News release

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Has the link between the financial sector and governments been broken?

Subdued growth in some emerging markets and low commodity prices have led to renewed interest in the link between governments and the financial sector. This has also been an important issue on the global policy agenda as policymakers have tried to loosen these ties. But, how successful have they been?

Figure 5 shows that the G7 have made significant progress in insulating public finances from future banking failures. Unlike in the past, regulation now ensures that banks' shareholders and creditors pay their share of the costs of a bank failure through a bail-in mechanism. Other regulatory tools like stress tests, which aim to forecast banks' balance sheets at times of severe but plausible events, have complemented this.

Fig 5: Advanced economies have made more progress with implementing bank resolution reforms

Countries	Overall	Availability of transfer / bail-in / temporary stay powers for banks	Recovery planning for systemic banks	Resolution planning for systemic banks
G7 economies				
Canada	Implemented	Partially implemented	Implemented	Implemented
France	Implemented	Implemented	Implemented	Implemented
Germany	Implemented	Implemented	Implemented	Implemented
Indonesia	Implemented	Implemented	Implemented	Implemented
Italy	Implemented	Partially implemented	Implemented	Implemented
United Kingdom	Implemented	Implemented	Implemented	Implemented
United States	Implemented	Implemented	Implemented	Implemented
E7 economies				
Brazil	Not implemented	Partially implemented	Not implemented	Not implemented
China	Partially implemented	Partially implemented	Implemented *	Partially implemented
India	Not implemented	Not implemented	Not implemented	Not implemented
Indonesia	Not implemented	Partially implemented	Not implemented	Not implemented
Mexico	Implemented	Partially implemented	Implemented	Implemented
Russia	Partially implemented	Partially implemented	Implemented	Not implemented
Turkey	Not implemented	Partially implemented	Not implemented	Not implemented

● Implemented ● Partially implemented ● Not implemented

*Recovery planning only applies to G-SIB(s) at present

Source: Financial Stability Board

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For the E7, the pace of reform has been slower, partly because of the relatively smaller impact of the 2008 crisis. With emerging market risks rising and GDP growth slowing down in large economies like China, Brazil and Russia, insulating governments from banking failures remains an unresolved issue.

However, less focus has been placed on insulating banks from weaknesses arising in government finances. The exposure to domestic sovereign bonds of banks in Germany, Spain, Portugal and Italy is similar to the levels held by Greek banks during the bailout.

This is not surprising as in Europe home government debt is treated as a risk-free asset from a regulatory perspective, despite events during the Eurozone debt crisis showing that this is not always the case.

Richard Boxshall, Senior Economist, PwC, says:

> "The next challenge is for policymakers around the globe to put in place measures that reduce banks' exposure to financially stressed governments. If this can be achieved, then the two-way link between governments and the financial sector will be weakened further. This would have positive impacts on financial stability at an individual economy and at a global level."

For more details, please see this month's Global Economy Watch at www.pwc.com/gew.

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