Bank Contagion in Europe

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Content

The aim is to estimate the extent of cross-border contagion in the EU banking sector. The focus is on tail observations of the 'distance-to-default' and co-exceedances, after factoring out common shocks.

As Europe gets more and more financially interconnected and integrated, understanding the size and nature of cross-border contagion is a key policy issue.

Punch line:

Strong evidence of cross-border contagion is found. Even stronger after the introduction of the euro. Findings are in line with a tiered banking structure.

1. Importance of contagion

The analysis shows the significance of contagion, but how important is it really?

Schoenmaker (1996) claims that it is only a 'second order' effect, dominated by common (macro-economic) factors.

There is not much empirical evidence on the 'size' of contagion risk relative to systemic risk. Can your analysis gauge this size effect?

2. Discussion of some results

Contagion patterns across banks and countries seem quite in line with what we expect.

But some strange results....

- NL: 1 bank in sample, but 14 coexceedances in NL..?

- NL-BE: no contagion, and adding GR gives much more explanatory power than adding NL..?

- PT: adding BE gives huge increase in Liklhood... but coefficients change 10-fold..?

3. Possible channels of contagion

The analysis identifies no real channel for contagion, but describes some in the introduction, although in a somewhat confusing way...

(page 1) Complete banking structure leads to less contagion, since more banks can absorb the negative shock.

(page 3) In Belgium, Degryse and Nguyen (2004) found a change from complete links among banks to multiple money centre banks, suggesting less contagion risk... What is going on?

4. Policy implications for supervision

The authors state that after the introduction of the euro 'the increased depth and efficiency of the interbank system seems to come at the cost of increased risk of cross-border contagion.'

Does this indicate a conflict between monetary stability and financial stability?

What type of regulation is then required?

Schoenmaker (1996) argues that LoLR-type of regulation can eliminate almost all contagion risk..?

5. Miscellaneous

- Data: Banco di Napoli has negative d-t-d, what does it mean? Did it really go bankrupt?

- Timing: It takes time to contaminate, 1 week, 2 weeks, ..., 2 months... How do you solve this timing problem?

- What exactly is the informational content of spillover effects during calm times for crisis times? Probably, correlation structures across banks change dramatically in crisis times..?

Thanks !