Liquidity and Sovereign Risk

Abstract and outline

Shlomo Cohen
Risk Senior Advisor
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Abstract

Until recently, liquidity was not considered a critical issue as it was commonly agreed that a solvent financial institution could always refinance itself; This has led to highly leveraged balance sheets and large liquidity transformation gaps; Today, the combined concerns of stronger regulatory requirements and sovereign refinancing squeeze generate an extensive deleveraging posture; The downward pressure on asset pricing appears particularly critical for those assets which were historically considered risk free, such as well rated sovereigns; This situation reveals that financial institutions are strongly exposed to sovereign risk, and under multiple forms; An economic analysis of the potential impacts on risk, return and capital leads to uncover many issues, and notably the current inability to address correctly sovereign credit risk; Unfortunately, this has become a major worry since seventeen European countries have given up their ability to print money; Restoring confidence will require time and adequate tools such as sovereign balance sheets; Working out such balance sheets is a complex but feasible task, already performed by some countries which now receive significant positive fallouts from this effort.
Condensed outline

Liquidity and Sovereign risk

- A quick history of liquidity assessment
- Liquidity and assets pricing
- The impact of sovereign risk on liquidity
- Current assessment of sovereign risk
- Towards sovereign balance sheets?
Detailed outline

Liquidity and Sovereign risk

- A quick history of liquidity assessment
  - Past and current issues
  - Trends in regulatory constraints
- Liquidity and assets pricing
  - Macroeconomic relationship
  - Microeconomic effects
- The impact of sovereign risk on liquidity
  - Impact on assets valuation
  - Impact on financial institutions funding
- Current assessment of sovereign risk
  - GDP, unemployment and other gimmics
  - Target assessment methodology
- Towards sovereign balance sheets?
  - Existing national disclosures
  - Proposed framework and expected benefits