Money, Finance and the Real Economy: what went wrong?

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Money, Finance and the Real Economy

What went wrong?

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FIRMS SPENDING BEHAVIOUR RESPONDS LESS TO INTEREST RATES CHANGES…

Non-financial firms’ borrowing flows and activity in the United States

*Borrowing flows (% of GDP)

Real Fed funds rate* (% [R.H.S.])


* Fed funds rate deflated by average inflation over the past 10 years.
Investment in equipment and activity
(year on year % change)

United States

France

Source: Thomson Datastream
IT IS BY INFLUENCING HOUSEHOLD BORROWING THAT INTEREST RATE CHANGES INFLUENCE THE REAL ECONOMY

Monetary impulse and change in household borrowing (% of GDP)

(*) The real interest rate is here the difference between a nominal interest rate and the average growth in household income over the past 10 years. The nominal interest rate is itself a weighted average of the 10-year public bond yield (70%) and the Fed funds rate (30%), lagged by four quarters. The shaded zones in the right-hand figure correspond to American recessions (NBER definition).

December 2015 | Sources: Bureau of Economic Analysis, Federal Reserve and Thomson Datastream
HOUSEHOLDS APPETITE FOR BORROWING AND THE AVAILABLE FINANCING CHANNELS ARE HOWEVER VERY DIFFERENT ACROSS COUNTRIES

**Note:** The left-hand figure relates to the period 1995-2006. The right-hand figure relates to the period 2002-06 for the five non-oil-exporting countries with the largest current-account surpluses (in dollars).
RELYING ON THE RESPONSE OF HOUSEHOLDS IN JUST A FEW COUNTRIES TO SUPPORT GROWTH IN THE WORLD ECONOMY COULD NOT LAST FOREVER!

Sources: National central banks and Thomson Datastream

Current account and household borrowing in the United States

Household borrowing (% of GDP) [Inverted R.H.S.]

Current-account balance (% of GDP)

Current accounts and growth in emerging regions

Growth of emerging economies (% over 2 years, annual rate)

Current account of emerging economies (% of GDP)
THERE IS HOWEVER A HUGE POTENTIAL OF SAVINGS AVAILABLE IN PARTICULAR IN FAST GROWING ECONOMIES

Household financial wealth and level of development

Note: In the figure on the left, there are 33 countries for the years 2010 and 2012, 31 for 2003 and 13 for 1993. These years were chosen to avoid valuation effects related to excessively pronounced rises or falls in asset prices – in this case, stock-market indices. The figure on the right shows all the points used in the regression.

Sources: IMF, OECD and authors’ calculations
TO ABSORB THOSE SAVINGS, PRIVATE DEBT HAS BEEN INCREASING…
IN CHINA IN PARTICULAR!

Debt of the non-financial private sector (% of GDP)

Brazil

Turkey

Russia

China

India

December 2015 | Source: Thomson Datastream
WHILE THE DEBT BURDEN HAS KEPT INCREASING IN EMERGING ECONOMIES, IN MANY DEVELOPED ECONOMIES PRIVATE DEBT TO GDP RATIOS BARELY FELL

Credit to the private sector (% of GDP)

“Back to normal” economies
- United Kingdom
- United States

“Lowflation” economies
- Japan
- Euro area

Commodity exporters
- Canada
- Australia

United States
United Kingdom
Japan
Euro area

Households
Non-financial private sector
Non financial enterprises

Source: Thomson Datastream
MANY DEVELOPED ECONOMIES WILL CONTINUE TO FIGHT AN APPRECIATION OF THEIR CURRENCY

Real effective exchange rates
(2011 = 100, PPI deflated)

“Back to normal” economies
“Lowflation” economies
Commodity exporters

Memo: 3 other European economies

Source: Thomson Datastream
THE IMPRESSIVE INCREASE IN THE ECB BALANCE SHEET HAS HARDLY LED TO AN INCREASE IN THE AMOUNT OF LOANS OUTSTANDING...

Sources: Thomson Datastream, ECB
… BUT IT HAS SIGNIFICANTLY CONTRIBUTED TO WEAKEN THE CURRENCY BY INDUCING MORE BUYING OF REST OF THE WORLD BONDS

**Net suppliers of debt securities**

(€ billion, moving average over 4Q, annual rate)

**Net buyers of debt securities**

(€ billion, moving average over 4Q, annual rate)

![Graphs showing net supplies and buyers of debt securities over time](image)

**Sources:** Thomson Datastream, ECB
CONCLUSIONS

“Printing” money by central banks will not solve the global growth problem.

There is a need to build new financing channels to tap the existing saving potential.

Governments have here a key role to play: if they don’t want to borrow, they should at least help put in place those new channels.