Mojmír Hampl: The trilemma of the banking sector

Speech by Mr Mojmír Hampl, Vice Governor of the Czech National Bank, at the Czech National Bank and OMFIF Central Bank Meeting "Central banking in Central and Eastern Europe: Policy making, investment and low yields", Prague, 7 June 2016.

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Ladies and gentleman, good morning,

First of all let me express my gratitude for the kind invitation to speak at this event. My special thanks go to our departing Governor Miroslav Singer and to David Marsh for the energy – I would almost say nuclear energy – he constantly invests in the OMFIF and its events and publications, which has made the OMFIF what it is now. Reading the OMFIF daily commentary has become an almost indispensable part of my working day, I have to say.

Looking at the impressive list of distinguished participants at today's meeting, I intuitively started asking myself: what really unites us? What do we share regardless of whether we come from the east, west, north or south, or here from Prague for that matter? And I am pretty certain that from the financial or monetary point of view there is at least one important thing.

In all our countries we have not only central banks, but also commercial banks operating in a system of elastic money, i.e. private banks as entities that also create money. And we all share the same desire. We want our monetary and financial systems to be stable, not only throughout the economic cycle, but also across cycles.

And what we also share is that we are still very much uncertain about how to achieve this goal perfectly.

One, rather harsh expression of this uncertainty of ours, is the adage popular among some policy-makers. As financial stability is hardly a quantified (or maybe even quantifiable) goal, some in the community grumble that central banks targeting inflation are delivering price stability, while central banks targeting financial stability are delivering just financial stability reports.

Yes, this is really a bit too strong statement, as we all know, explicitly or implicitly, that the banking sector faces a trilemma – or an impossible trinity of a kind, if you will. Banks can never be simultaneously:

1. perfectly safe,
2. perfectly efficient and
3. always free of moral hazard

It is like in the area of public health care. This complex system also cannot simultaneously achieve three goals perfectly and be:

1. cheap,
2. of the highest quality and
3. universally accessible to all without entry barriers

In the banking sector – like in the area of health care – we can either abandon one principle in order to achieve the remaining two more or less perfectly, or we have to balance all the three principles somehow, but all of them will be achieved and maintained only partially, imperfectly (and sometimes deeply imperfectly). That is the limitation we face and will always face in the banking sector, and that's why no perfect and once-and-for-all accepted way of achieving the "ideal state of affairs of banks" will probably ever be established.

All the more so as the reality makes achieving any ideal less likely in the future than it is now. Look, for instance, at the issue of resolvability of banks. Yes, we in the EU have the BRRD

(Bank Recovery and Resolution Directive) as our European answer to the question of resolvability. Let's put aside the fact that its practical implementation and the enforcement of its key principles have not always been convincing so far. And we are not sure that these principles (namely bail-in) will be applied in a dynamically consistent way across countries and banks in the future. But still many believe we have made banks more resolvable (and also resilient) since 2008. And I think there are underlying real-time processes that are actually making banks *less resolvable* now compared to the past.

Why? What worries me is that over time many end-users (and also policy-makers) tend to look at standard commercial banks as utilities with all their typical features. One of those features is that the population is becoming more and more *incrementally dependent* on the services such utilities provide, quite often without the very same population even noticing it.

A typical example is electricity. We have been getting more and more dependent on electricity incrementally, in small steps, for many, many years now. So an electricity blackout now – in 2016 – would cause more harm and damage than it would have done say forty or fifty years ago, as many more devices, processes and productions are partially, or even fully, dependent on a continuous supply of electricity. And this continuous supply in turn incentivises the use of electricity as a tool of production and a source of power for various devices etc.

This phenomenon of incrementally increasing dependence is also typical for financial services, or the banking sector as such, due both to state regulation (such as compulsory cashless transfers above certain thresholds) and to the markets and technological progress (such as credit cards, smooth money transfers, contactless payments etc.)

All this is happening on-line in small steps, *incrementally*, and all this means banks might in bad times be seen as utilities, much less resolvable due to the complex services they provide, than in the past. And the complexity of the services of a utility is sometimes visible only very shortly before its potential collapse. So "utilities" providing products with incrementally increasing dependence will be able to exit the market in a much more complicated way, if at all. The same applies to the financial sector, all the more so if we go down the road to a *less-cash economy* (which is, of course, a slightly different concept than a *cashless economy*. And I do not believe we will ever achieve *a cashless economy* completely spontaneously).

And this is something we should take into account in the future, as it will further complicate balancing the vertices of the banking triangle, or the banking trilemma I mentioned earlier.

Thank you for your attention.