The Role of Finance in the Fall of Investments in Europe¹

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¹ The views expressed herein are those of the authors and should not be attributed to the IMF, its Executive Board, or its management.
Sharp Credit Contraction in the Periphery

Real Credit Growth (y/y) (percent)

Sources: BIS
...Contributing to a Collapse of Investment in the Euro Area

A Creditless Recovery in the Euro Area?
(GDP, investment and credit, yoy change, percent)

Sources: IFS, Haver Analytics
Weak Demand or Financial Constraints? Evidence from Lending Surveys

Decomposing Credit Growth: Corporate Loans

Sources: European Central Bank, Bank Lending Survey; Federal Reserve, Senior Loan Officer Survey; and IMF staff calculations.
Weak Demand or Financial Constraints?
Evidence from Firm-Level Data

Change in Debt-Asset Ratios for Firms

1/ Based on a sample of listed NFCs
Impact of Tight Credit: Case of Italy

Difference between Estimated Demand and Supply in Bank Credit to Firms 1/
(Quarterly growth, percentage points)

Monetary Conditions Index

Source: 2013 IMF Article IV Staff Report for Italy
1/ Loan supply and demand are estimated as linear functions of the indicators of supply and demand conditions obtained from the bank lending survey, using equation [1] from Appendix 4.
Link between Credit and Growth

Growth and Credit Conditions, 2010-12 1/

Average annual fiscal adjustment = -1.8% of GDP

Average annual fiscal adjustment = -2.1% of GDP

2012 growth

Change in bank lending rate 2010-12
Risk of a Credit-less Recovery?

Normal and Credit-less recoveries
(average annual growth rates during recoveries)

Source: IMF staff estimate.
Policy Response: Supply & Demand

- Supportive demand policies
  - Lower real interest rates; remove tail risk of credit crunch
  - Rebalance to lower taxes, raise allowance for investment.

- Address fragmentation to ease supply constraints
  - Provide ample liquidity; prevent disorderly deleveraging
  - Higher capital buffers to lower funding / borrowing rates
  - Progress in banking union.

- Promote corporate restructuring to ease debt overhang
  - Facilitate NPL sales and market for distressed debt.
  - Improve insolvency regimes/out of court workouts

- Reforms to encourage new investment.
  - Promote start-ups in new growth areas, e.g. credit support.
  - Deregulation for new spending.
Impact of Financial Fragmentation on Savings and Investment

Correlation between saving and investment
1.00=perfect correlation

Non-euro-area OECD

Euro area

Source: European Central Bank