

BANK FOR INTERNATIONAL SETTLEMENTS

Monetary policy and bank lending after the crisis

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The views expressed in the following do not necessarily reflect those of the Bank for International Settlements



Old division of labor

- **Regulatory** policy:
 - Eliminate the contagion created by individual failure
 - Control the moral hazard created by the safety net
- **Fiscal** policy:
 - Long-term growth
 - Division of Y into $C+I+G+NX$
- **Monetary** policy:
 - Short-term stabilization using short-term interest rates
 - Insure availability of liquid assets in the very short term



Old order of action

- **Regulatory** policy was timeless
- **Fiscal** policy was focused on the long-term acts infrequently
- **Monetary** policy flexible and frequent



But life is more complicated

- **Monetary** policy influences **fiscal** policy
(central bank balance sheet policy)
- **Fiscal** policy influences **regulatory** policy
(subsidizes debt)
- **Monetary** policy influences **regulatory** policy
(interest rates affect incentives)
- **Regulatory** policy influences **fiscal** policy
(demand for sovereign debt)

These are not second order effects!



The lending channel...

- Monetary policy affects demand and supply of loans
- Supply:
 - By changing lending spreads and profitability
 - By changing the level of bank capital
- Demand:
 - Business prospects increase
 - Net worth and cash flow



...during the crisis

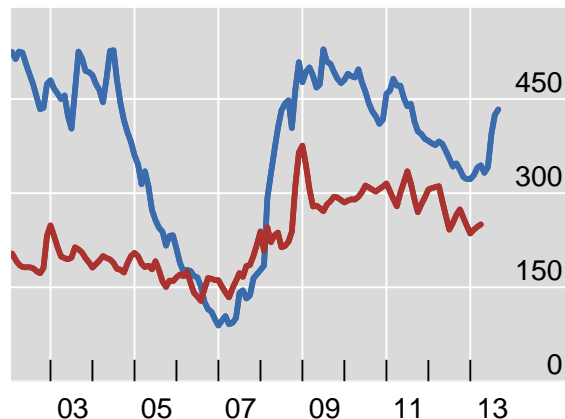
- Growth and lending collapsed
- Policy responded with policy rates at zero
- But low policy rates did not translate into
 - low lending rates



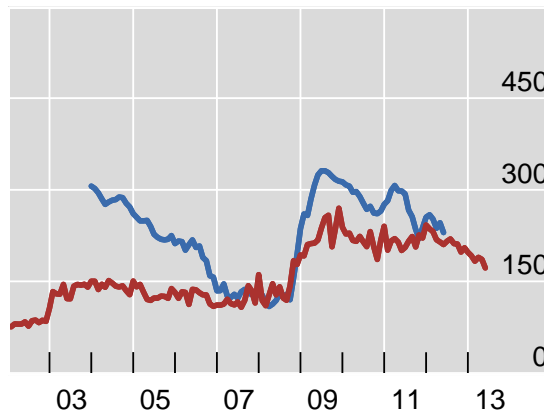
Lending rate spreads over policy rates

In basis points

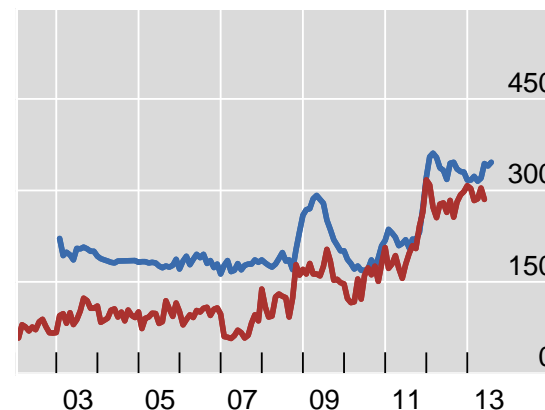
United States



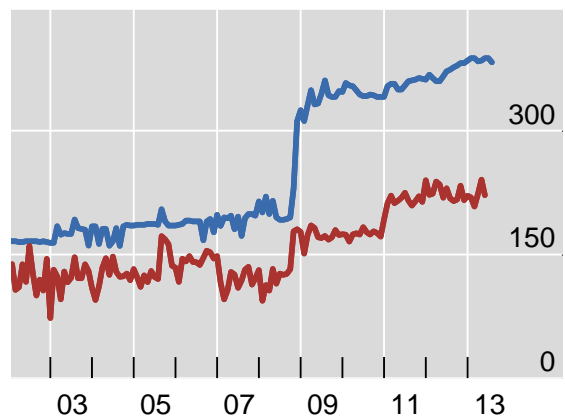
Germany



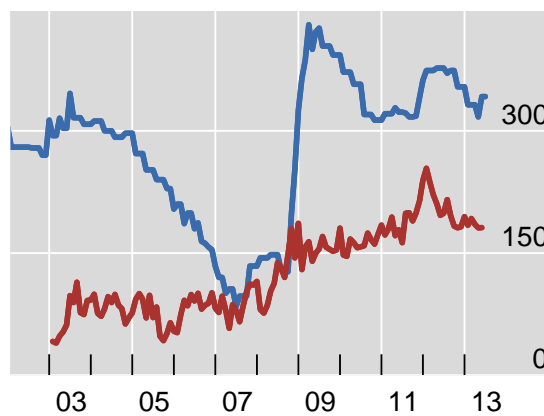
Italy



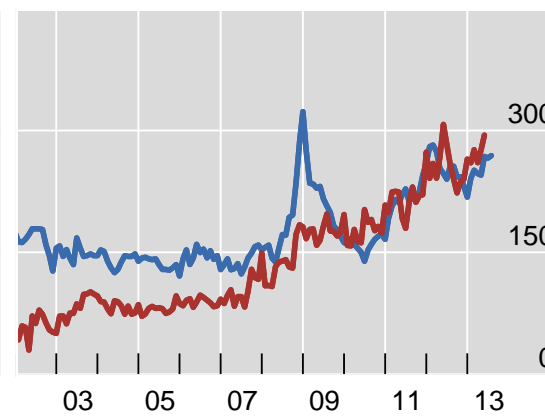
United Kingdom



France



Spain



— Loans to non-financial firms

— Loans to households (mortgage)

Notes: New loans. The average maturity on loans to non-financial firms is considerably shorter than that on household mortgage loans.



...during the crisis

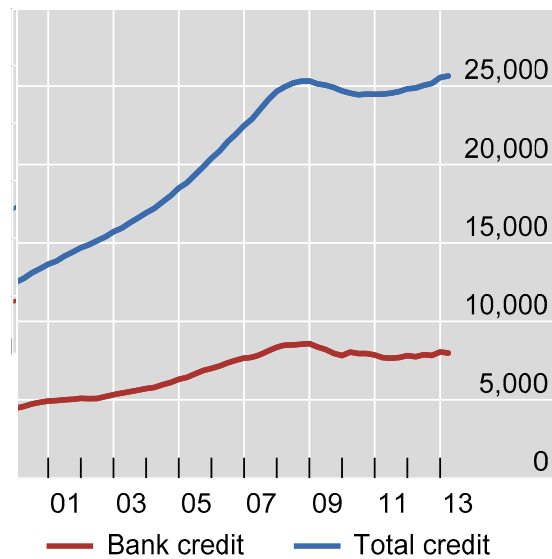
- Growth and lending collapsed
- Policy responded with policy rates at zero
- But low policy rates did not translate into
 - low lending rates
 - and increased lending



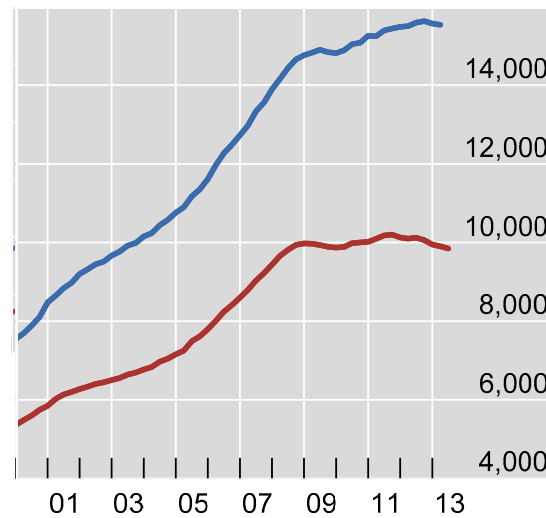
Private credit

In billions of national currency units

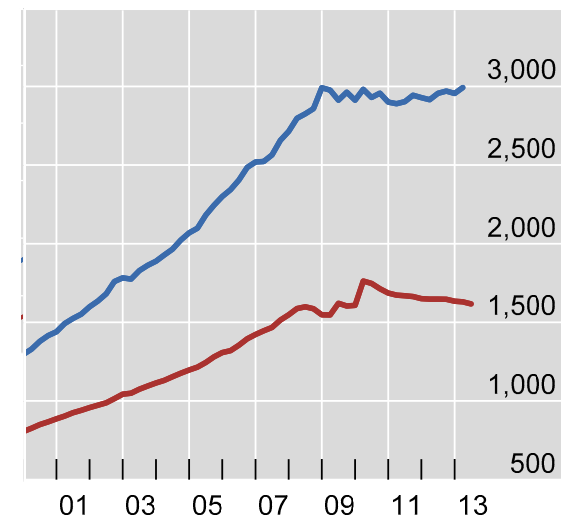
United States



Euro area



United Kingdom



Sources: National data.

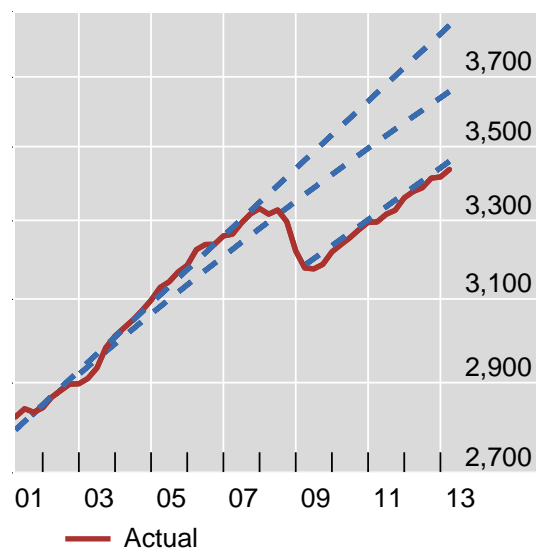


Why hasn't the stimulus delivered more growth?

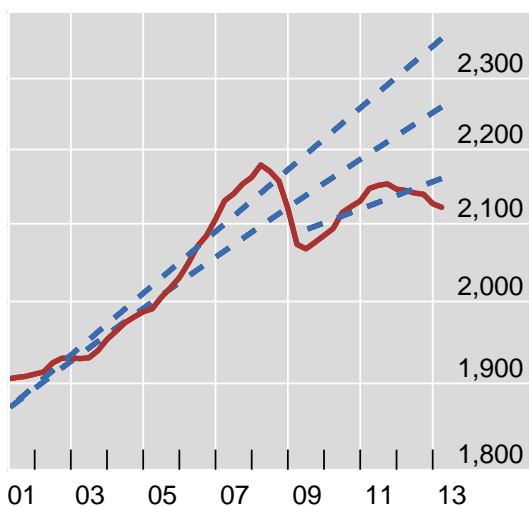
Real GDP

Quarterly data, in billions of respective currency units

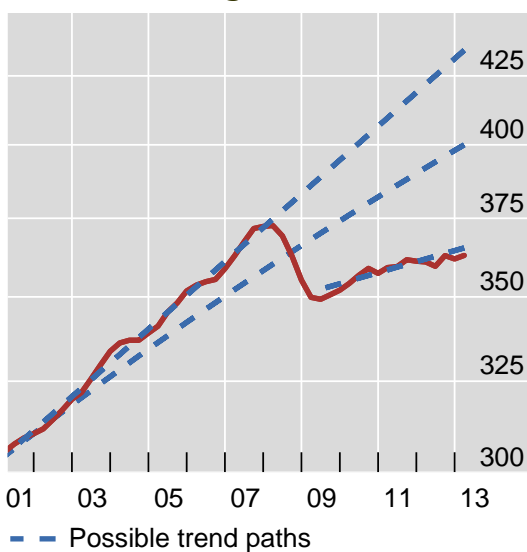
United States



Euro area



United Kingdom



Seasonally adjusted, on a logarithmic scale.
Sources: National data; BIS calculations.



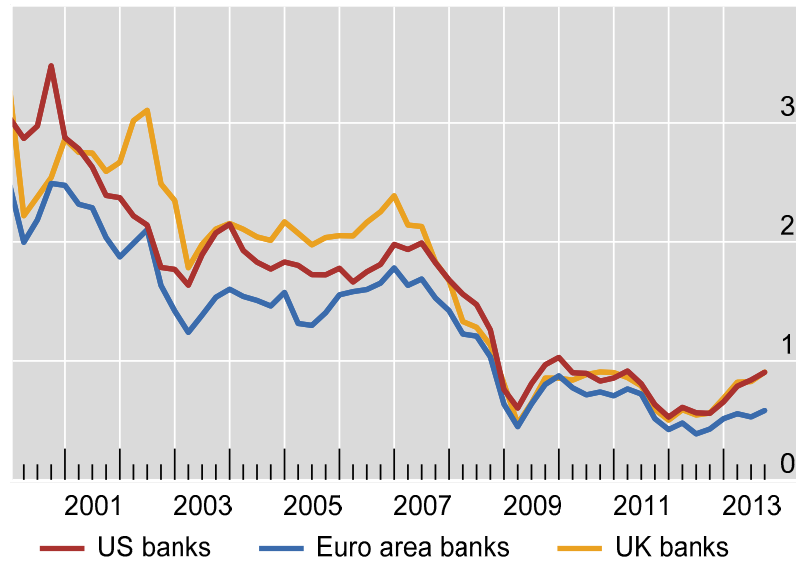
Why hasn't the stimulus delivered more growth?

- Banks
 - Low capital
 - Impaired assets

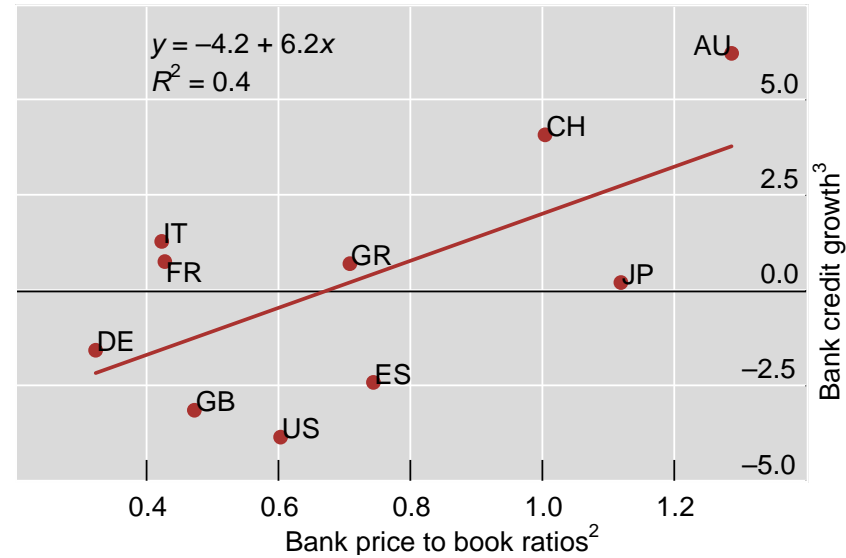


Bank price to book ratios¹

United States and Europe



Bank price to book ratios and bank credit



AU = Australia; CH = Switzerland; DE = Germany; ES = Spain; FR = France; GB = United Kingdom; GR = Greece; IT = Italy; JP = Japan; US = United States.

¹ Simple averages across major banks. ² Averages of 2009 Q1. ³ Changes from 2009 Q1 to 2010 Q1, in per cent.

Sources: Bloomberg; Datastream; national data; BIS calculations.

Why hasn't the stimulus delivered more growth?

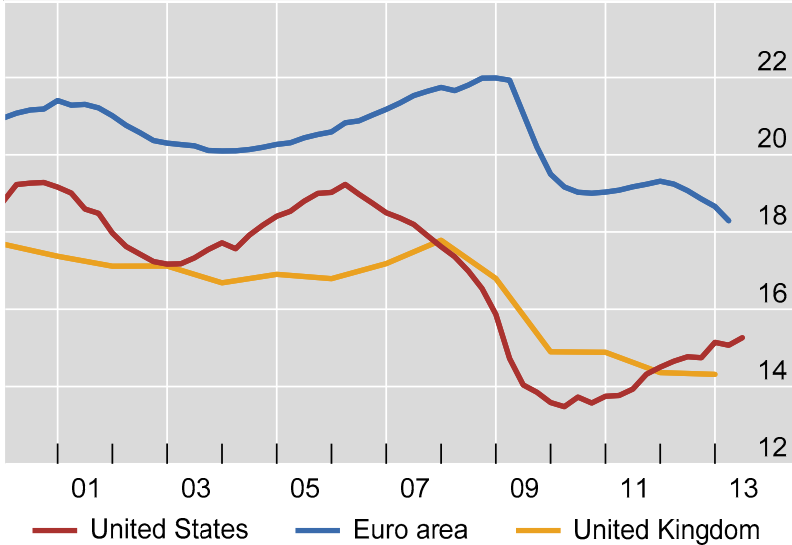
- Businesses
 - Banks and other financial firms are still weak
 - Poor business prospects and high uncertainty



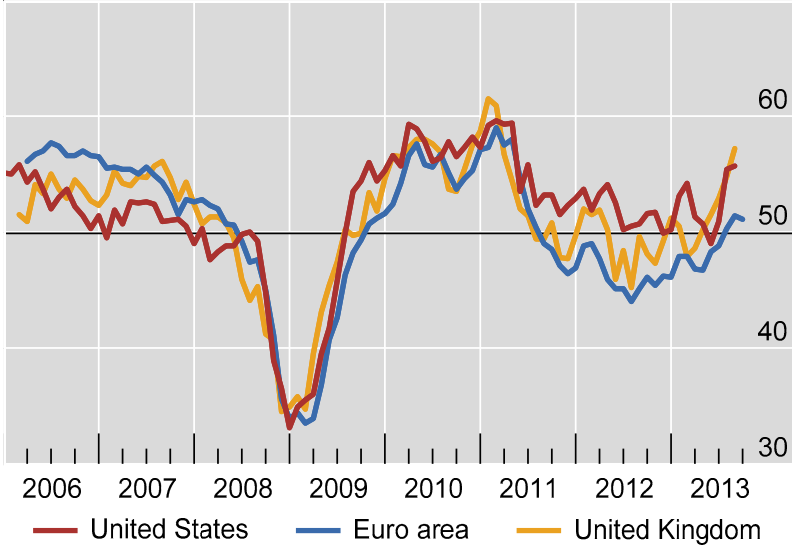
Business outlook

Gross fixed capital formation

In per cent of nominal GDP



Purchasing managers' index¹



¹ Purchasing managers' index (PMI) derived from monthly surveys of private sector companies. Values above (below) 50 indicate expansion (contraction).

Sources: ECB; U.K. Office for National Statistics; U.S. Bureau of Economic Analysis; Bloomberg; Datastream; Markit.



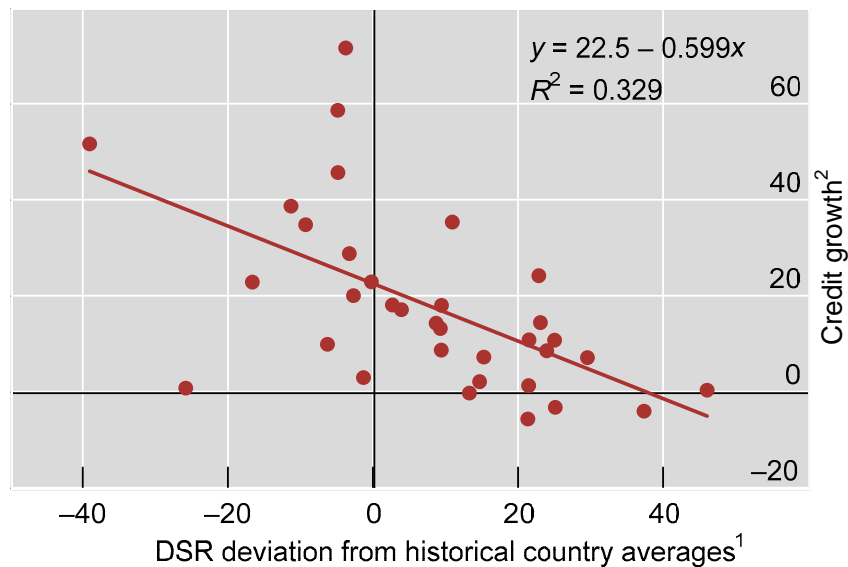
Why hasn't the stimulus delivered more growth?

- Households
 - Are still highly leveraged in many countries
 - Debt-service remains a burden

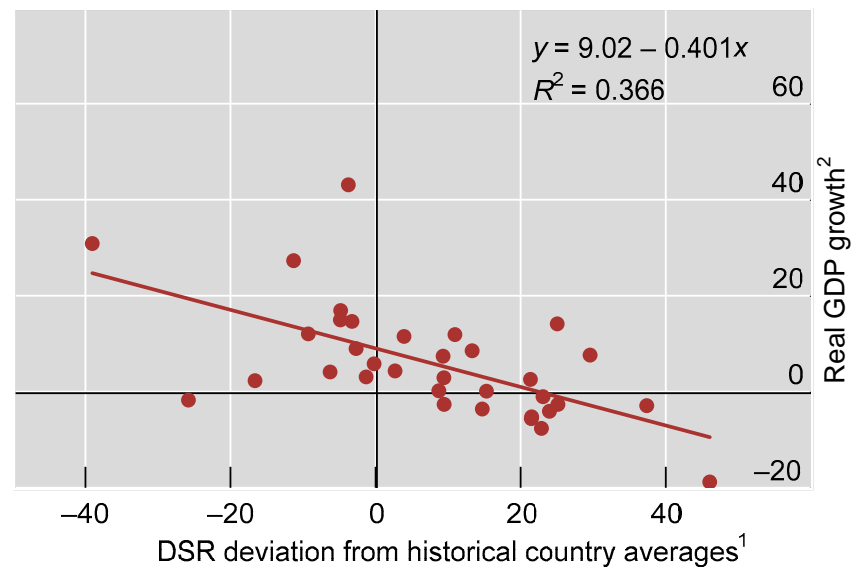


Debt service ratio

Debt service ratio and credit



Debt service ratio and GDP



¹ At end-2007, in per cent. ² Changes from 2008 Q1 to 2012 Q4, in per cent.

Sources: National data; BIS calculations.



Unconventional measures

- With weak lenders & weak borrowers equilibrium real rates < 0
- Policies to directly influence lending:
 - Quantitative Easing
 - Funding for lending
 - Forward guidance
 - LTRO
- Real effects are muted:
 - Bank balance sheets weak
 - Household balance sheets weak
 - Business prospects poor



Lessons

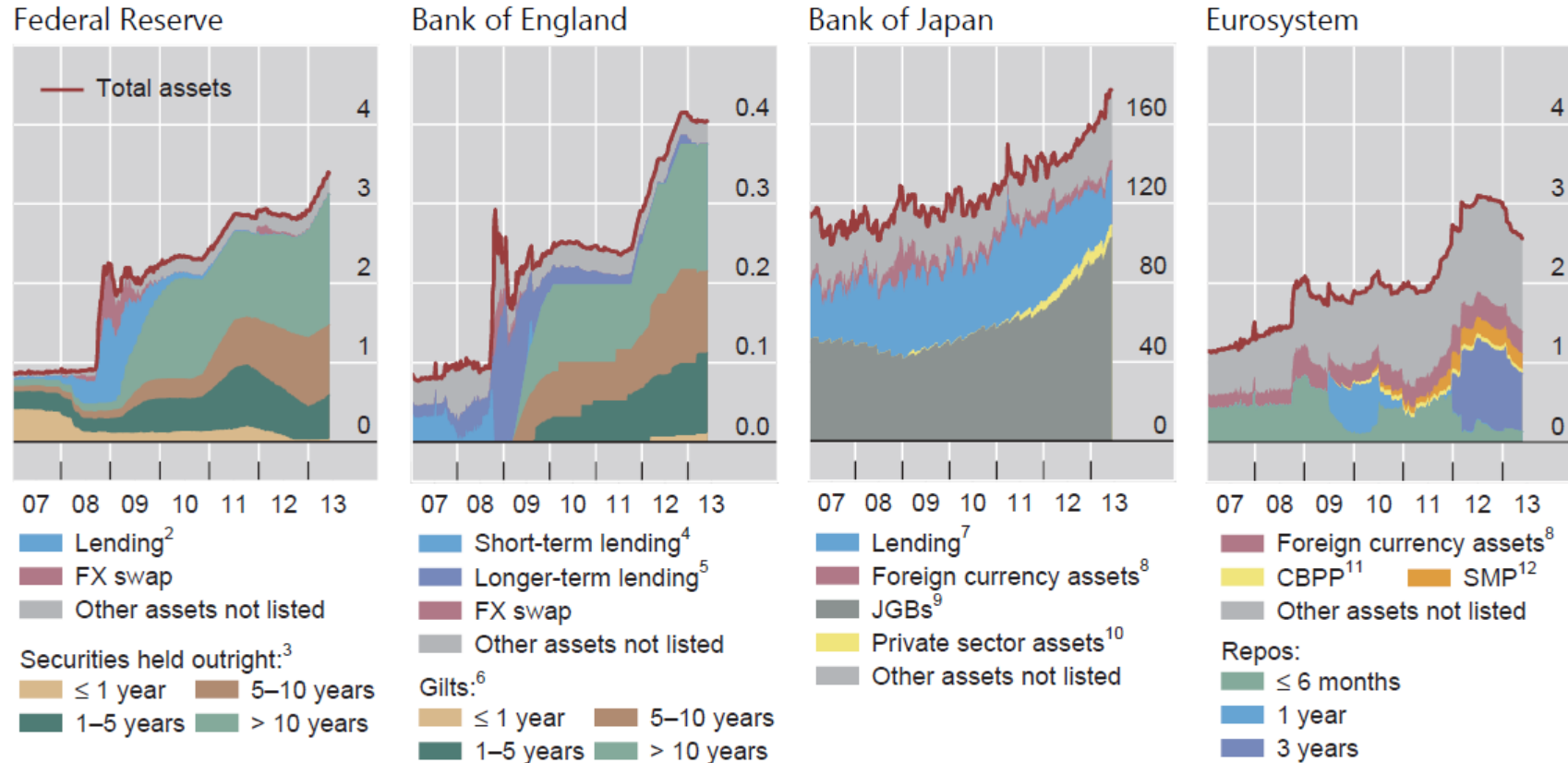
- Weak banks do not lend
- Indebted households do not borrow
- Businesses with poor prospects do not invest



Central bank balance sheet size and composition

Appendix Graph 1

In trillions of respective currency units



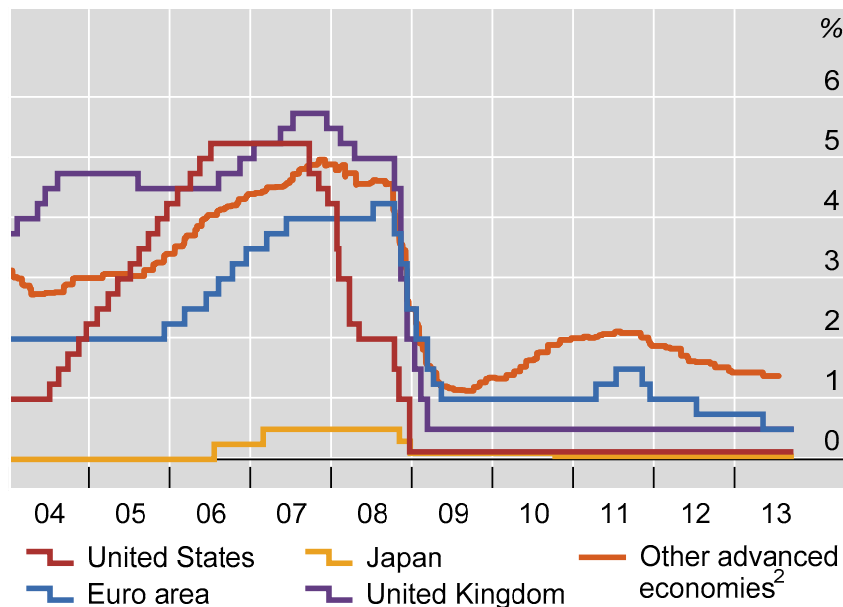
¹ Bank of England and Federal Reserve: breakdown by remaining maturity; Eurosystem: breakdown of outstanding repo operations by original maturity. ² Outstanding in repos, term auction facility, other loans and net portfolio holdings of Commercial Paper Funding Facility LLC. ³ US Treasury securities, mortgage-backed securities and agency debt; face value. ⁴ One-week, other maturity within-maintenance period, and fine-tuning repo operations. ⁵ Longer-term repo operations. ⁶ Holdings of the Asset Purchase Facility; proceeds. ⁷ Receivable under resale agreements and loans excluding those to the Deposit Insurance Corporation. ⁸ Includes US dollar liquidity auctions. ⁹ Japanese government bonds. ¹⁰ Commercial paper, corporate bonds, exchange-traded funds and listed real estate investment trust securities. ¹¹ Covered bonds held under the Covered Bond Purchase Programme (CBPP) 1 and the CBPP 2. ¹² Securities held under the Securities Markets Programme (SMP).
Sources: Datastream; national data.



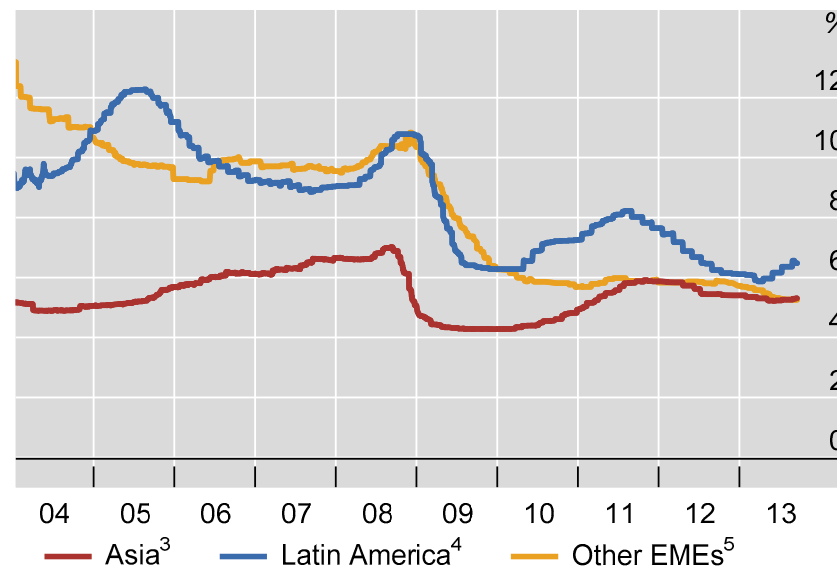
Policy rates¹

Appendix Graph 2

Advanced economies



Emerging market economies



¹ Policy rate or closest alternative; for target ranges, the midpoint of the range. Aggregates are weighted averages based on 2005 GDP and PPP exchange rates. ² Australia, Canada, Denmark, New Zealand, Norway, Sweden and Switzerland. ³ China, Chinese Taipei, Hong Kong SAR, India, Indonesia, Korea, Malaysia, the Philippines, Singapore and Thailand. ⁴ Argentina, Brazil, Chile, Colombia, Mexico and Peru. ⁵ Other emerging market economies (EMEs): the Czech Republic, Hungary, Poland, Russia, Saudi Arabia, South Africa and Turkey.

Sources: Bloomberg; Datastream; national data.

