



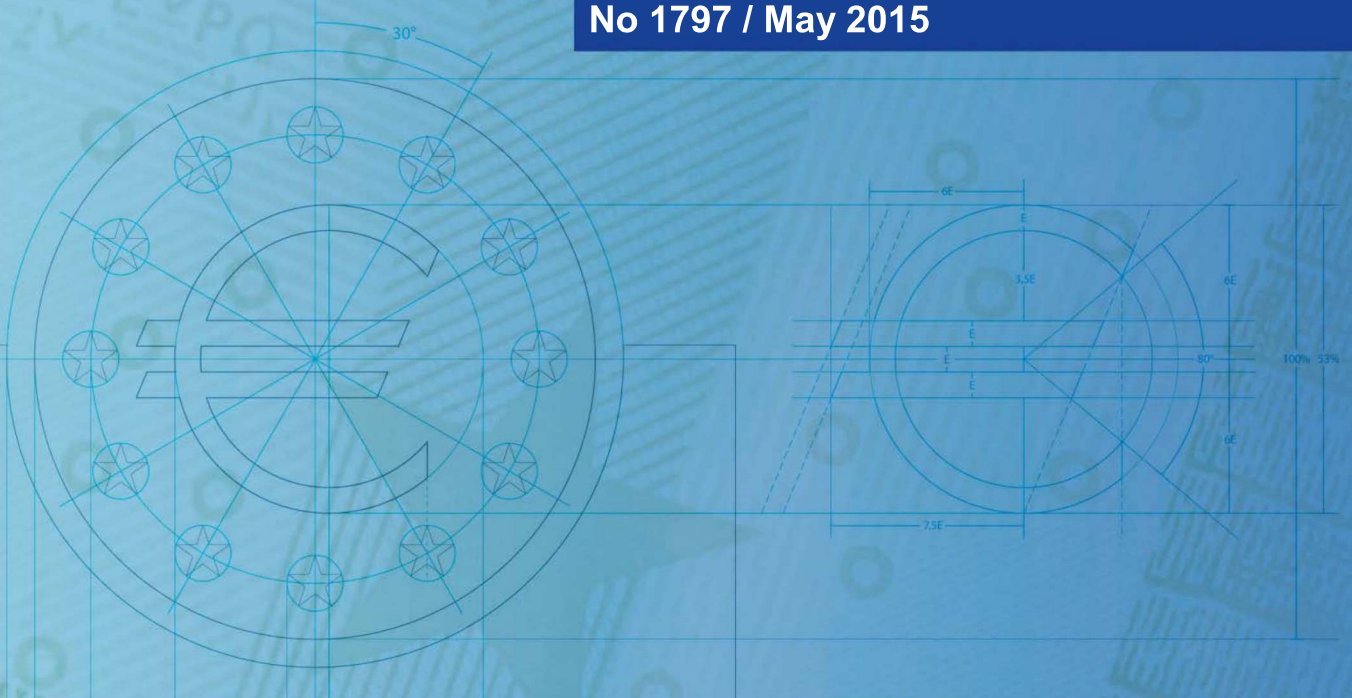
EUROPEAN CENTRAL BANK
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Bank bias in Europe:
effects on systemic risk
and growth

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Abstract

Europe's financial structure has become strongly bank-based – far more so than in other economies. We document that an increase in the size of the banking system relative to equity and private bond markets is associated with more systemic risk and lower economic growth, particularly during housing market crises. We argue that these two phenomena arise owing to an amplification mechanism, by which banks overextend and misallocate credit when asset prices rise, and ration it when they drop. The paper concludes by discussing policy solutions to Europe's "bank bias", which include reducing regulatory favouritism towards banks, while simultaneously supporting the development of securities markets.

JEL Codes: G1, G2

Keywords: banks, financial structure, systemic risk, bank regulation