Institute For
New Economic Thinking

Too Much Debt, Financial System Stability and Wider Economic Impacts

16th Annual Chicago Federal Reserve Bank International Banking Conference: *Shadow Banking Within and Across National Borders*

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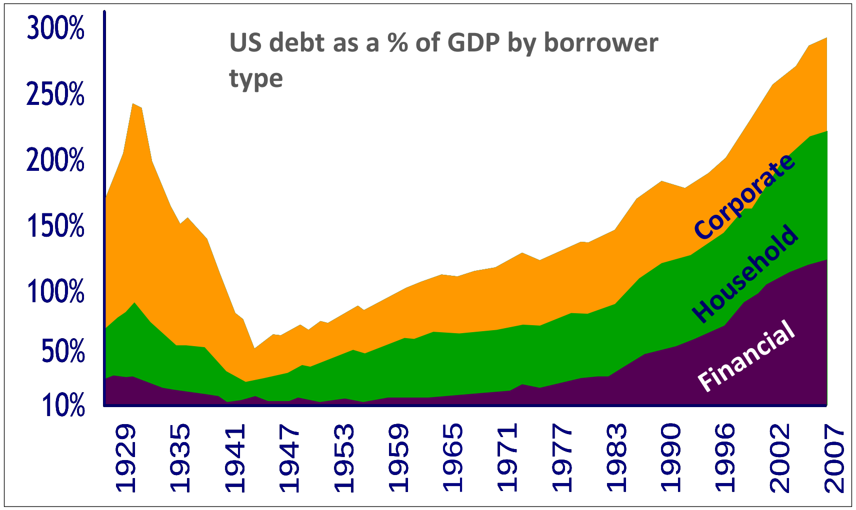
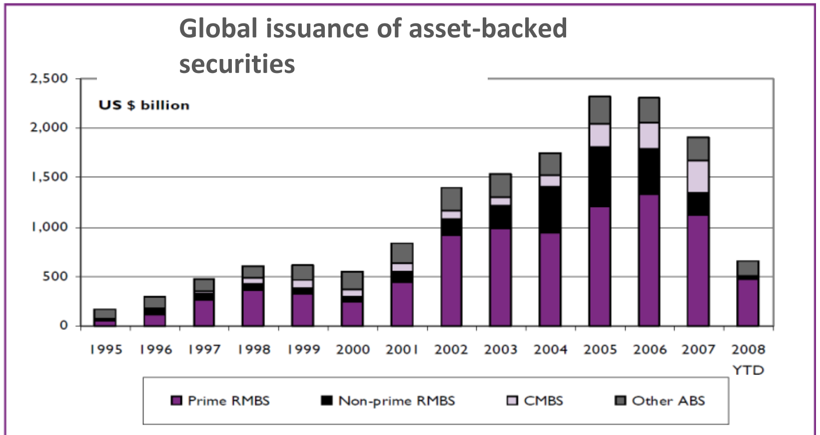
Two Recent Lectures:

- ***Credit, Money and Leverage: What Wicksell, Hayek and Fisher Knew and Modern Macro-Economics Forgot***
  Stockholm School of Economics, September 2013
  http://ineteconomics.org/blog/institute/adair-turner-credit-money-and-leverage

- ***Securitisation, Shadow Banking and the Value of Financial Innovation*****.** The Rostov Lecture on International Affairs
  School of Advanced International Studies (SAIS), John Hopkins University, Washington DC, April 2012
  http://www.econ2.jhu.edu/courses/336/Rostov%20Lecture%202012.pdf

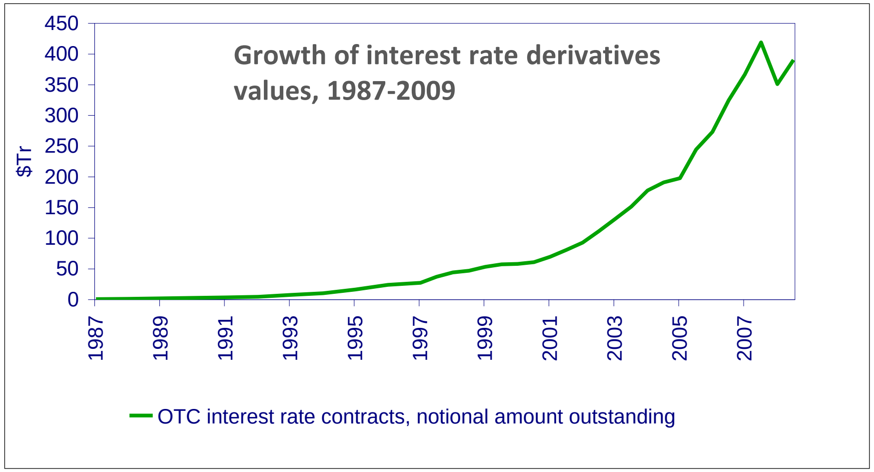
Measures of increasing financial intensity

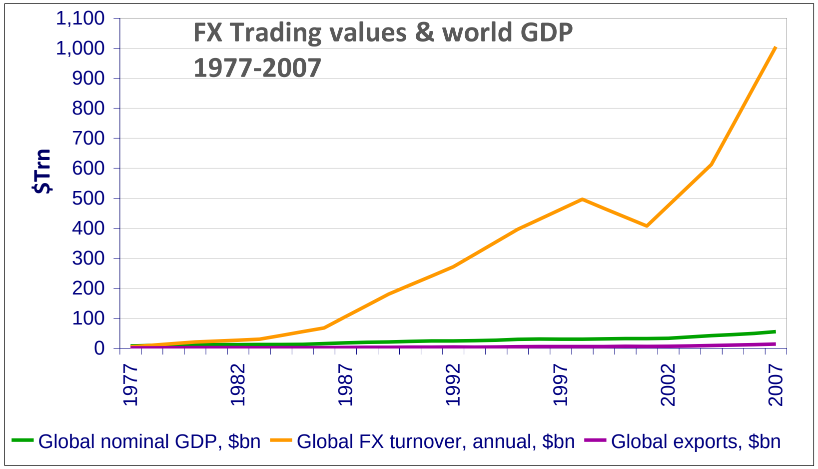




Notes: Public issuance only. Full-year issuance, except for 2008 which is up to and including September 2008. 'Other ABS' includes Auto, Credit Card and Student Loan ABS.

Source: Bank of England





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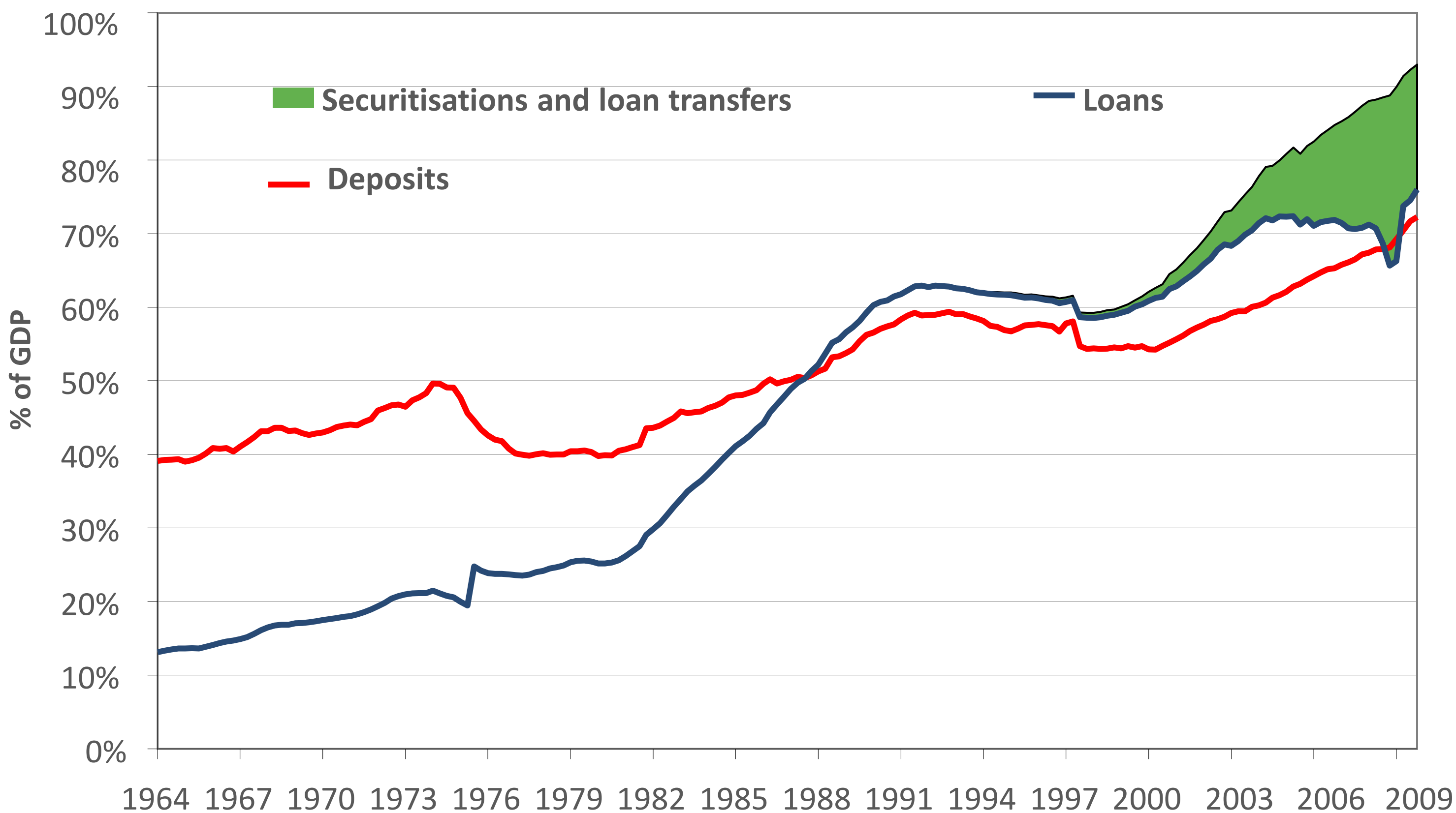
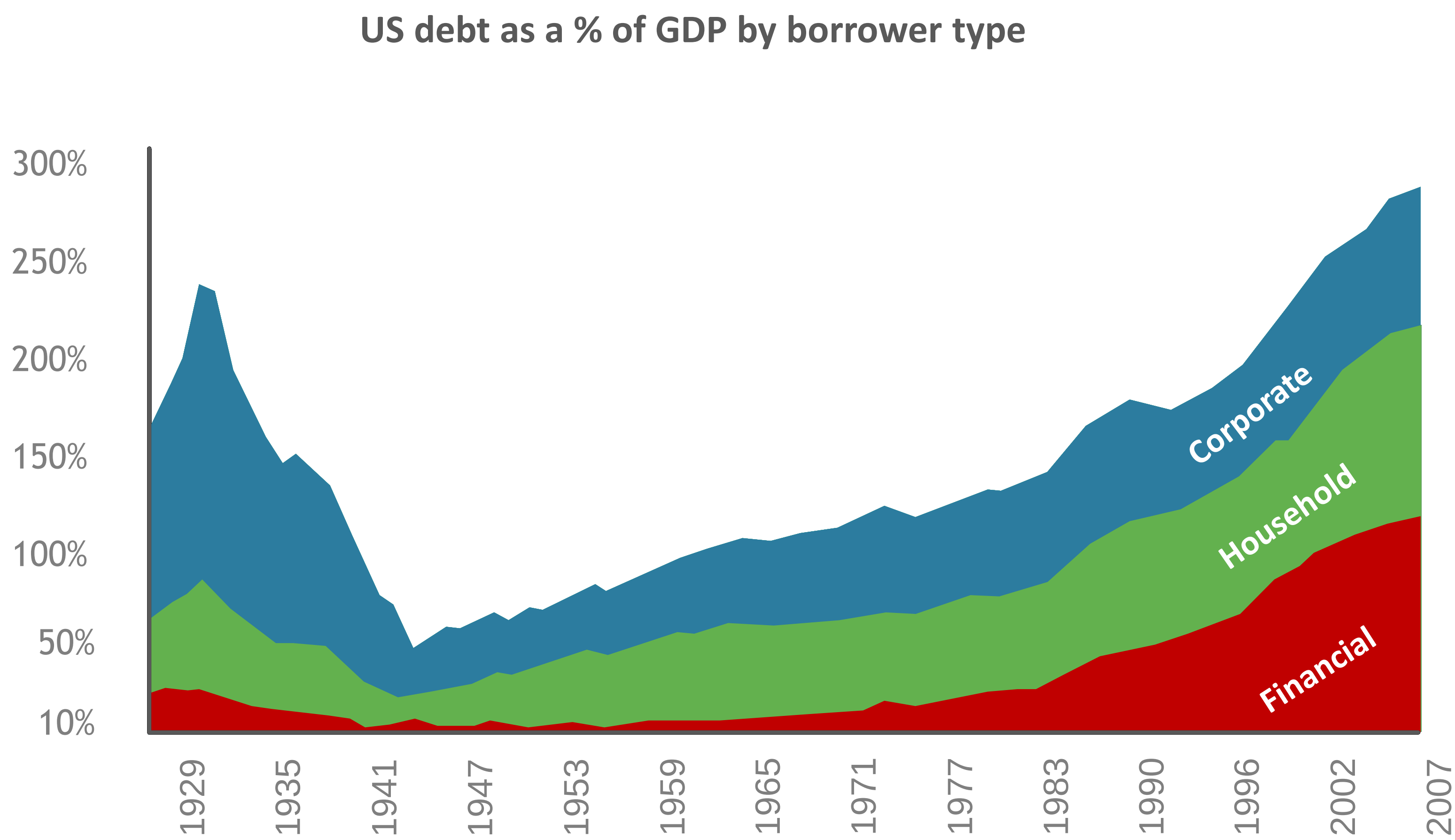
Household deposits and loans: 1964 – 2009

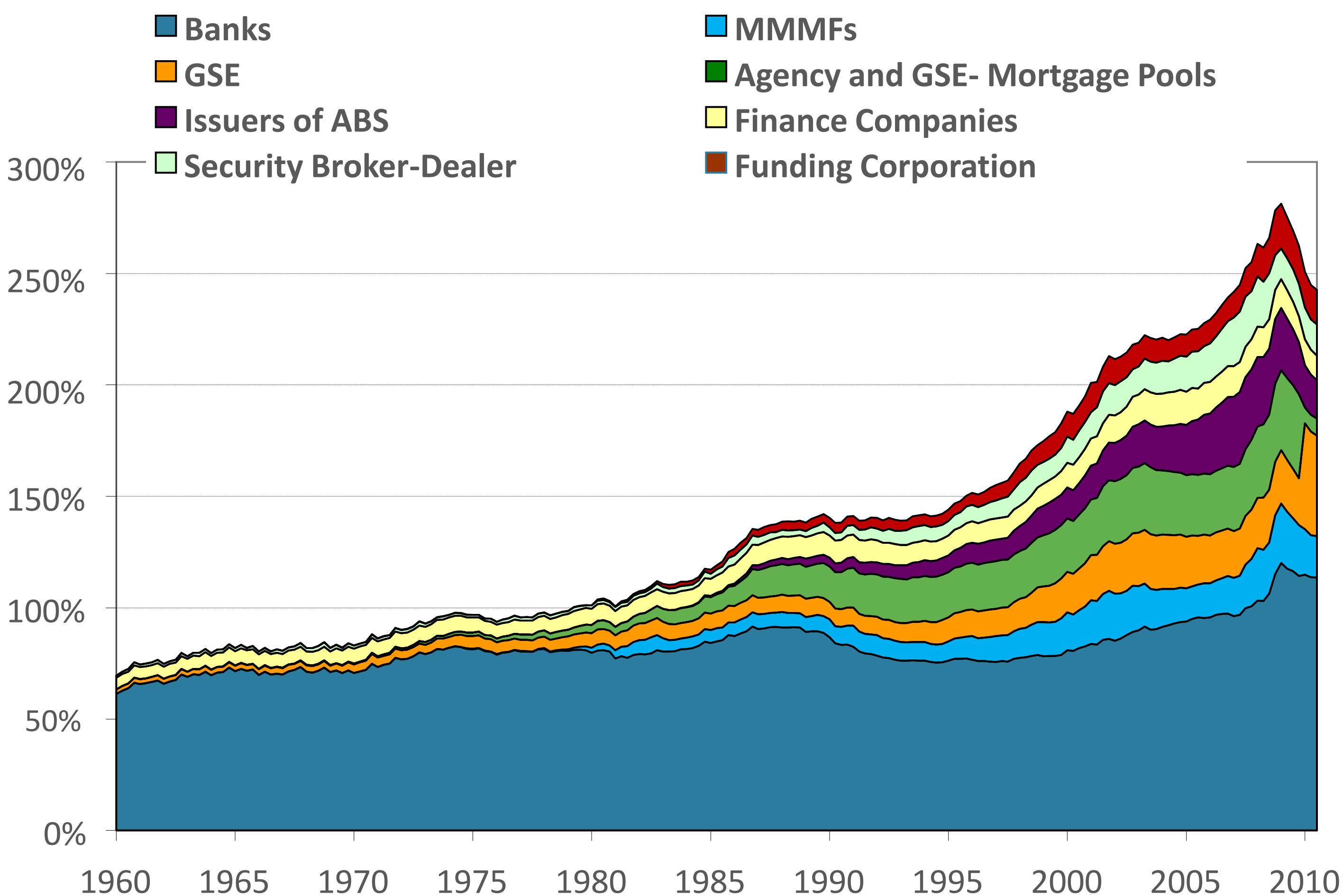


Source: Bank of England, Tables A4.3, A4.1

Measures of increasing financial intensity



US financial sector assets



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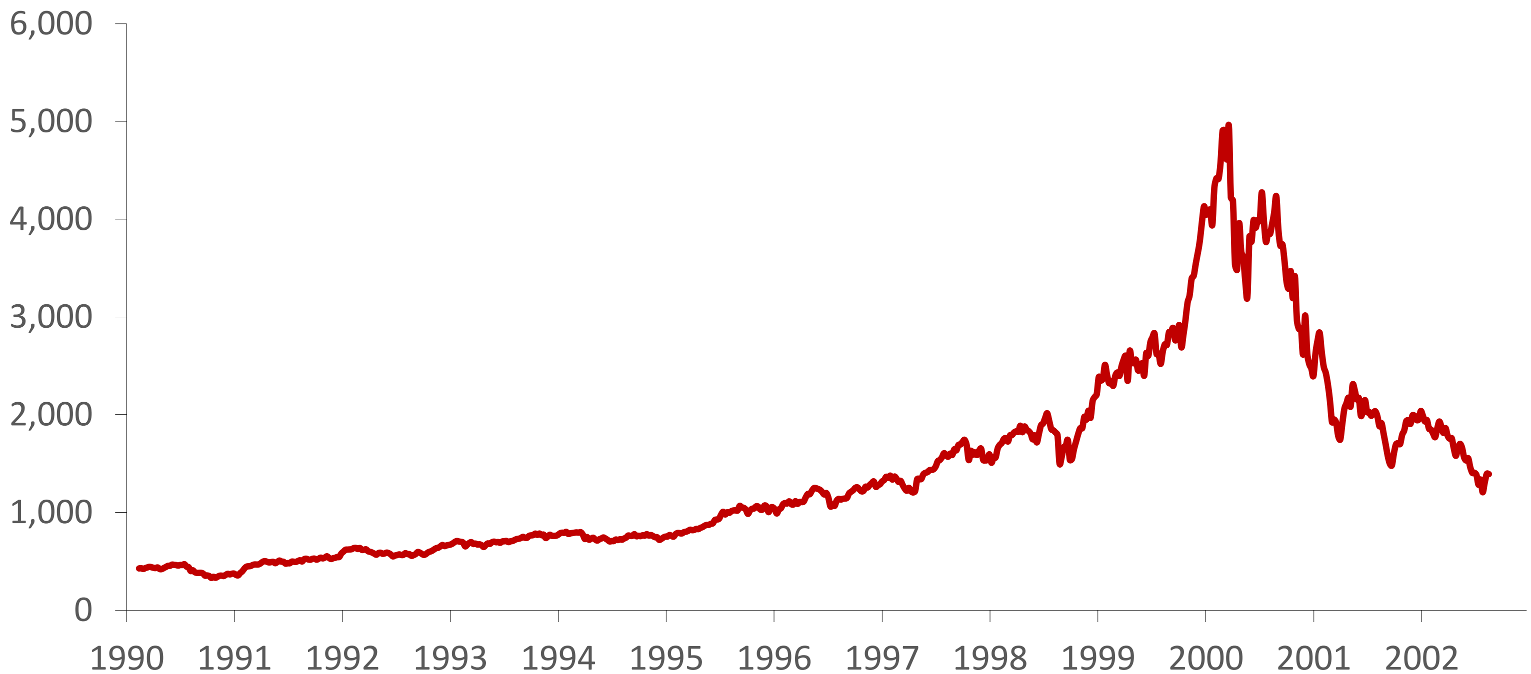
NASDAQ index 1990 – 2003



Source: Datastream

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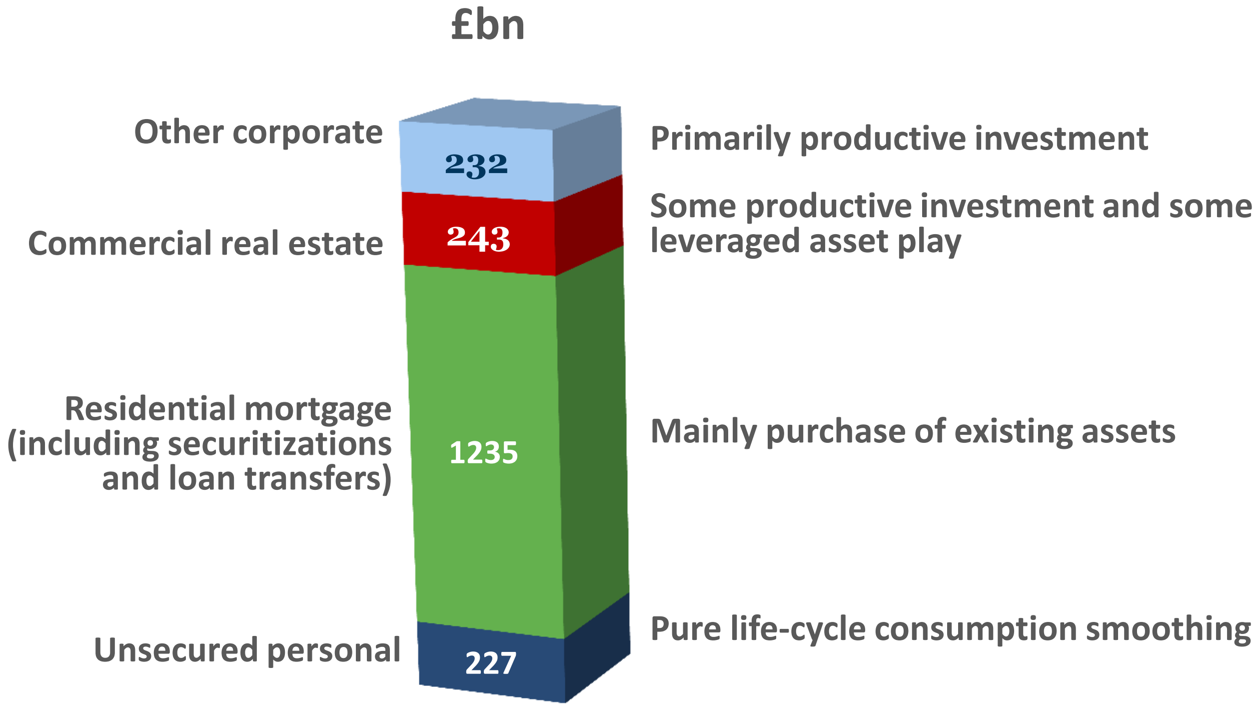
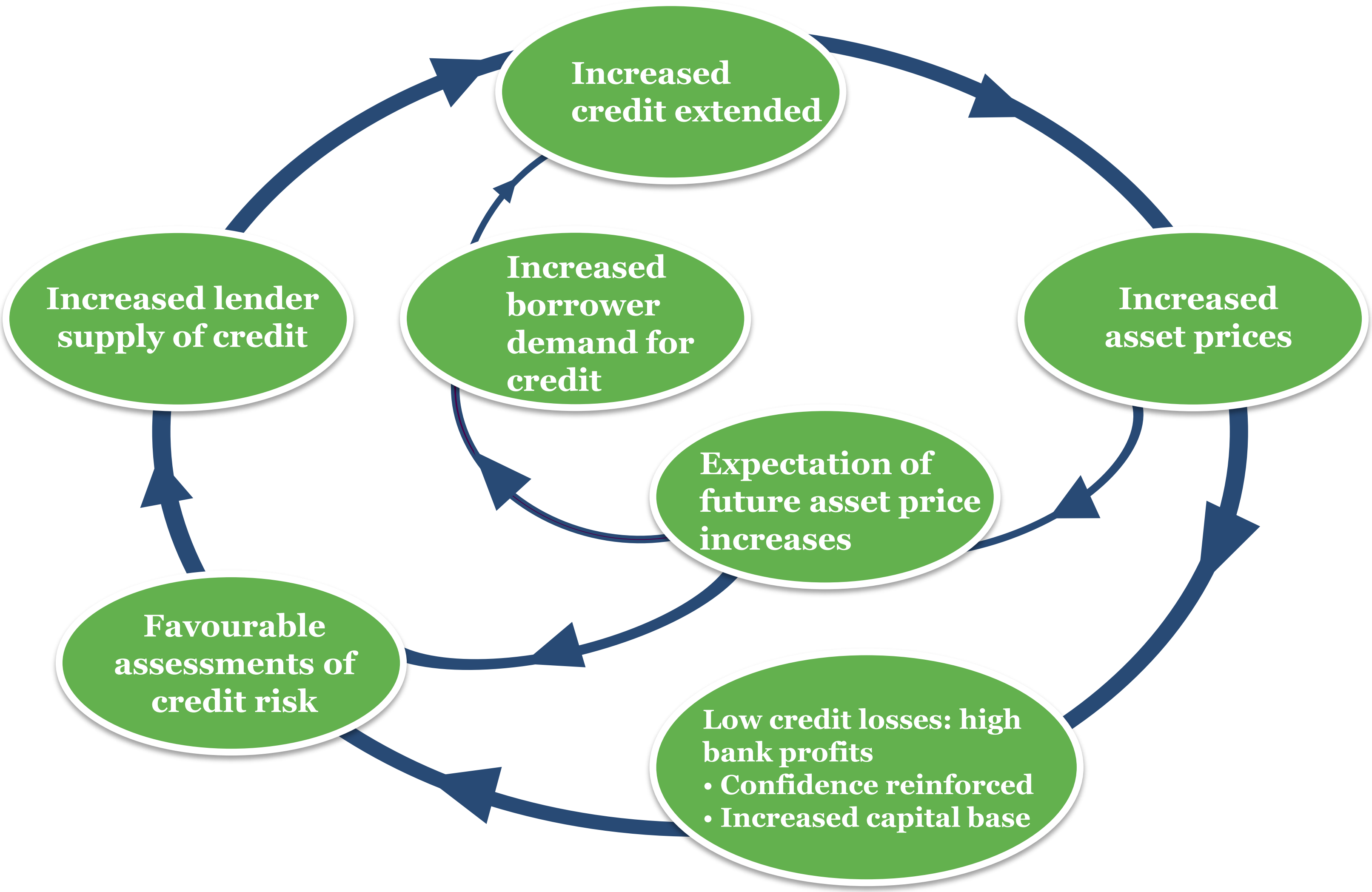
Categories of credit

Loans to businesses / "entrepreneurs"	**… to finance real investment projects**
Loans to businesses / speculators / investors	**… to finance purchase of existing assets**
Mortgage loans to households	**… to finance residential houses**
Loans to "impatient" / temporarily cash limited / poorer households	**… to bring forward consumption**

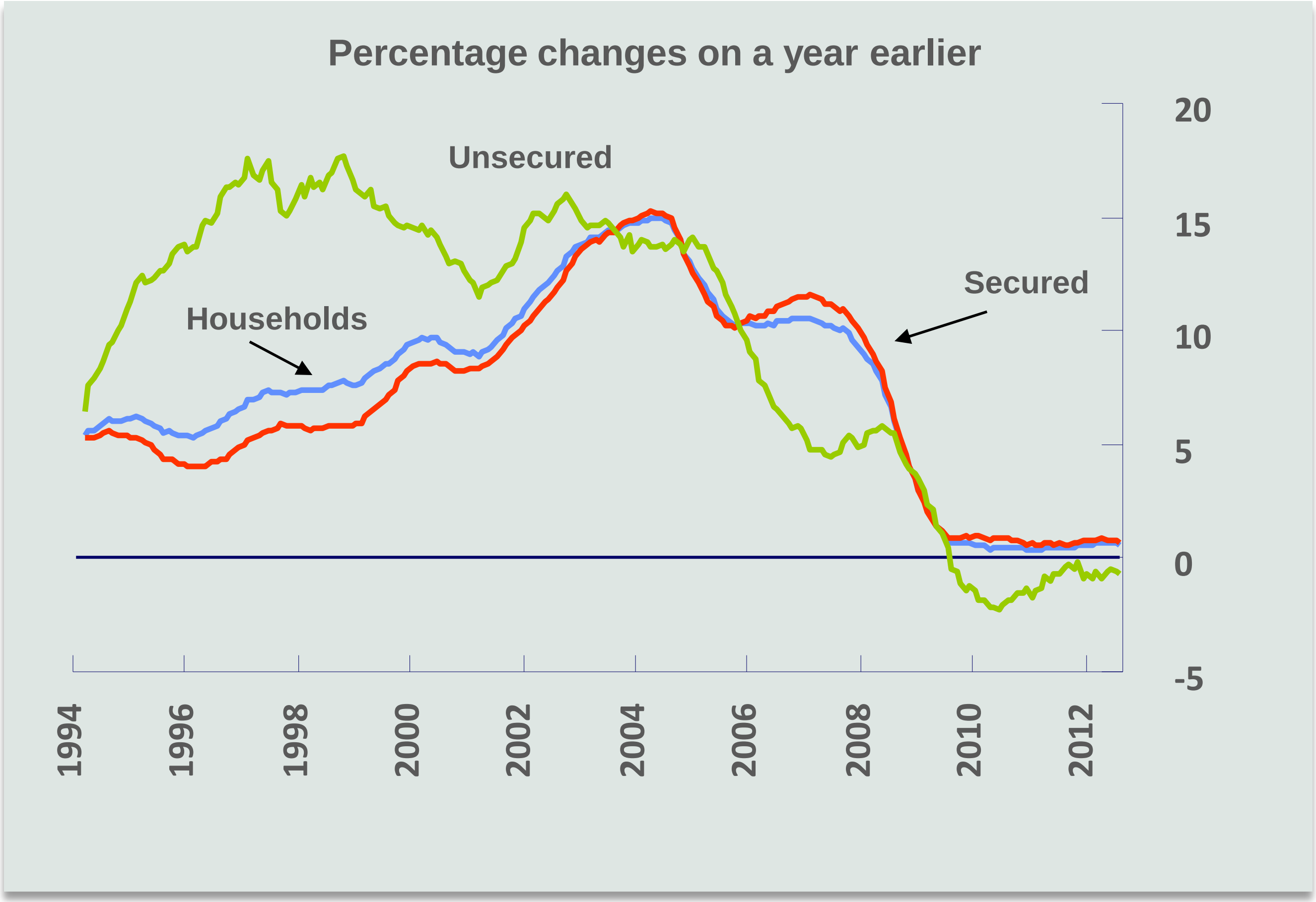
Categories of debt: UK, 2009



Credit and asset price cycles

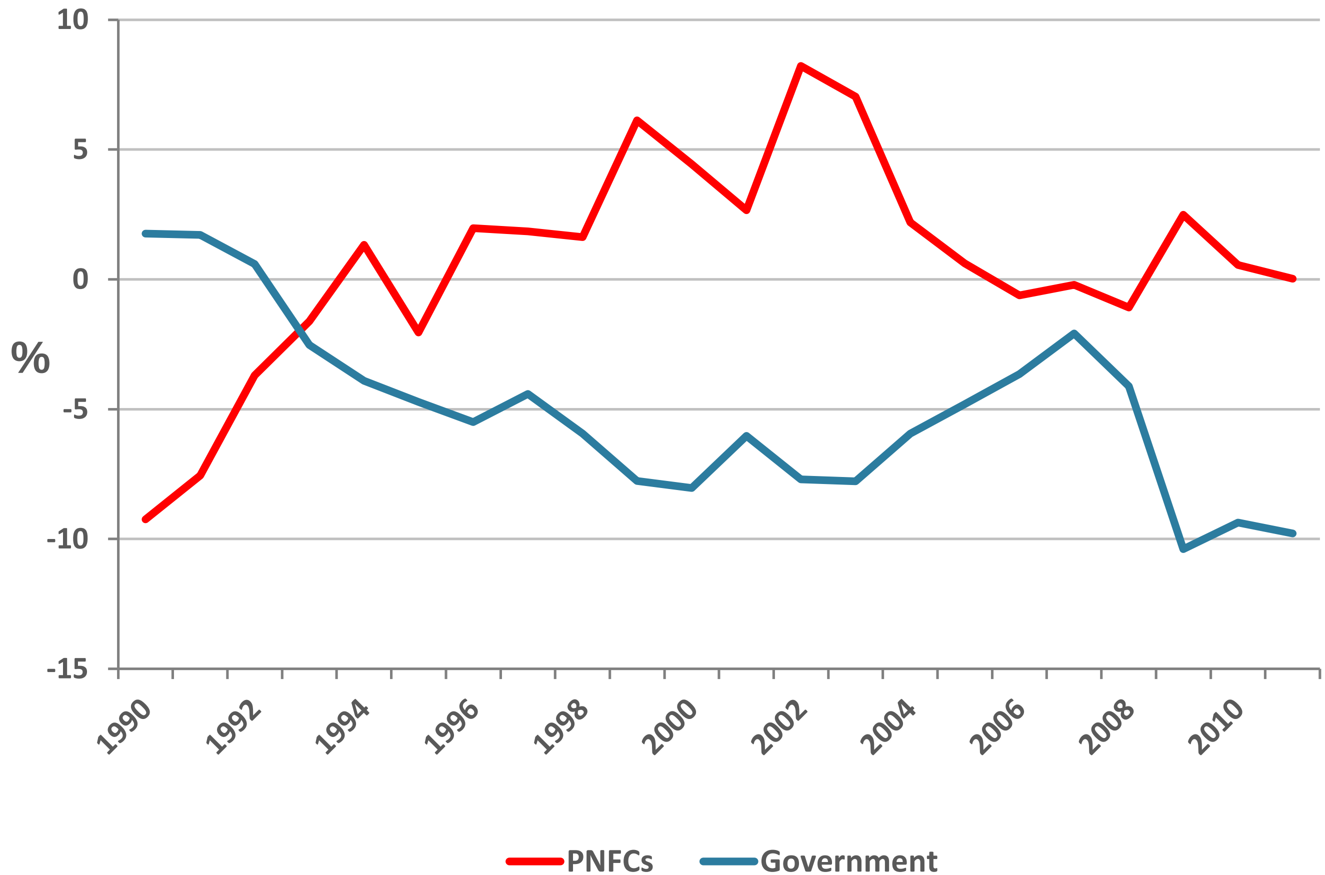


Lending to UK households



Source: Bank of England "Trends in Lending"

Sectoral financial surpluses/deficits as % of GDP: Japan 1990 – 2012



Source: IMF, Bank of Japan Flow of Funds Accounts

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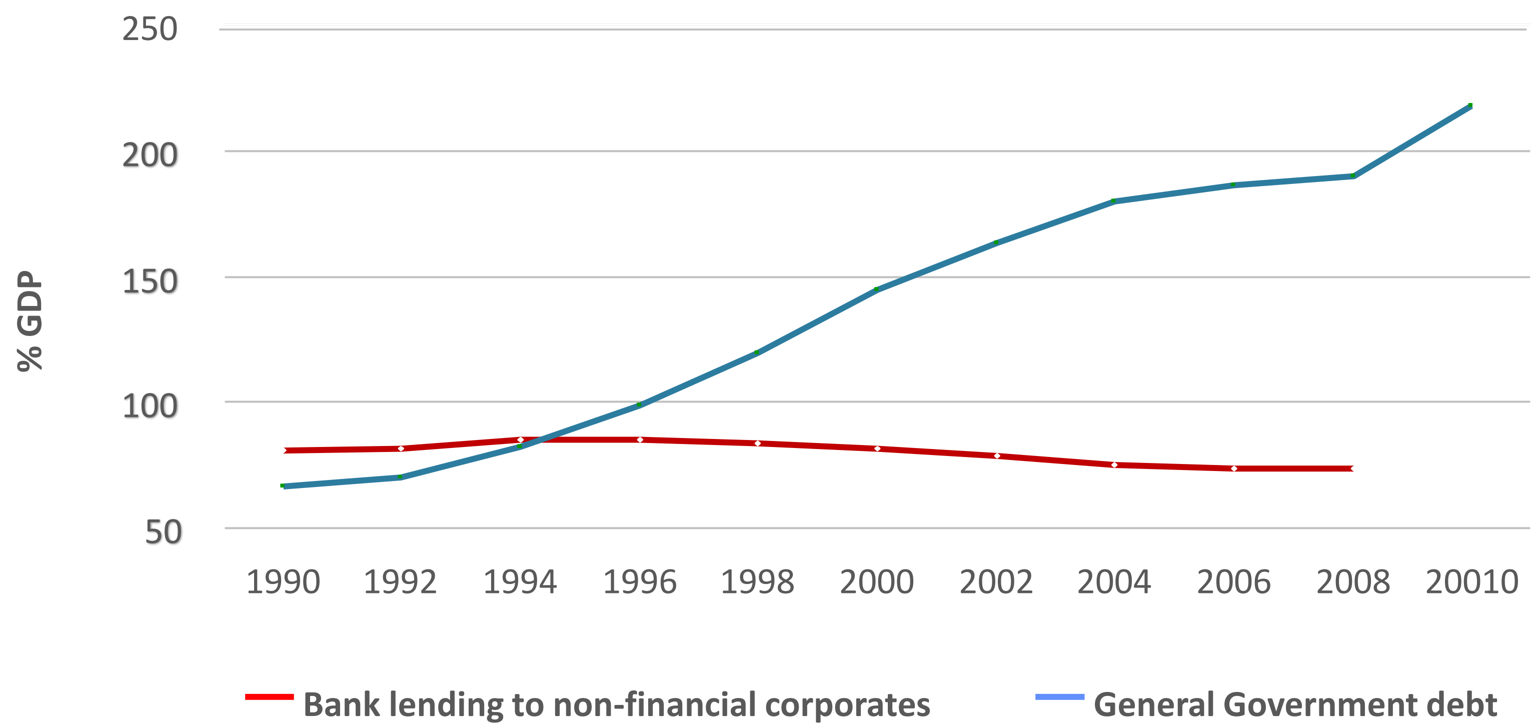
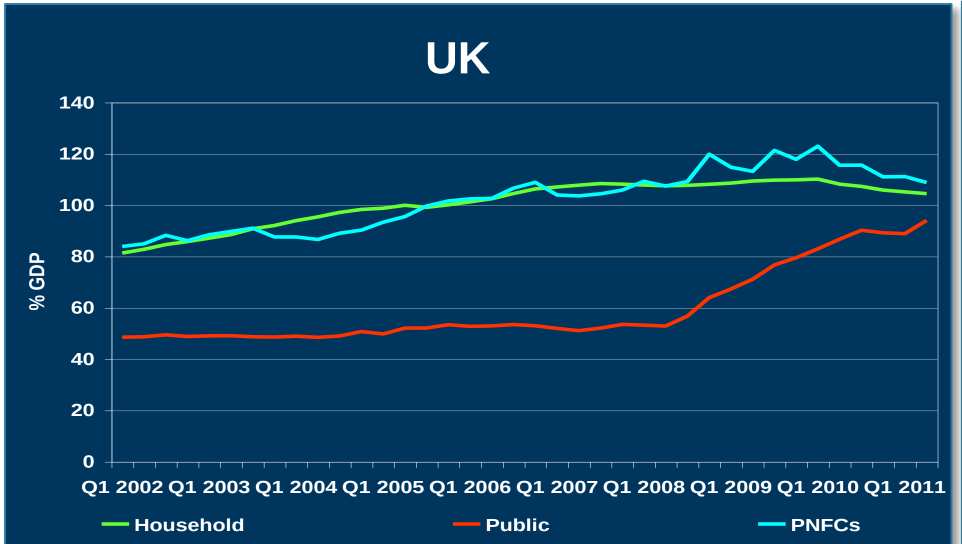
Japanese government and corporate debt: 1990 – 2010

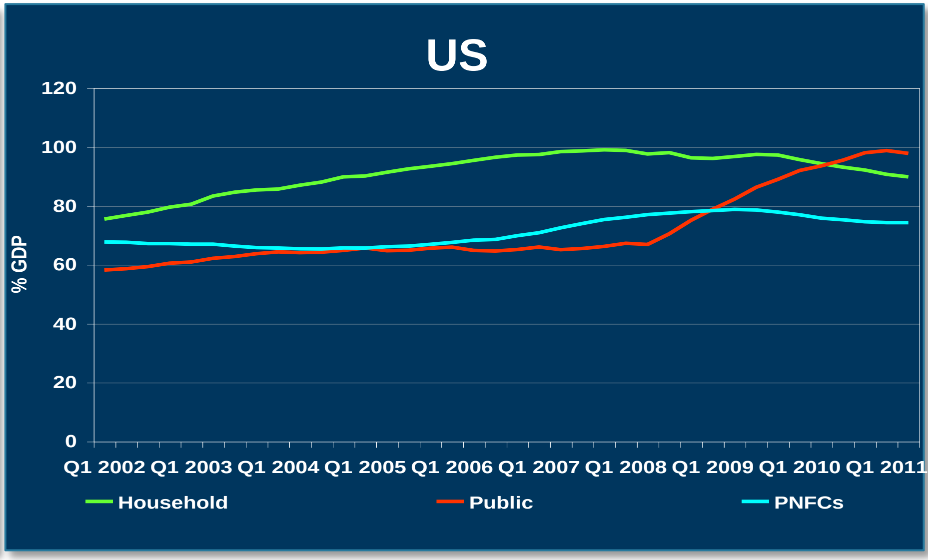


Source: BoJ Flow of Funds Accounts, IMF WEO database (April 2011), FSA calculations

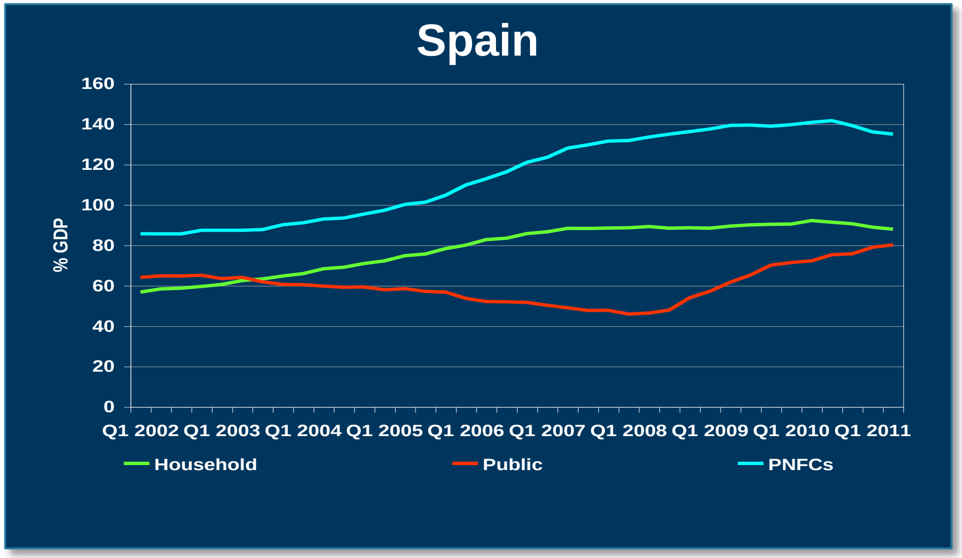
Shifting leverage: private and public debt-to-GDP



Source: ONS Note: PNFC = private, non-financial corporates; Public = central and local government



Source: BEA Note: PNFC = private, non-financial businesses; Public = federal, state and local government



Source: ECB Note: PNFC = private, non-financial corporates; Public = central and local government

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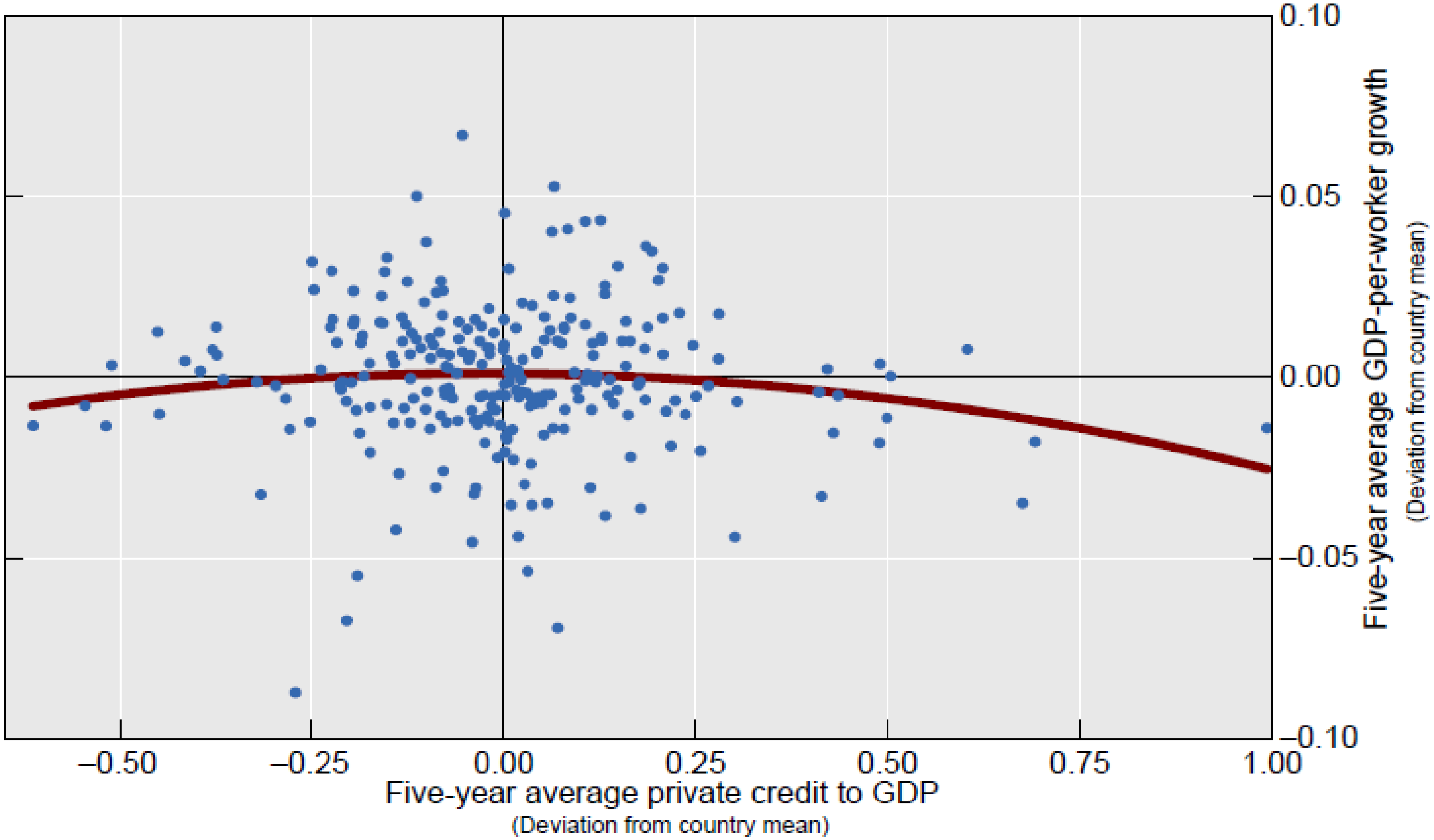
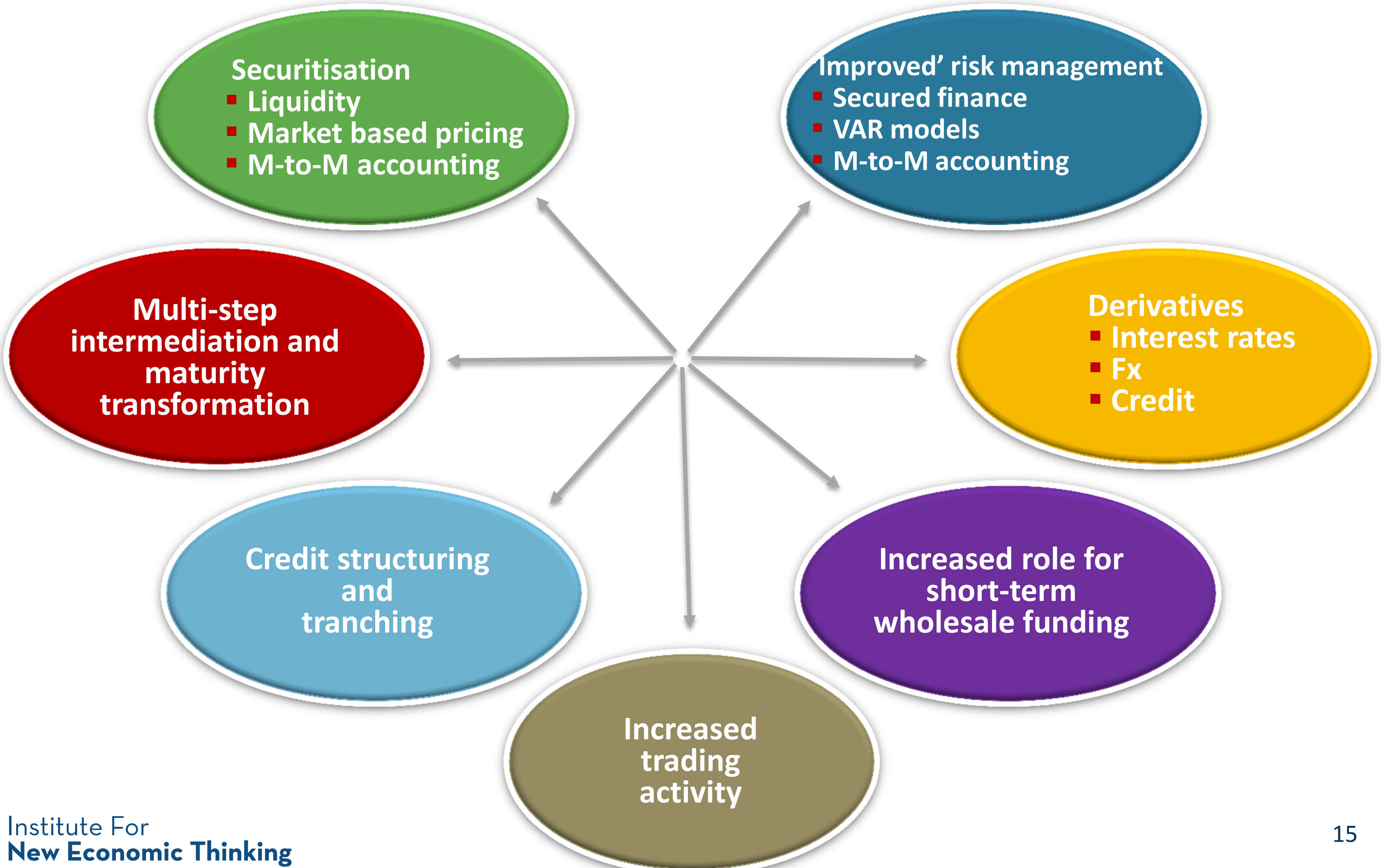
Private credit to GDP and growth

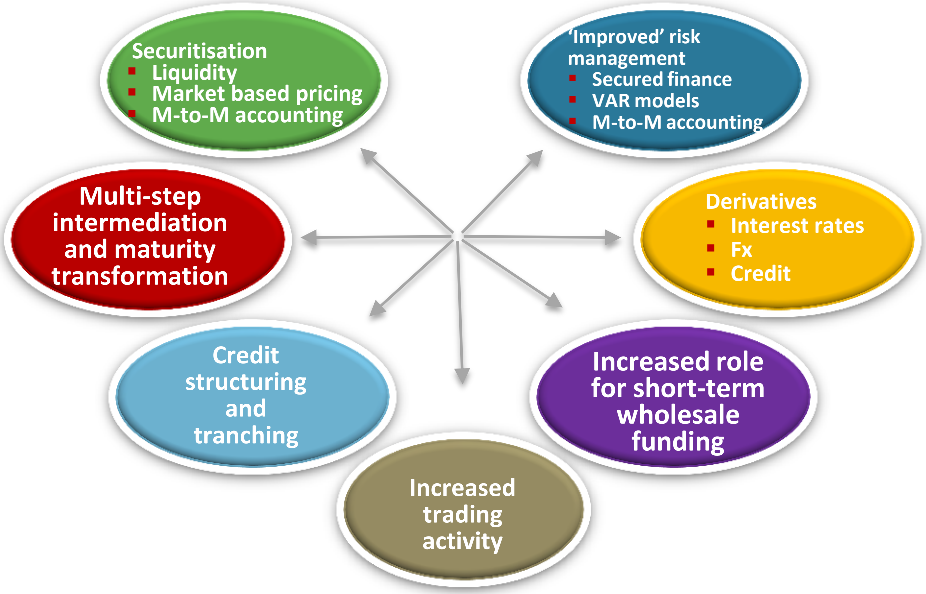


Source: *S. Cecchetti and E. Kharroubi, BIS Working Paper No. 381 "Reassessing the impact of finance and growth"*

Dimensions of increasing complexity



Increasing complexity – not just a parallel shadow system



- Increasing integration of commercial and investment banking
- Multiple bank to shadow bank links (SIVs, repo markets)
- Large expansion of banking trading books
- Increase in wholesale funding – secured and unsecured
- Treasuries become profit centres
- Intra-financial system assets grow rapidly

Credit derivatives "*enhance the transparency of the markets collective view of credit risks…* [and thus]… *provide valuable information about broad credit constraints and increasingly set the marginal price of credit*".

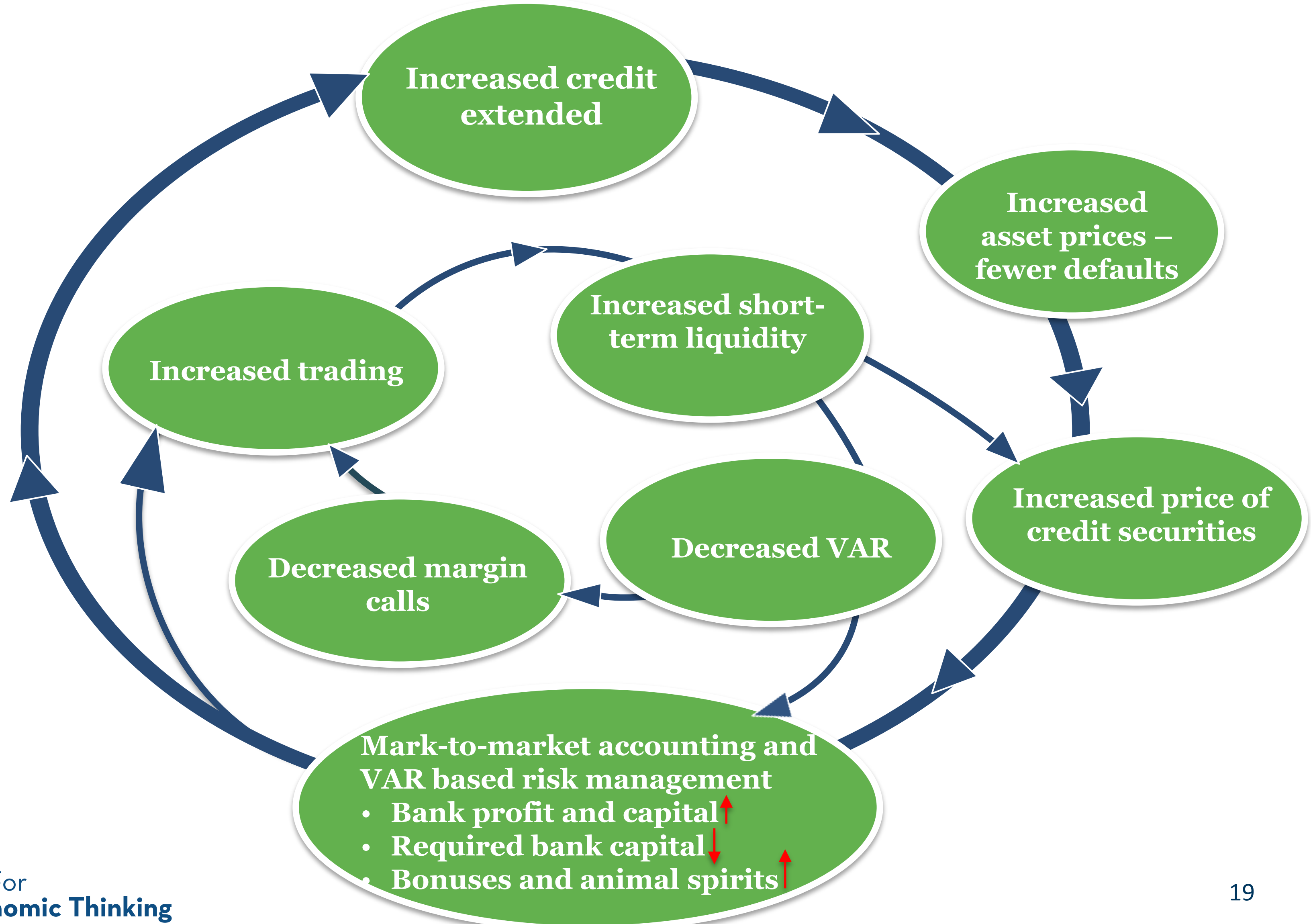
IMF Global Financial Stability Report, April 2006

Additional credit creation

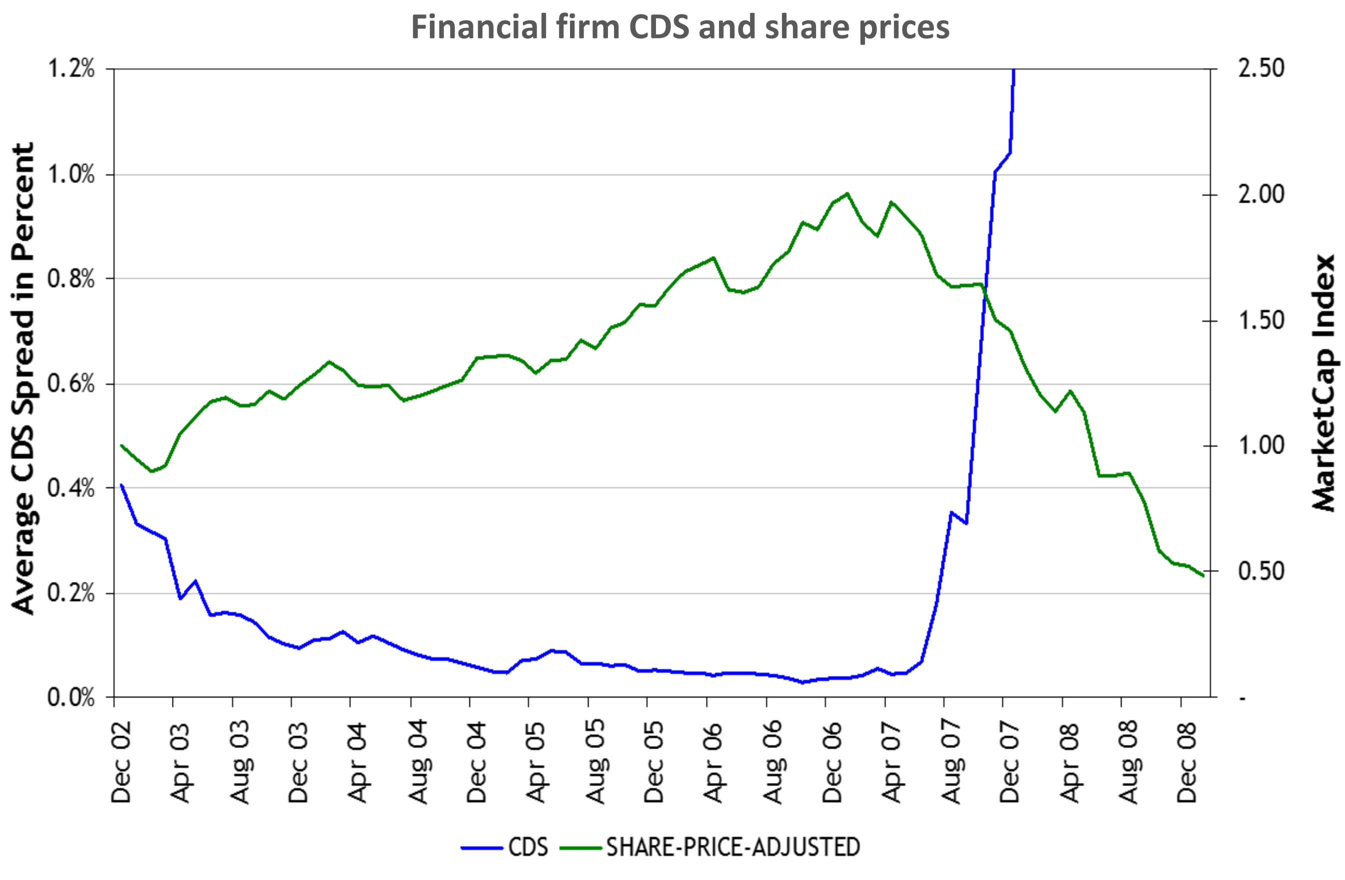
"Securitisation is a good thing. If everything was on bank balance sheets, there would not be enough credit."

"Senior American Regulator", quoted in the *Economist Special Report on Financial Innovation*, February 2012

Credit and asset prices: with securitised credit and mark-to-market accounting

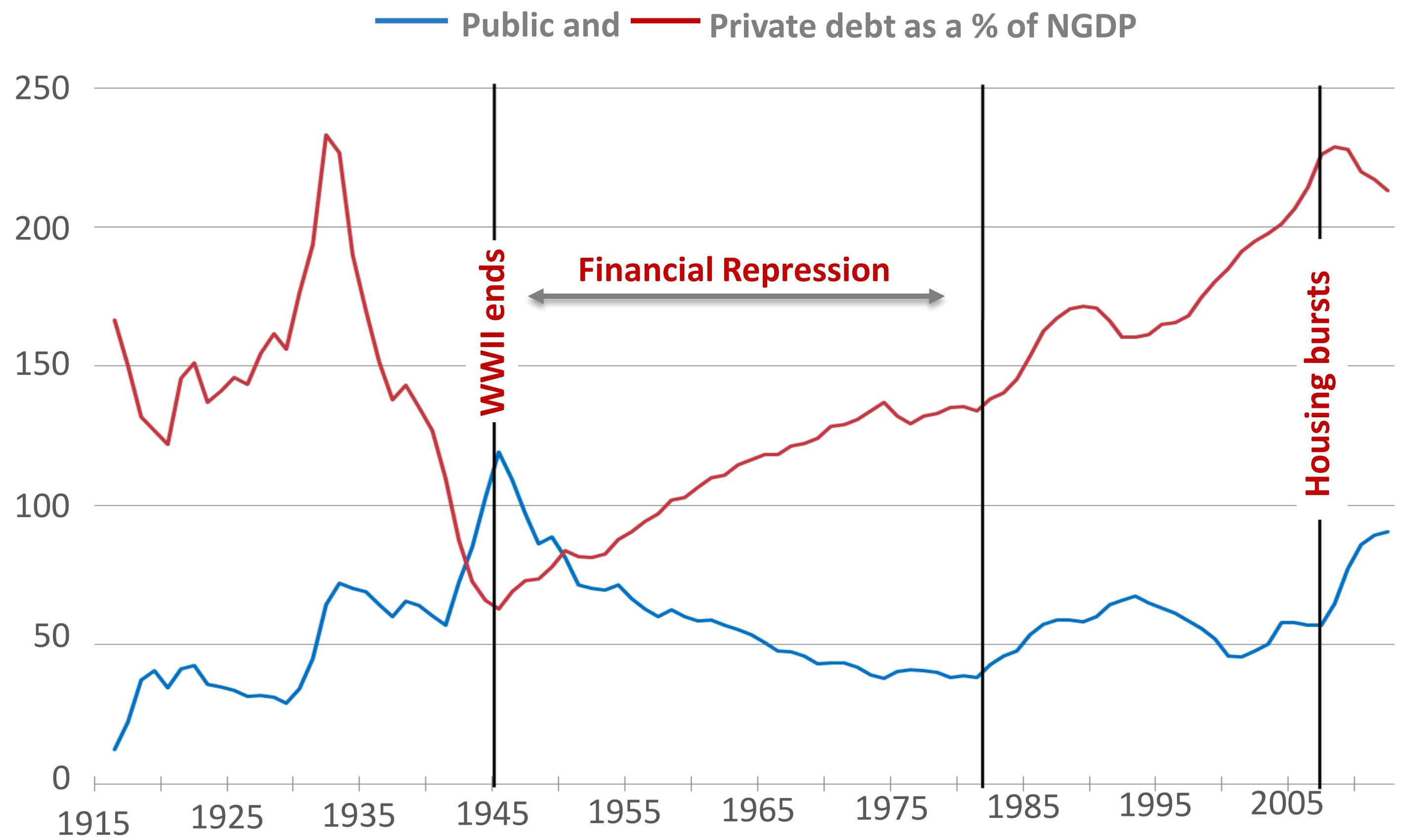


Irrational exuberance in equity and debt markets



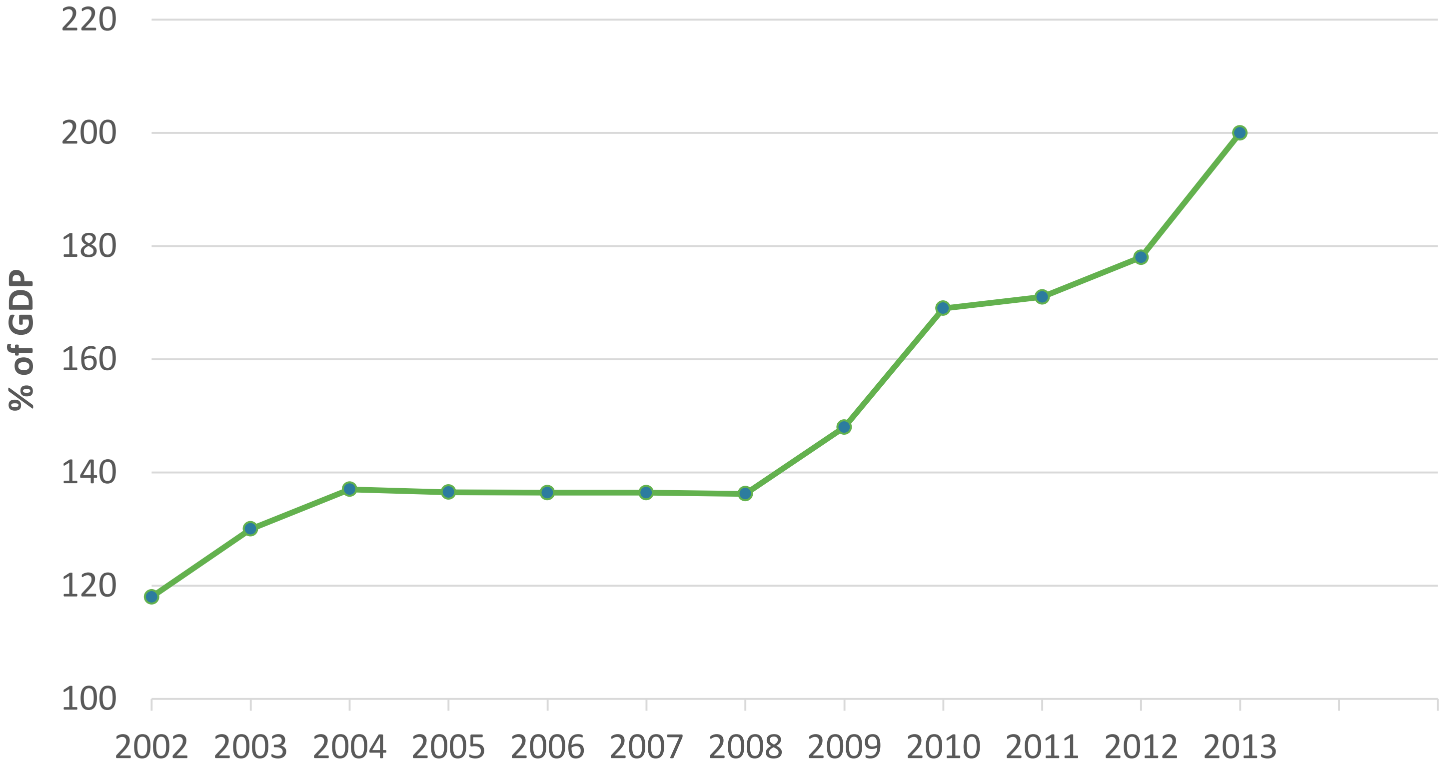
***Source**: Moody's KMV, FSA Calculations*

Private and public leverage cycles: US

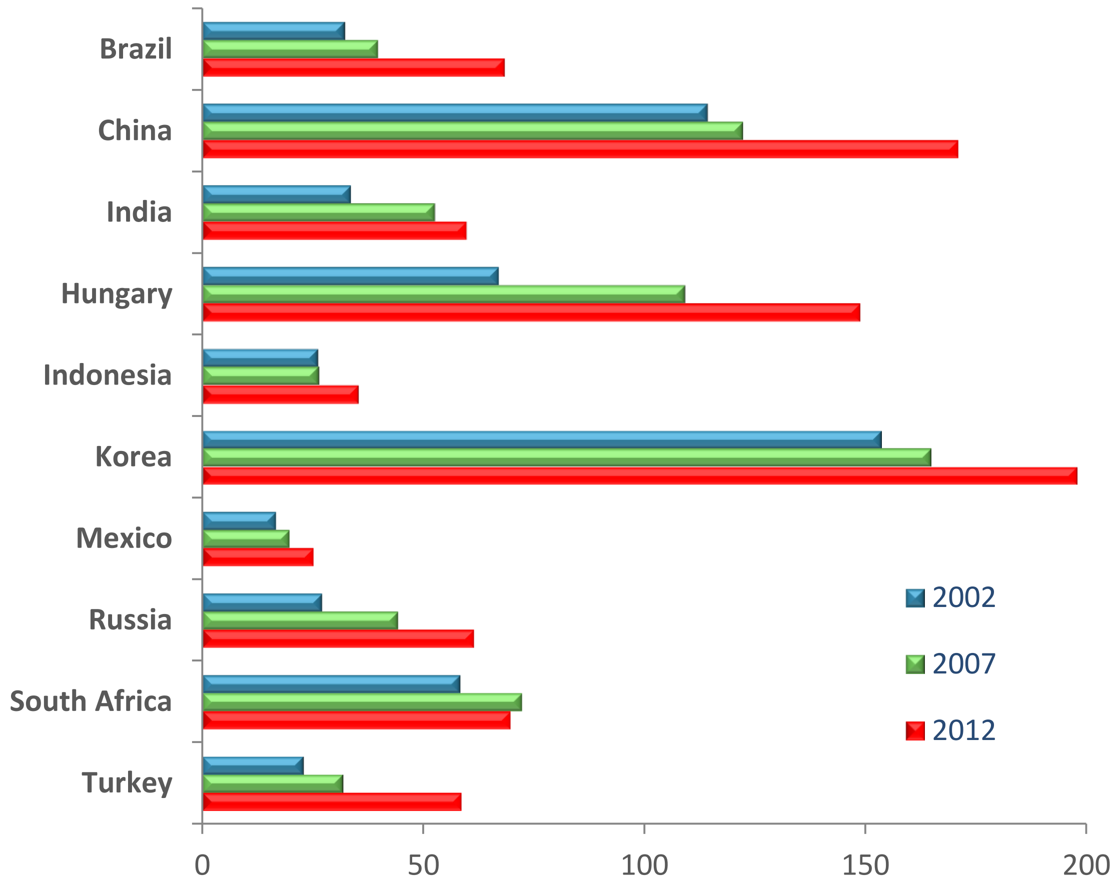


***Source:** McCulley and Pozsar*

China: total social finance to GDP



Non-financial private sector* credit outstanding, % GDP



Source: BIS, Citi Research
*Households + corporates

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Leaning against credit cycles: monetary or macro-prudential levers?

	Monetary policy – interest raises	Macro-Prudential levers
Pros	• Gets into all the cracks	• Can address specific credit categories
Cons	• Elasticity of response variable by category of credit	• Will stimulate innovation to avoid