Banks should tighten belts, Carney says

Lower costs offset interest rate hikes: BoC governor

BY PAUL VIEIRA, FINANCIAL POST SEPTEMBER 15, 2010

Bank of Canada governor Mark Carney says the G20 should create a "system that is robust to the failure of a single firm."
Photograph by: Todd Korol, Reuters, Financial Post

B anks could consider cutting jobs and wages to help finance the implementation of new global banking reforms, rather than raising borrowing costs or fees for customers, Bank of Canada governor Mark Carney said Tuesday.

The suggestion was in remarks Carney delivered before academics and business executives in Berlin, in which he issued a strong defence of the new rules agreed to by the so-called Basel Group of banking supervisors. The Basel III rules, as they are deemed, would require banks to more than double their capital requirements but give them as long as eight years to comply in full.

Carney said he believed the Basel pact strikes "exactly the right balance" between protecting the global economy from future crises while preserving an efficient financial system. "The point is not to pile up so much capital in our institutions that they are never heard from again, either as a source of instability or of growth."

But he also used the speech to counter fears from the banking industry about the high cost the reforms, and how lenders would have no choice but to pass them on to their customers through higher spreads on loans.

The Institute of International Finance, for instance, has warned the changes to capital rules could shave three per cent off the combined GDP of the big three economies -- the United States, Japan and the Europe -- by 2015.

"Banks are assumed to fully pass on the costs of higher capital and liquidity requirements to borrowers" to adjust to the new rules, he said in prepared remarks.

"Consider the alternative. If banks were to reduce personnel expenses by only 10 per cent -- equal of a five per cent reduction in operating expenses -- they could lower spreads by an amount that would completely offset the impact of a two-percentage-point increase in capital requirements."

Mark Calabria, director of financial regulation studies at Washington-based Cato Institute, said banks have been overly critical of the Basel process, in terms of the implications for the economy.

"Carney is trying to rebut a lot of the (industry's) criticisms, and I think that's the direction he's taking," Calabria said.

Nancy Hughes Anthony, president of the Canadian Bankers Association, said at this point the overall costs related to implementing Basel III reforms remain uncertain.

"Once these regulations are implemented, each bank will have to determine how to deal with any potential impact on its own operations," she said. "These are business and pricing decisions made by individual banks in a competitive marketplace."

Under the bank's estimates, increased capital requirements and a tighter leverage limit would knock roughly 0.3 percentage points from Canadian annual GDP -- an estimated deemed "reasonable" by Craig Alexander, chief economist at Toronto-Dominion Bank.

"There is a significant cost of doing this, but it is spread out over many years and as a consequence it isn't going to derail the economy or prevents households and firms from getting credit," he said.

However, analysts at London-based Lombard Street warn Basel III could be more costly than central bankers and regulators are letting on.

"The costs of the banking reform agenda over the short to medium-term are set to be more substantial than assumed by the (Basel group)," Lombard said.

"The very announcement of the new Basel III rules is likely to alter the capital and liquidity levels demanded by markets, so that banks are forced to build up capital buffers and issue more long-term debt early on in the phase-in period."

At the end of the day, Calabria added, the cost of implementing the new Basel rules won't be as steep as feared, but nor will it be as modest as regulators and central bankers claim.