Discussion of: Credit Booms Gone Bust: Monetary Policy, Leverage Cycles and Financial Crises, 1870-2008 (by M. Schularick and A. Taylor)

by Giovanni Dell'Ariccia (*IMF* and *CEPR*)

Atlanta Fed 2011 Financial Markets Conference

Major Contributions I

- The paper builds a remarkable dataset of credit data (and other variables):
  - Goes back to 1870
  - Covers most developed economies
  - Builds consistent cross-country comparable series
  - How does this compare to the widely used credit-to-the-private-sector (IFS line 22d)?

Major Contributions II

- Data allows to identify two very different money and credit regimes

- Pre-war (1870-1945), Monetarist view:
  - Money and credit stable relative to GDP
  - Bank liabilities primarily monetary (deposits)
  - Stable relative to credit

- Post-war (1945-current),
  - Bank assets rising relative to GDP
  - Increasing recourse to non-monetary instruments
  - Rising leverage (?)

Additional Contribution

- Study link between credit growth and financial crises:
  - Regress crisis dummy on lagged credit growth measures and controls
  - Higher past credit growth rates associated with greater probability of crisis (but is this linear?)
  - Some evidence of differences between pre- and post-war: Money matters less now

General Comments

- Truly impressive data collecting exercise
- Very interesting analysis of historical changes in relationship among money/credit/real aggregates
- Still interesting (but less novel econometric work on crises)
- Topical for debate on monetary and macro-financial policies

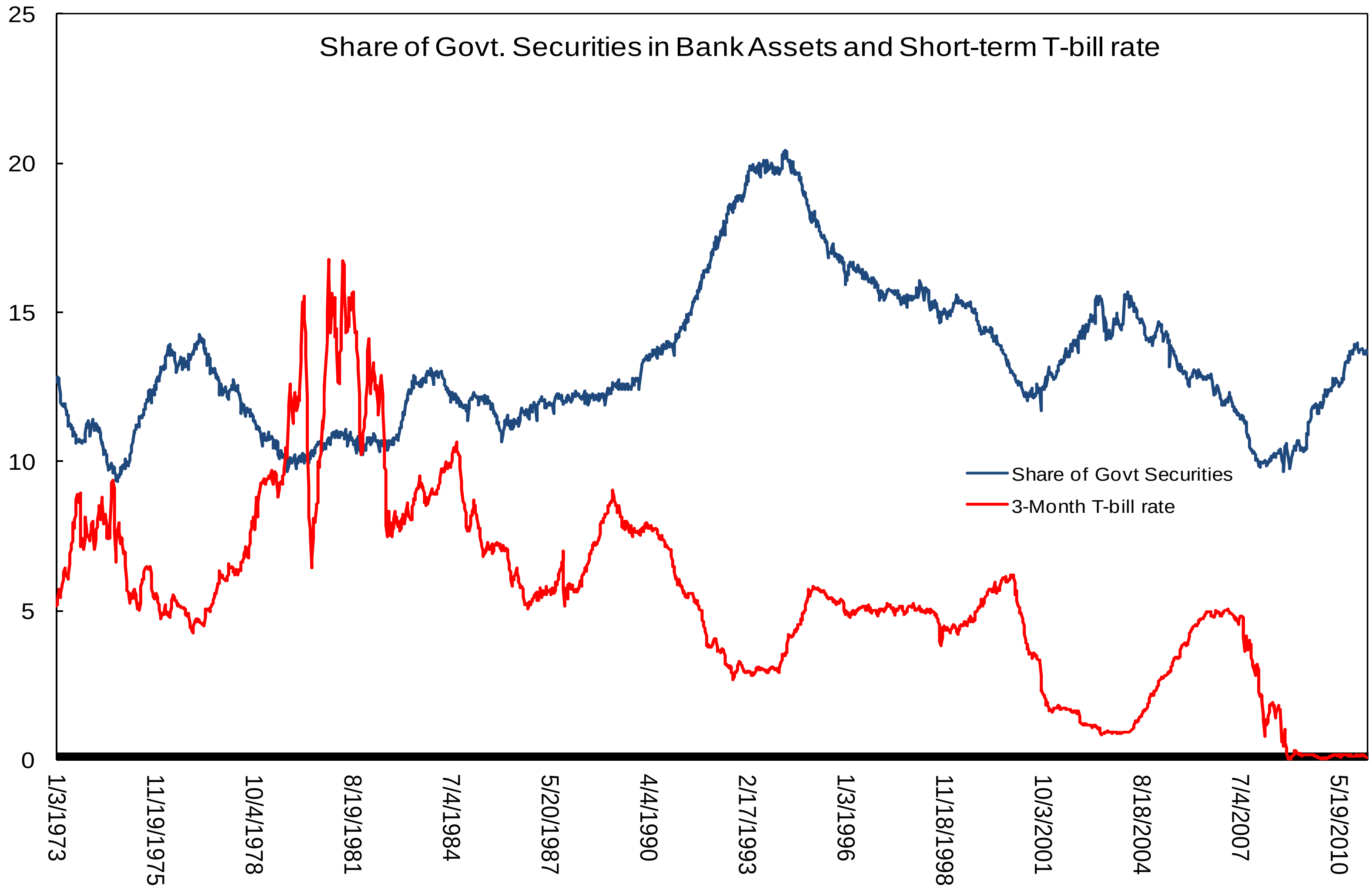
Suggestions: Interpretation of Trends I

- Increasing ratio of assets to broad money:
  - Interpreted as rise in leverage at banks
  - Yet, says little about nature of liabilities
  - It could be equity or equity-like claims such as convertible bonds (role of "good" securitization?)
  - Trend virtually identical in boom years and "above suspicion" years (1950-1970)
  - There are benefits: Financial deepening (credit cards ?)

Suggestions: Interpretation of Trends II

- Decreasing share of govt. securities in bank portfolios
  - There has been a recent trend, but with major fluctuations
  - Changes not enormous
  - A role for monetary policy?
  - Fiscal policy?

Govt. Securities and Monetary Policy



Suggestions: Credit Booms

- Paper focuses more on long-term structural factors than on cyclical episodes
  - Novel literature on “too much” finance

- Yet, fast growing credit good indicator of financial crisis risk

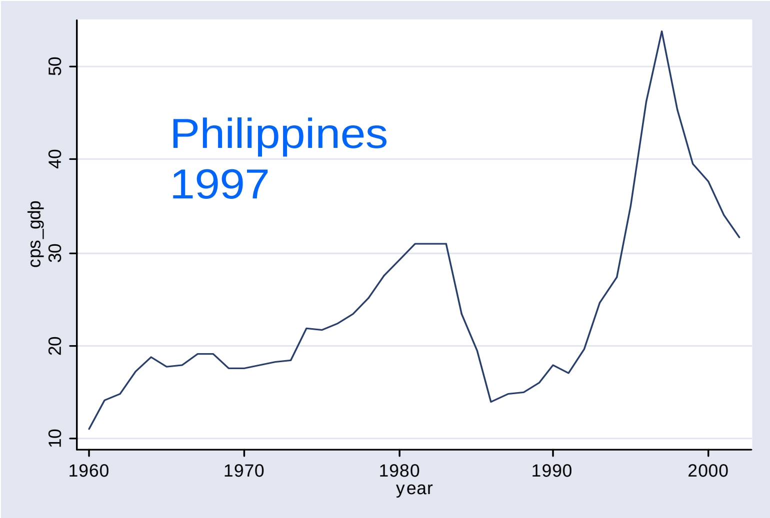
  - Scandinavia 1990, Mexico 1995, Asia 1997, East Europe 2008, Ireland/Iceland 2008, Spain 2008, US-Subprime 2008

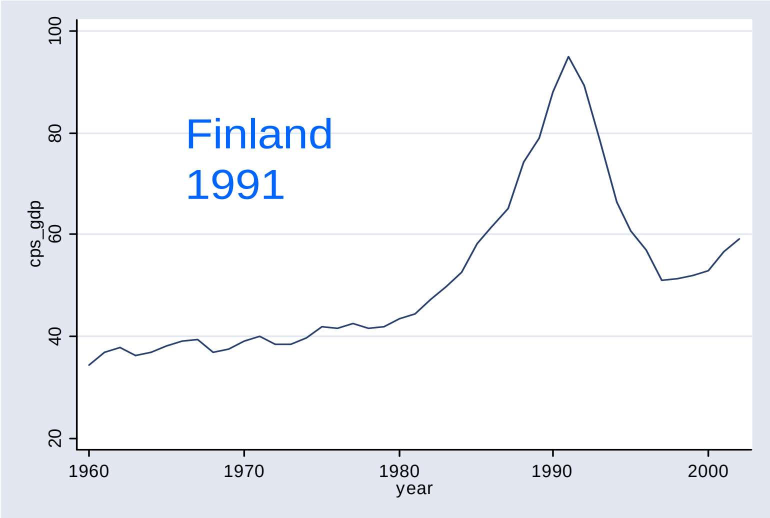
  - Favor a more non-linear approach: some growth is good, too much is bad

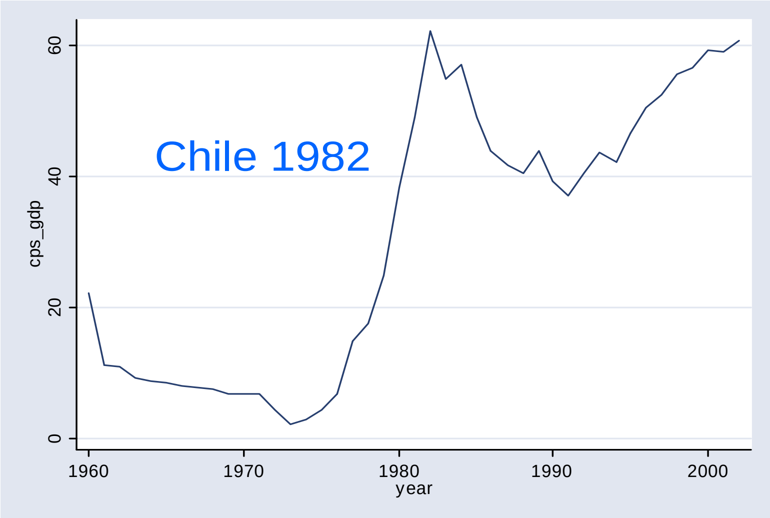
  - (see Mendoza and Terrones, 2009, Barajas, Dell’Ariccia, Levchenko, 2009, Gourinchas, Valdes, Landerretche, 2001)

Older Cases


Thailand
1997
cps_gdp
0
50
100
150
1960
1970
1980
1990
2000
year


Philippines
1997
cps_gdp
10
20
30
40
50
1960
1970
1980
1990
2000
year


Finland
1991
cps_gdp
20
40
60
80
100
1960
1970
1980
1990
2000
year


Chile 1982
cps_gdp
0
20
40
60
1960
1970
1980
1990
2000
year

Most Recent Episodes in Europe

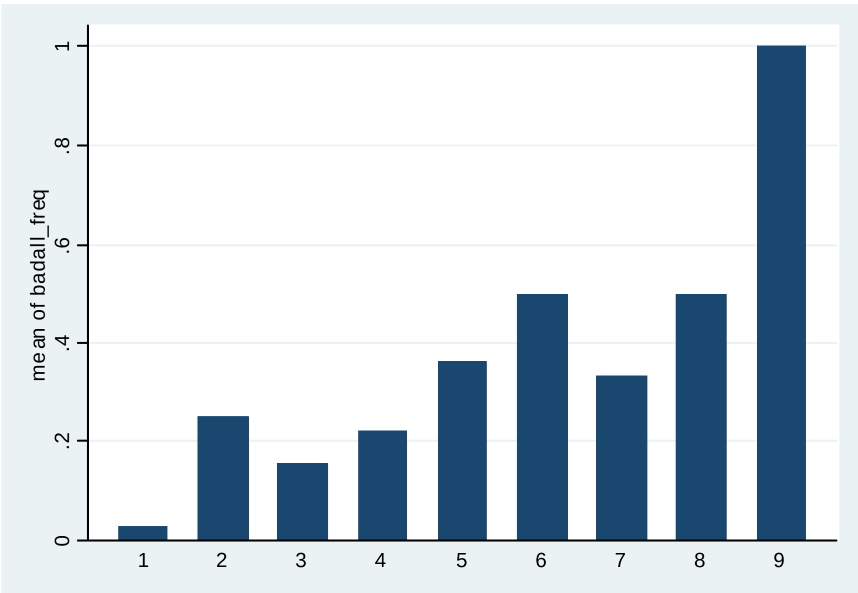
Average Annual Real Credit Growth (2003-2007)	
Selected Eastern European Countries	
Ukraine	46.3
Lithuania	44.7
Romania	43.5
Latvia	39.0
Bulgaria	35.6
Estonia	28.5
Czech Republic	16.3
Hungary	15.2
Poland	14.0
Slovak Rep	8.6
Selected Western European Countries	
Ireland	18.4
Spain	17.1
Greece	13.6
UK	10.1
France	6.4
Italy	6.1
Portugal	4.9
Germany	-1.3

Source: IFS, Staff calculations

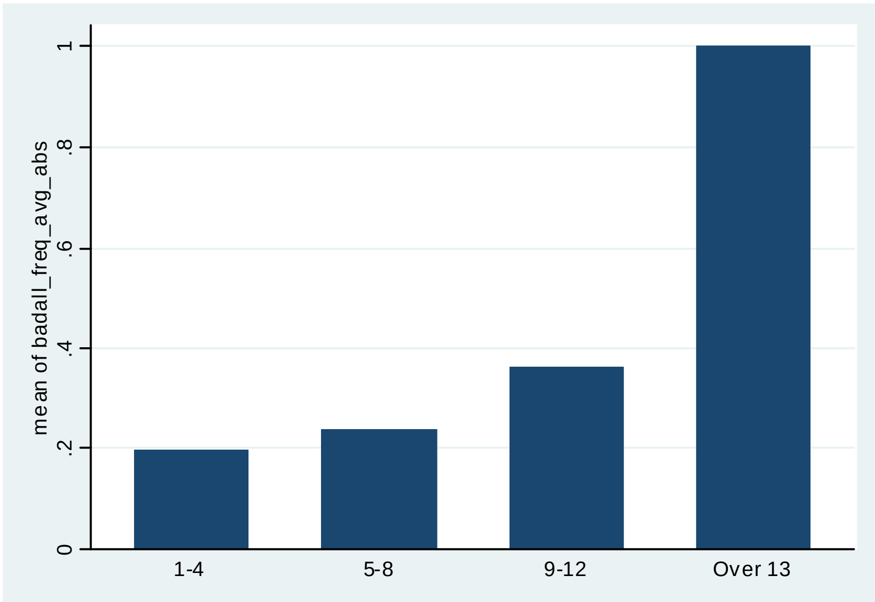
Subprime Crisis: A Credit Boom Gone Bad?

Boom Characteristics Matter

Frequency of booms ending in crisis by duration



Frequency of booms ending in crisis by size



Boom defined as 1.5 SD from Credit-to-GDP ratio rolling non-linear trend (see *Barajas/Dell'Ariccia/Levchenko, 2009*, for details)

Paper Identifies Important Policy Tension

- Need for greater financial intermediation
  - Especially in emerging markets
- Not all booms end up in crises
  - Costs of policy action immediate, benefits uncertain
- Need to reevaluate Taylor-rule-based monetary policy?
  - Inflation/output gap no longer enough
  - Bubbles
- It is difficult to stop a boom
  - Monetary policy has limits (more so when ER is somewhat of a target)
  - Macroprudential measures can be circumvented (especially in more sophisticated/open markets)