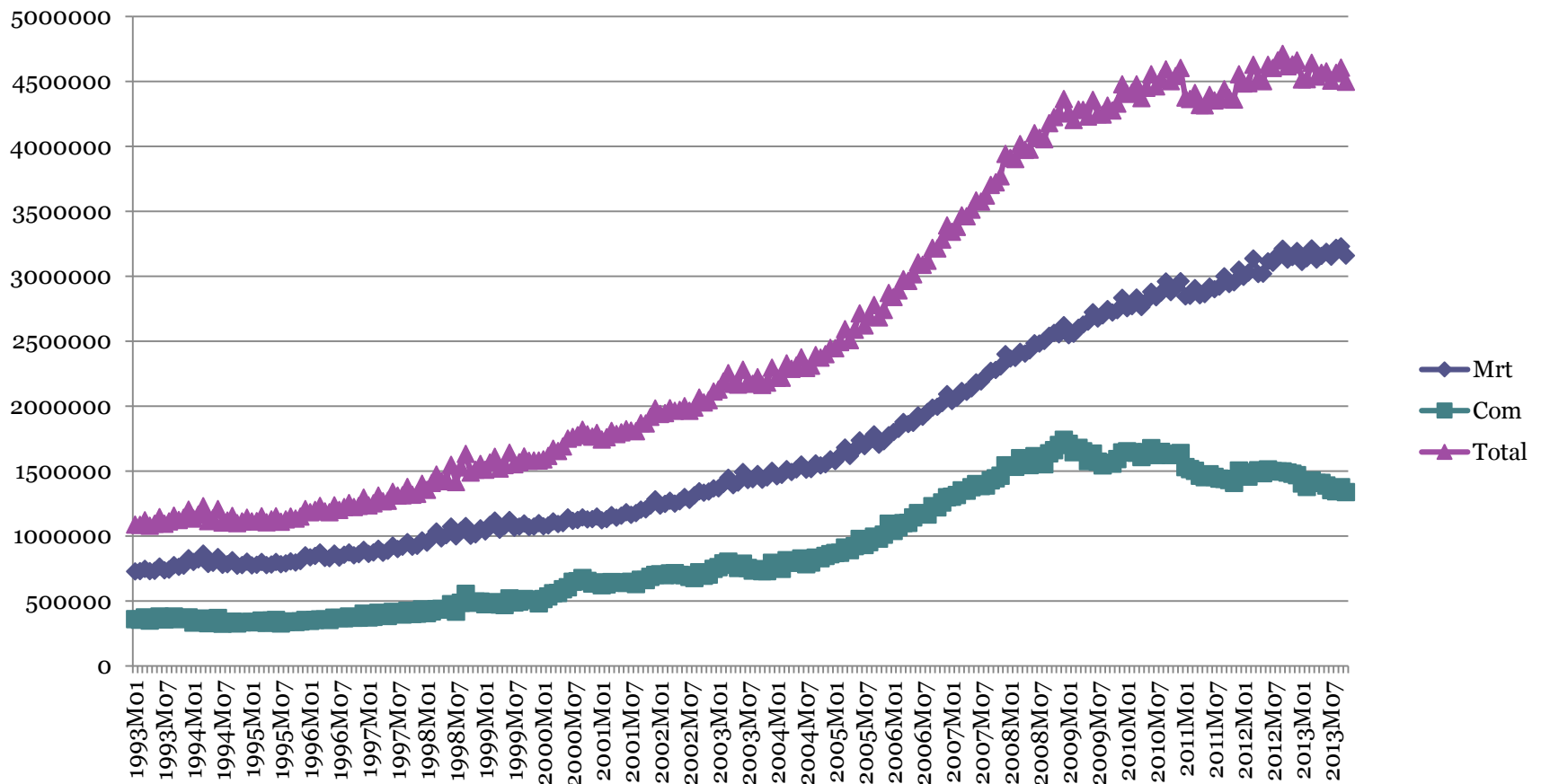
Varieties of Market Based Banking

| Banking | Practice | Development | Financial Sectoral Organization |
|---------|---|--|---|
| Ireland | <ul style="list-style-type: none"> • Credit/GDP High • New Bank Funding <ul style="list-style-type: none"> ○ Funding Gaps <ul style="list-style-type: none"> ▪ More Bank Based, primarily foreign capital. ○ Securitization (Shadow Banking) • De – Regulation • Majority of Risk Concentrated in a small number of large banks. | <ul style="list-style-type: none"> • Under Developed • Growth Through property and mortgage based lending in commercial banks. • EMU removal of exchange rate risk. • Large presence of foreign banks, growth in lending activity driven by competition and de-regulation of lending conditions. | <ul style="list-style-type: none"> • No separation between mortgage, commercial and real estate lending. • Dis-jointed pension industry with no national investment strategy • Non coordinated response to crisis . • Bonus culture, share holder value and yes culture. |
| Denmark | <ul style="list-style-type: none"> • Credit /GDP High • New Bank Funding <ul style="list-style-type: none"> ○ Pass Through Securitization (Mortgage Sector) <ul style="list-style-type: none"> ▪ More Market Based, primarily national capital. ○ Funding Gaps (Commercial Sector) • Highly Regulated • Risk spilt between market and small number of large banks. | <ul style="list-style-type: none"> • Well developed, experience of prior financial crisis. • Growth through Consolidation, followed by asset based growth. • National mortgage banks, growth in lending through product innovation in the mortgage sector. • Largely national Banks in commercial sector. | <ul style="list-style-type: none"> • Erosion of sectoral barriers, but continued separation across mortgage and commercial activity. • Large coordinated pension industry, with clear national investment strategy. • Coordinated response to crisis. • No bonus culture, |

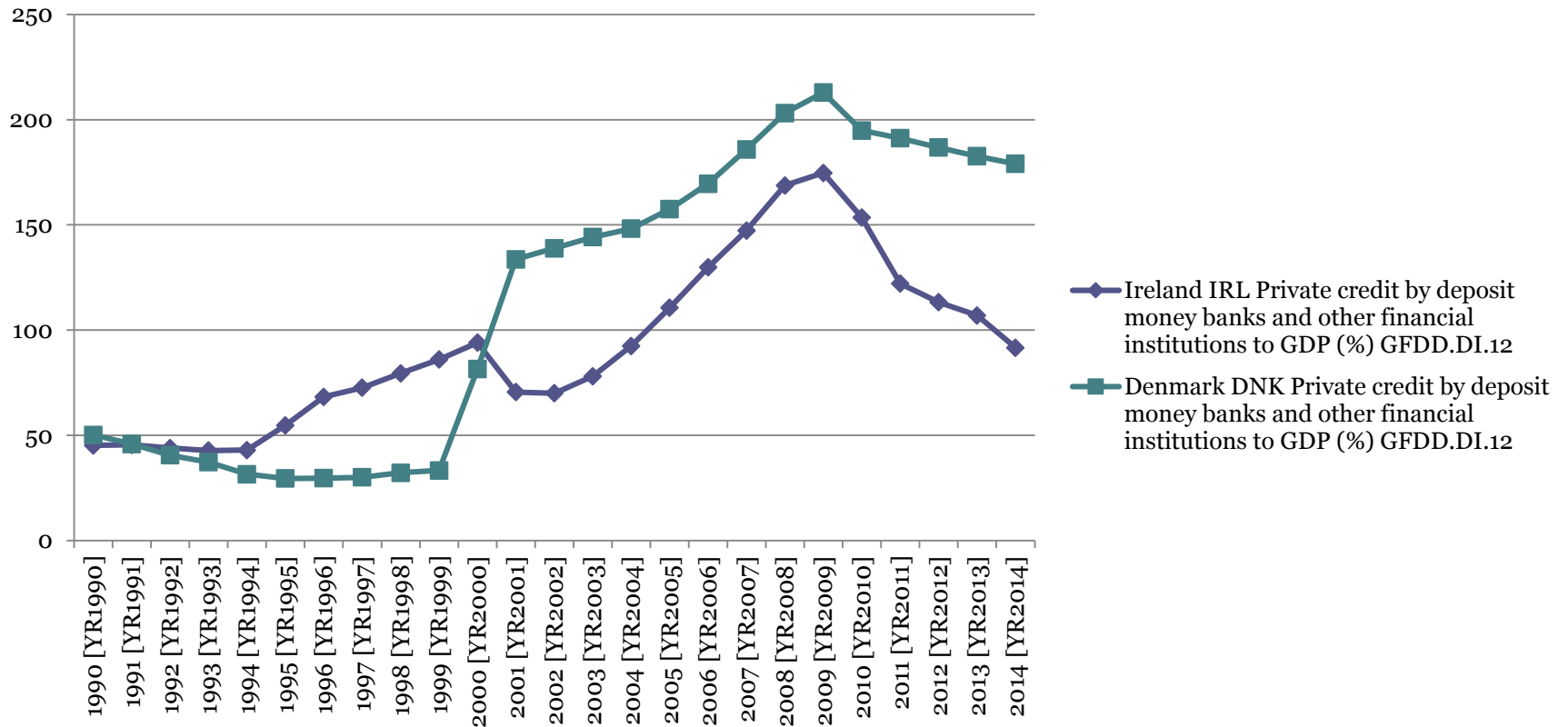
Banking Practice

| | Ireland | Denmark |
|--|---|---|
| | <p>Under Developed / Passive</p> <ul style="list-style-type: none"> • New Bank Funding <ul style="list-style-type: none"> ○ Funding Gaps <ul style="list-style-type: none"> ▪ More Bank Based, primarily foreign capital. ○ Securitization (Shadow Banking) • Drivers of Growth: De – Regulation & Competition. • Majority of Risk Concentrated in a small number of large banks. Banks shoulder both the credit and marker risk. | <p>Well Developed / Passive</p> <ul style="list-style-type: none"> • New Bank Funding <ul style="list-style-type: none"> ○ Pass Through Securitization (Mortgage Sector) <ul style="list-style-type: none"> ▪ More Market Based, Covered Bonds, Primarily National Capital. ○ Funding Gaps (Commercial Sector) • Highly Regulated • Driver of Growth: Financial liberalisation & Pro Cyclical Tax Policy. • Risk spilt by sectoral barriers and then between market and small number of large banks who only bear the credit risk. |
| | | |

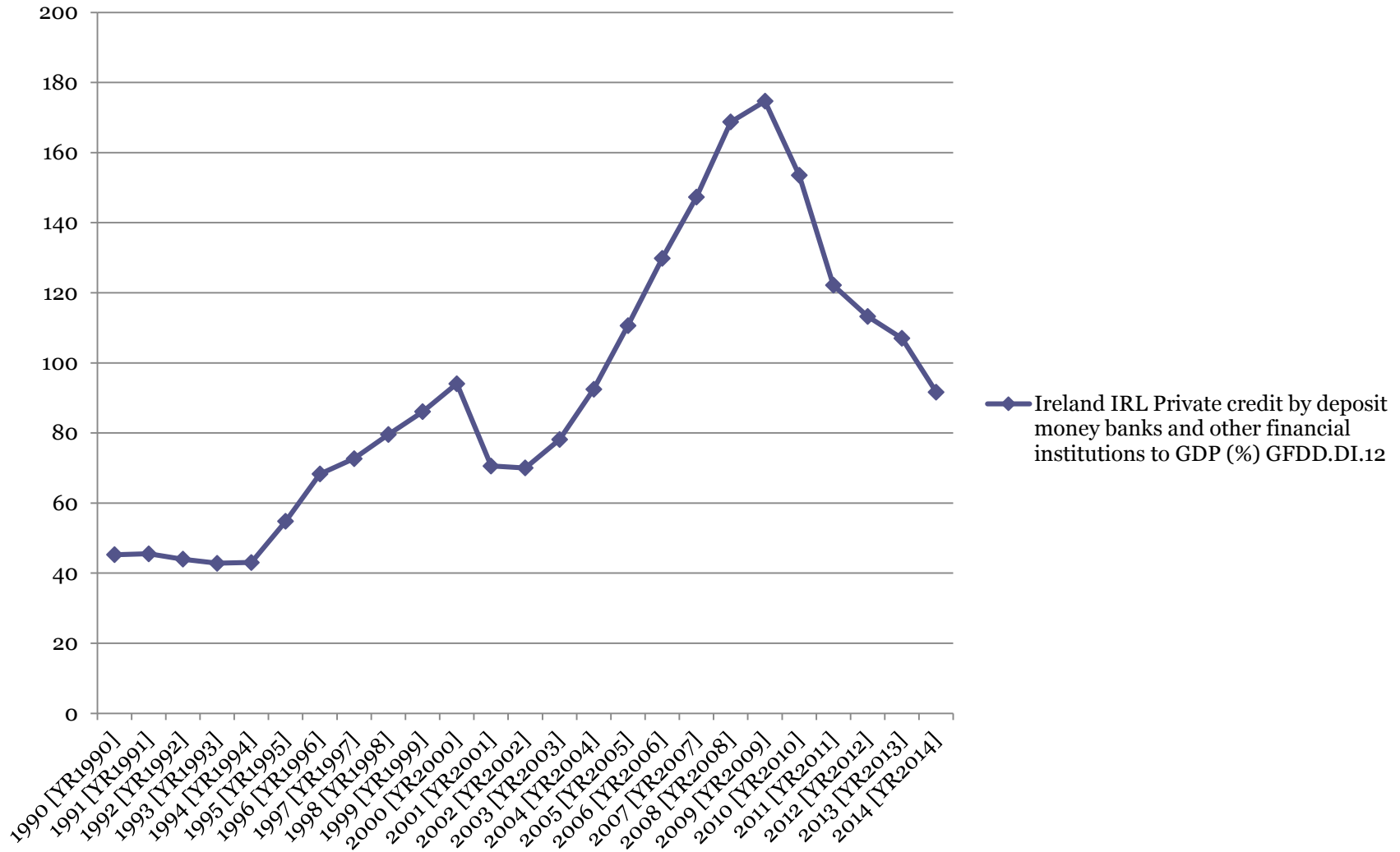
Separation of Comm & Mort Lending Dnk



Private Credit / GDP



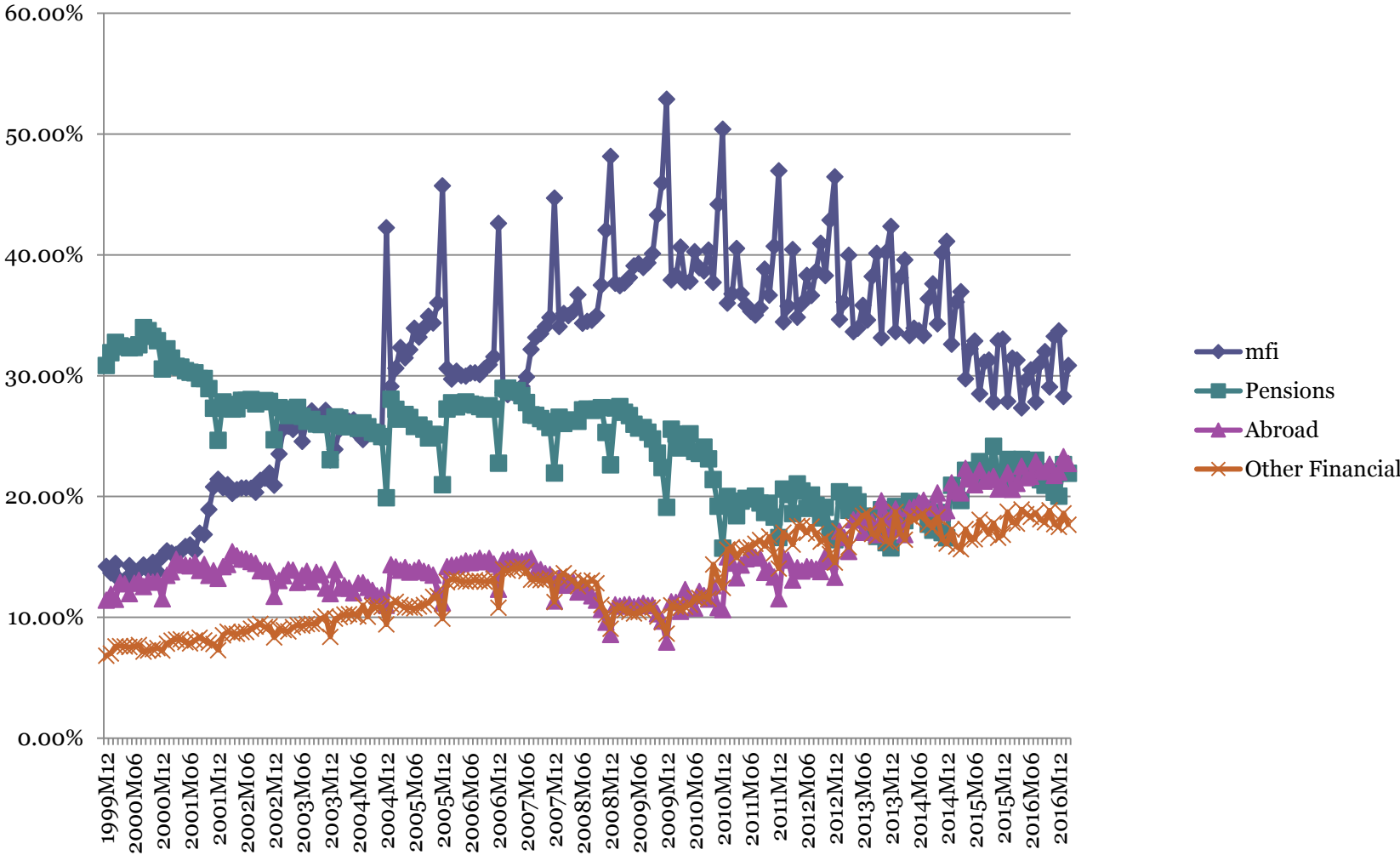
Ireland IRL Private credit by deposit money banks and other financial institutions to GDP (%) GFDD.DI.12



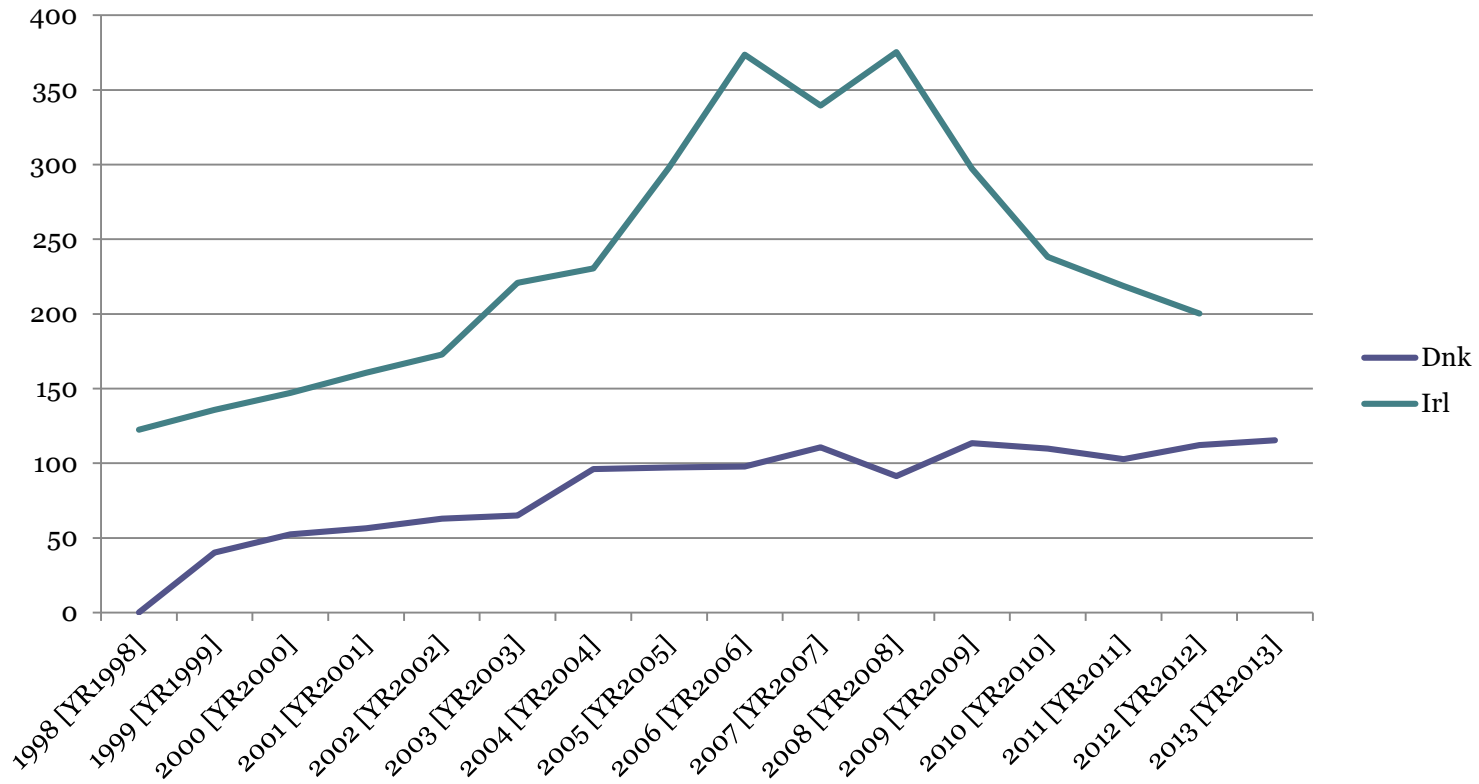
Banks & Pensions

| | Ireland | Denmark |
|--|--|---|
| | <ul style="list-style-type: none">• Disjointed pension industry, 127,000 individual pension funds.• Mortgage securitization sold as MBS, through shadow banking sector.• No large national investors in mortgage debt. | <ul style="list-style-type: none">• Large coordinated pension industry, with clear national investment strategy.• Pensions also work as a balance of wealth for the Build up of HH Debt.• Securitized Mortgage bonds are systemically important to money market.• large presence of national investors in mortgage debt. |

Funding of Dnk Mort Bonds



Consolidated Claims of Foreign Banks Ratio to GDP



Banks & Housing

| | Ireland | Denmark |
|---------|--|--|
| Debt | <p>Growth in lending from 2002 onwards driven by BTL.</p> <p>Debt has been located in the mid and lower income deciles, first time buyers very badly affected.</p> <p>Large landlord class emerging.</p> | <p>Growth in Lending Driven by Home Buyers and Re-Mortgage.</p> <p>Debt has been located in the upper income deciles.</p> |
| Housing | <p>Welfare Retrenchment and demand based housing welfare.</p> <p>Large private rental market.</p> <p>Privatisation of social housing provision</p> <p>Favours favourable housing market speculation</p> | <p>Welfare Stability</p> <p>Alternative affordable housing available.</p> <p>Regulation and taxation which rules out speculative housing markets or second home ownership.</p> |

The Concepts of *Risk & Insurance*

| | Irl : Risks | Dnk: Risk & Insurance |
|---------|---|---|
| Banking | <ul style="list-style-type: none"> • De Regulation of lending Conditions increased risk to borrowers. • Commercial banking exposed to both mortgage and real estate debt. • <i>Funding gaps expose banks to run by other financial investors who are even more un stable than depositors.</i> | <ul style="list-style-type: none"> • Continued Regulation. • Continued separation between mortgage and real estate lending. • <i>Stability of funding in mortgages given the presence of large national blocks of investors.</i> • Funding gaps expose banks to run by other financial investors who are even more un stable than depositors but largely separated from mortgage borrowers. |
| Macro | <ul style="list-style-type: none"> • <i>Financialisation driven by Capital inflow from the core nations proved very un-stable.</i> • Presence of a large number of <i>foreign banks</i> driving competition on price. • Speculative housing market covering all area's including social housing. • Debt is concentrated in lower income households and BTL speculators. | <ul style="list-style-type: none"> • <i>Financialisation driven by national capital, located in pensions, finance foreign capital.</i> • <i>National banking system</i>, growth driven by product innovation, price is dictated by the <i>Market</i>. • Speculative Market for homes, no welfare retrenchment and continued presence of non speculative housing alternatives. • Debt is concentrated in upper income deciles (<i>who can afford it</i>) |

Form of Financialisation

| | Ireland | Denmark |
|--------------------------|---|---|
| Banking | More Bank Based but Driven by Market Forces . | More Market Based Driven by Planned policy change. |
| Housing | Speculative Housing Market | Coordinated Housing Market Which Includes a Speculative Market for Homes. |
| Pensions | Dis-jointed system, workers' wages are invested primarily in American equities. | Coordinated system, workers' wages are re-cycled into mortgage credit. |
| Form of Financialisation | Volatile, speculative financialisation which is driven by flows of Foreign capital from core to periphery. | More stable, balanced form of Financialisation, less speculative, built on national capital. |

The Concepts of *Risk & Insurance*

| | Irl : Increasingly Risky | Dnk: Balance of Risk & Insurance |
|---------|---|--|
| Banking | <ul style="list-style-type: none"> • De Regulation of lending Conditions increased risk to borrowers. • Commercial banking exposed to both mortgage and real estate debt. • <i>Funding gaps expose banks to a run by other financial investors who are even more un stable than depositors. The global liquidity crisis.</i> | <ul style="list-style-type: none"> • Continued Regulation. • Continued separation between mortgage and real estate lending. • <i>Stability of funding in mortgages given the presence of large national blocks of investors.</i> • Funding gaps expose banks to run by other financial investors who are even more un stable than depositors but largely separated from mortgage borrowers. |
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