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

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

Bank credit

Total credit

Euro area

Bank credit

Total credit

United Kingdom

Bank credit

Total credit

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 ratios

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

Purchasing managers’ index

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

![Graph showing the relationship between debt service ratio and credit growth.](image)

\[ y = 22.5 - 0.599x \]
\[ R^2 = 0.329 \]

Debt service ratio and GDP

![Graph showing the relationship between debt service ratio and real GDP growth.](image)

\[ y = 9.02 - 0.401x \]
\[ R^2 = 0.366 \]

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

Federal Reserve | Bank of England | Bank of Japan | Eurosystem
---|---|---|---

- **Total assets**
- **Lending**
- **FX swap**
- **Other assets not listed**

**Securities held outright:**
- US Treasury securities, mortgage-backed securities and agency debt; face value.
- One-week, other maturity within-maintenance period, and fine-tuning repo operations.
- Longer-term repo operations.

**Foreign currency assets**
- Covered bonds held under the Covered Bond Purchase Programme (CBPP 1 and the CBPP 2).

**Private sector assets**
- Securities held under the Securities Markets Programme (SMP).

Sources: Datastream; national data.

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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.
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).
_Policy rates_¹

### Advanced economies

- United States
- Japan
- United Kingdom
- Other advanced economies²

### Emerging market economies

- Asia³
- Latin America⁴
- Other EMEs⁵

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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.