EUROPEAN CENTRAL BANK
EUROSYSTEM

Corporate credit and sectoral prudential measures

ESRB Ieke van den Burg Prize Award Ceremony

Frankfurt, 1 October 2021

Philipp Hartmann
Deputy Director General Research

A well-deserved prize!

Public good to the research community

- Construction of a new credit data base
- Great complement/addition to the JST macrofinancial history data base (Jorda, Schularick and Taylor 2017)
- Broad (116 countries), long (since 1940) and granular (up to 60 industries and 4 types of household lending)
- Make it available online!

Evidence found for an interesting and theoretically well-founded hypothesis

- Credit booms to non-tradable corporate sector tend to end with adverse effects on growth and productivity or even crises
- Refines benign perspective on corporate as opposed to household credit booms (Jorda et al. 2020)
- Harmony to micro theory (Myers 1977)

A well-deserved prize!

Inspiring for public policy

- Useful for complementing the macroprudential toolkit and for banking supervision
- As pointed out by the authors: research supports efforts to develop sectoral countercyclical capital buffer frameworks
- Also suggests targeted sectoral credit and risk monitoring
- But need harmonised sectoral credit data for the EU/euro area

Relevant for Europe

- Lending to non-tradable corporate sector, notably for construction and real estate, sounds awfully familiar from the European financial crisis
- But additional component: partly financed through cross-border short-term interbank lending that led to a sudden stop

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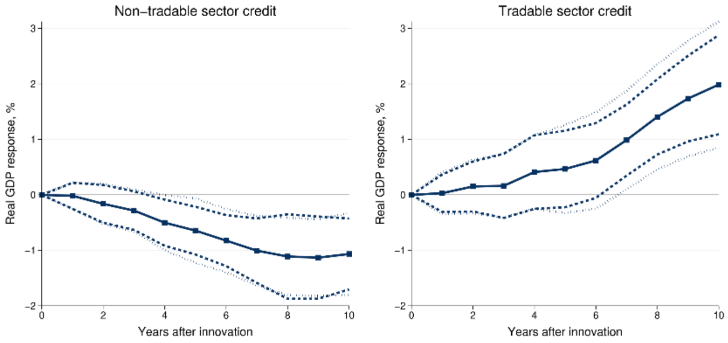
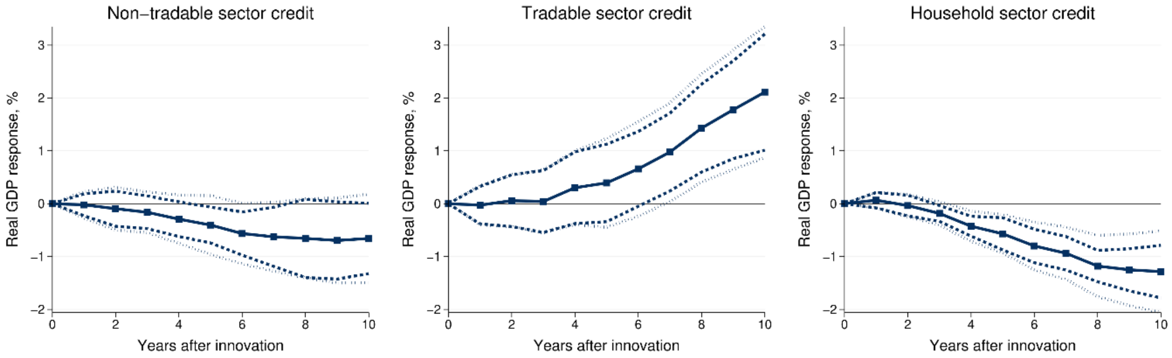
Adverse effects of household credit booms more robust

Estimation without household credit:



Estimation with household credit:



(also very low R^2)

→ One word of caution regarding mechanical policy application:

- **Not all non-tradable credit booms may be equally bad**
- **Which factors make them bad?**

Source: Müller and Verner (2021), figure 8.

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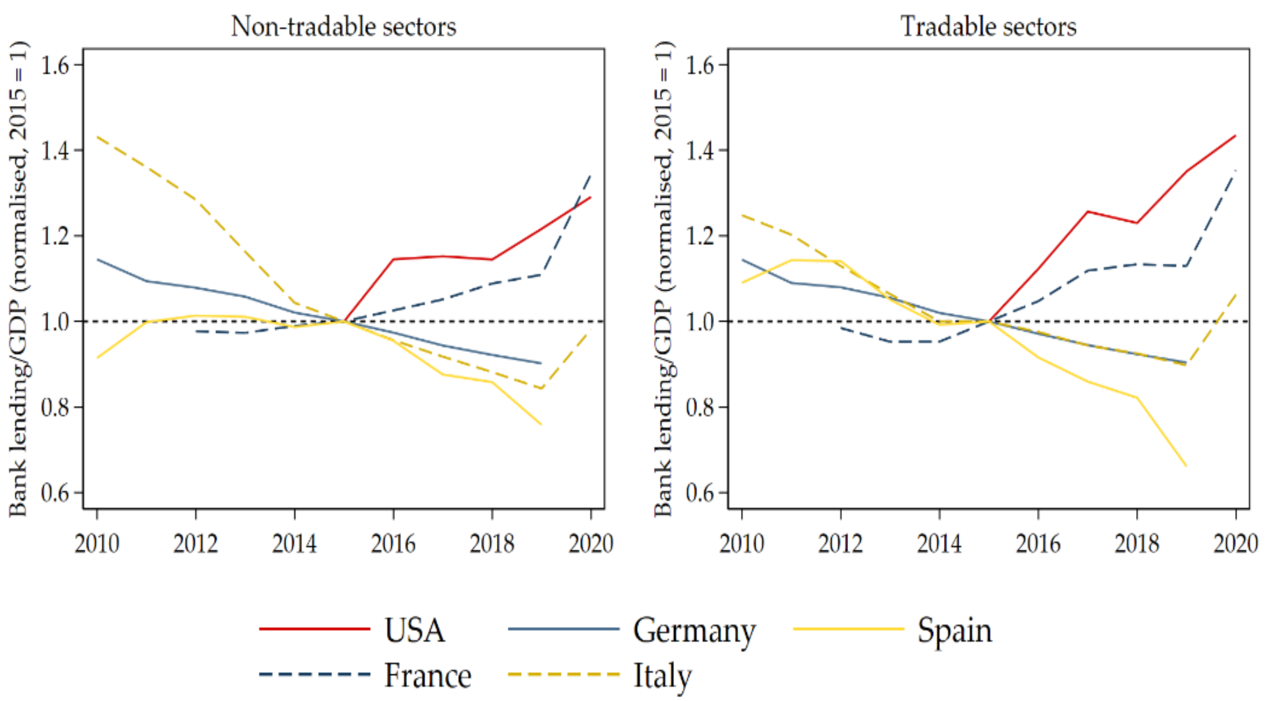
Non-tradable corporate credit growth not the main financial stability problem in the euro area at present?



Source: Schularick (2021), figure 11.

French case:

- Strong credit growth since a while
- Not limited to non-tradable or corporate sector in general
- More attenuated on a net debt basis (e.g. cash hoarding of companies)
- Tightening of large exposure limits to highly indebted French companies in July 2018 (special macroprudential measure under Art. 458 CRR still active)
- Adoption of general countercyclical capital buffer in July 2019, but released with COVID crisis

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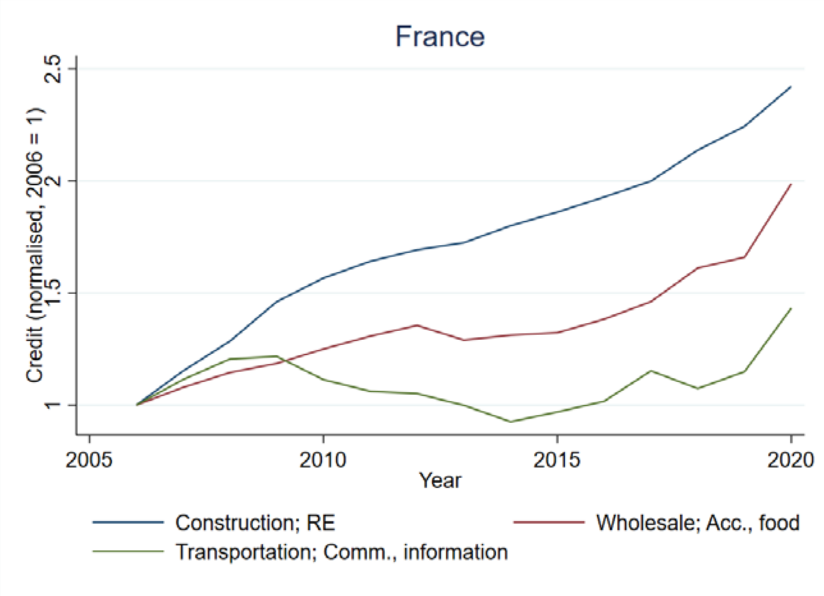
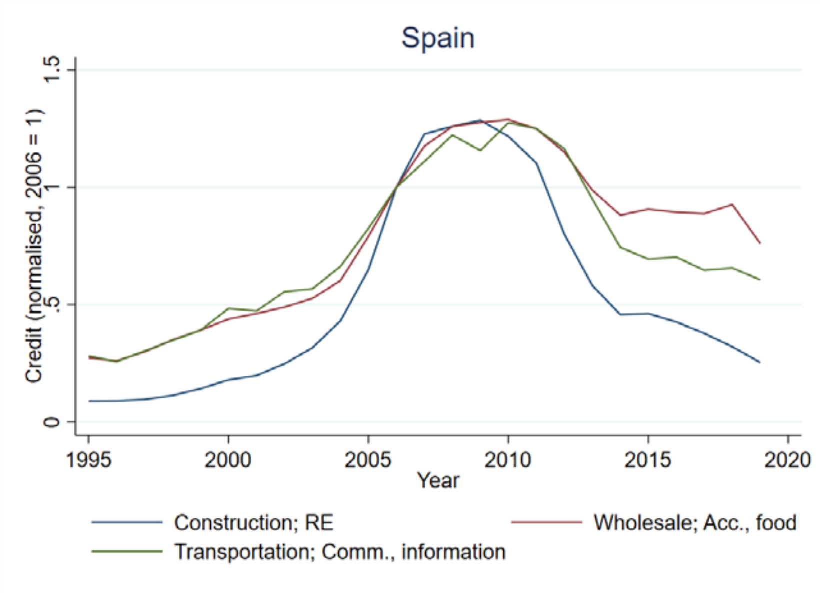
It is not generally construction and real estate activities that primarily drive non-tradable corporate credit booms in Europe in recent times





Source: author's calculations; data courtesy Müller and Vermeer (2021) and Schularick (2021, used for extrapolation beyond 2014).

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Policy recommendation for integrating sectoral countercyclical capital buffers in the prudential framework well taken

Broadly embraced by the Basel community

- Basel Research Task Force working paper discussing rationale and challenges (BCBS 2019a): more targeted and less costly instrument
- Basel Committee developed guiding principles for operationalisation (BCBS 2019b), supported by ECB

EU bank prudential framework just incorporated a tool

- Capital Requirements Directive V and Capital Requirements Regulation II (2019) just enabled the sectoral use of the systemic risk buffer (type of operationalisation)
- Applicable as of January 2021 (subject to some countries lagging CRD V implementation)
- European Banking Authority has issued guidelines for the appropriate subsets of sectoral exposures to which this buffer may be applied (EBA 2020)
- No EU country used it so far (likely also due to the COVID situation)

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Policy recommendation for integrating sectoral countercyclical capital buffers in the prudential framework well taken

But some caveats

- Growing complexity of the prudential framework
- Complicated process for adopting such measures in the EU framework
- Difficulty of member countries to initiate countercyclical buffers in a timely way
- Basel Committee work and CRD V/CRR II apply only to bank exposures, not to corporate debt securities (held by non-banks) or lending by non-bank financial intermediaries
  → Need for macroprudential framework for non-bank intermediaries
- Trade-off of targeted measures with greater leakage risk?
- Cost-benefit considerations in comparison to alternative measures on a case-by-case basis

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Background slides

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Household and corporate credit growth in France

Source: ECB and ECB calculations.

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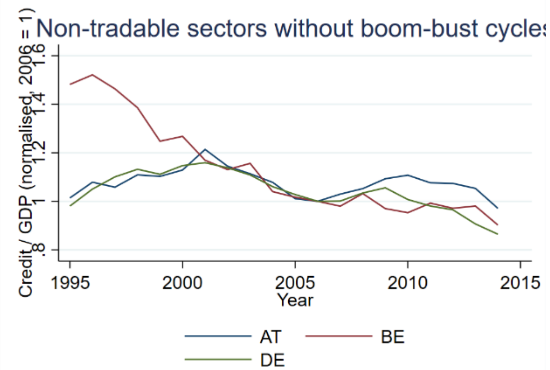
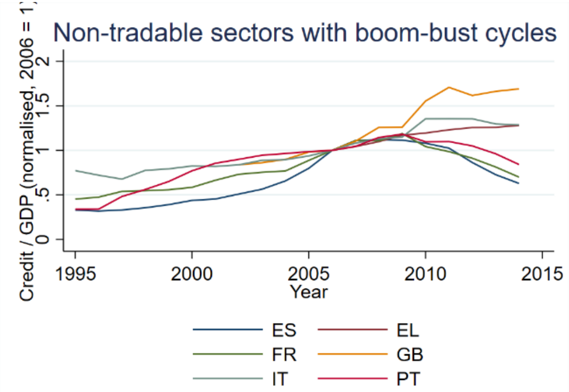
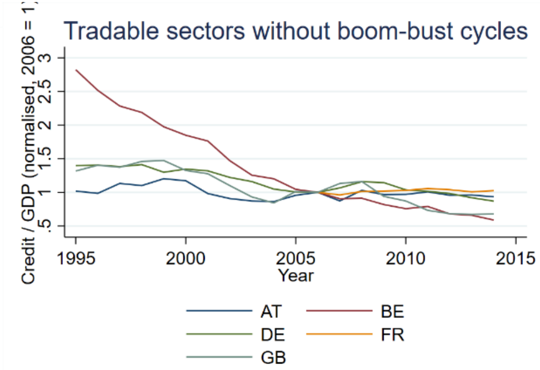
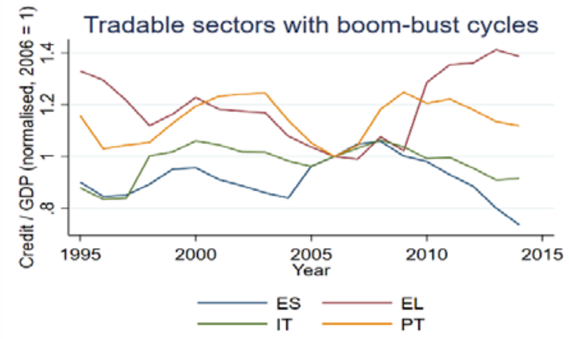
Total private credit to the non-financial corporate sector relative to GDP in selected European countries









Source: EL=Greece; data courtesy Müller and Vermeer (2021).

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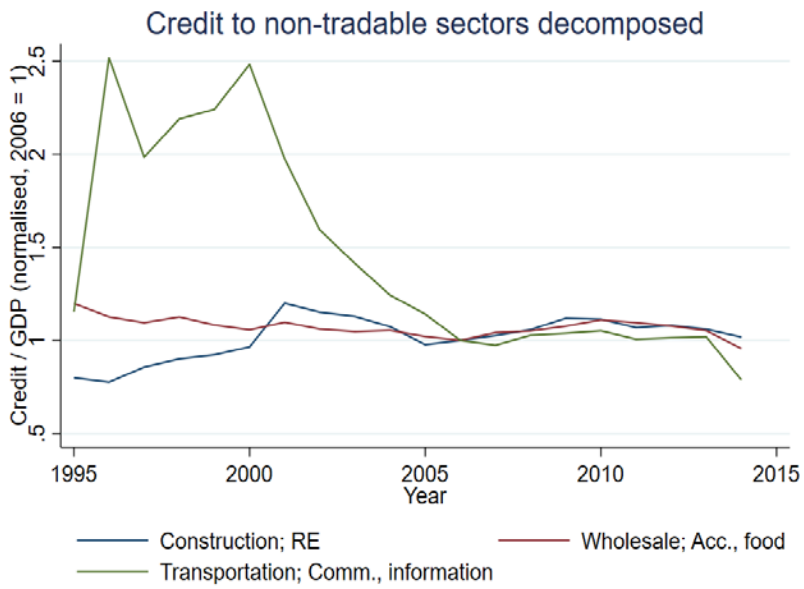
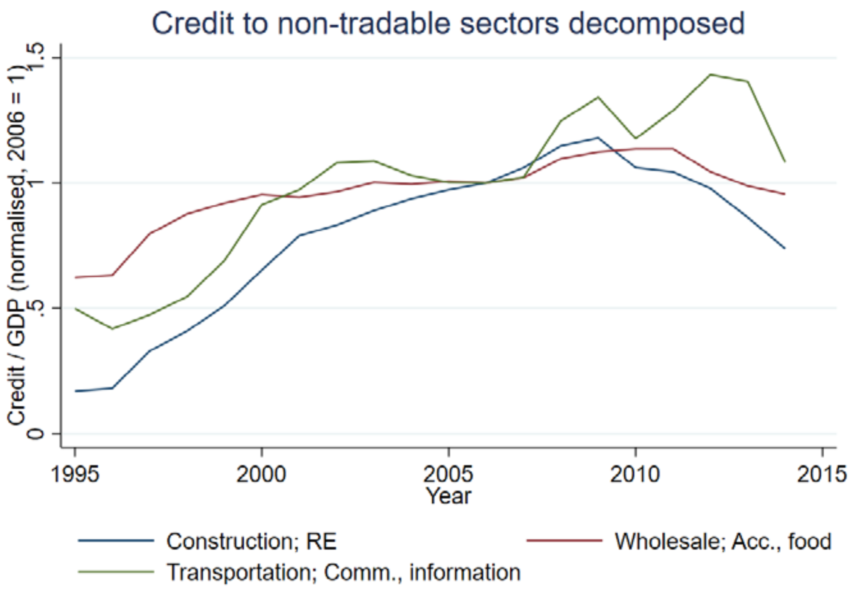
Two more European cases in which non-tradable corporate credit growth is not primarily driven by construction and real estate activities

Austria



Portugal



Source: data courtesy Müller and Vermeer (2021).

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