Corporate credit and sectoral prudential measures

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Prize Award Ceremony

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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
Adverse effects of household credit booms more robust

Estimation without household credit:

\[ \text{Real GDP response, \%} \]

\[ \text{Years after innovation} \]

Estimation with household credit:

\[ \text{Real GDP response, \%} \]

\[ \text{Years after innovation} \]

(also very low $R^2$)

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

→ One word of caution regarding mechanical policy application:

- Not all non-tradable credit booms may be equally bad
- Which factors make them bad?
Non-tradable corporate credit growth not the main financial stability problem in the euro area at present?

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

Source: Schularick (2021), figure 11.
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).
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)
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
References 1

- Basel Committee on Banking Supervision (2019b), Guiding principles for the operationalisation of a sectoral countercyclical capital buffer, November.
- ESCB Heads of Research (2014), Report on the macro-prudential research network (MaRs), Frankfurt am Main, 20 June.
- European Banking Authority (2020), Final guidelines on the appropriate subsets of sectoral exposures in the application of a systemic risk buffer, EBA/GL/2020/13, 30 September.
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Müller, K., and E. Verner (2021), Credit allocation and macroeconomic fluctuations, mimeo., 30 March.
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- Schularick, M. (2021), Corporate indebtedness and macroeconomic stabilisation from a long-term perspective, paper presented at the online ECB Forum on Central Banking, 28-29 September.
- Zakrajsek, E. (2021), Discussion of “Corporate indebtedness and macroeconomic stabilisation from a long-term perspective” from M. Schularick, presented at the online ECB Forum on Central Banking, 28-29 September.
Household and corporate credit growth in France

Source: ECB and ECB calculations.
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).
Two more European cases in which non-tradable corporate credit growth is not primarily driven by construction and real estate activities

Austria

Portugal