Banking & financial markets

The 2008 financial crisis serves as a reminder of the important role of banks, financial markets, and their interconnections in the global economy. I analyse three of these interconnections. Financial markets may offer a source of income for banks through securities trading. However, banks with expertise in securities trading reduce loan supply to the real economy more than their peers during financial crises.
Banks may also use financial markets to hedge risks. However, under current accounting rules for financial derivatives, banks tend to under-report the extent of their hedging activities. Finally, equity trading strategies like betting-against-beta claim to exploit market anomalies created by behavioural biases of market participants. But the anomaly is spurious as it results from mismeasurement of market risk due to purely statistical factors rather than behavioural biases.