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)

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The views in this presentation are those of the authors and do not necessarily represent those of the IMF
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?
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

- 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

Philippines 1997

Finland 1991

Chile 1982
## Most Recent Episodes in Europe

<table>
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<th>Average Annual Real Credit Growth (2003-2007)</th>
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<td><strong>Selected Eastern European Countries</strong></td>
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<td>Ukraine</td>
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| **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
Boom defined as 1.5 SD from Credit-to-GDP ratio rolling non-linear trend (see Barajas/Dell’Ariccia/Levchenko, 2009, for details)
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)