The Financial Sight of the Post-crisis Economic Growth

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Abstract

The analysis of the tendencies regarding economic growth and the identification of factors that print a certain trajectory to economic growth are objectives in the spotlight of the political decision-making authorities, especially that these factors can reveal certain risks for the macroeconomic and financial environment. In this context, knowing the risks to the macro-financial stability is of interest to the central bank, as a monetary authority, being involved in ensuring a sustainable economic growth from the financial perspective. The article focuses on highlighting the main factors that influence the economic growth in the recent post-crisis period, after 2013, following the analysis on the two categories of economies, advanced and emerging economies. The results show that the post-crisis period is fraught with challenges for the global economy, as well as for decision-makers, and the macro-prudential policy can play a major role in sustaining the long-term economic growth.

Key words: Emerging and developed economies, financial conditions, central bank challenges
J.E.L. classification: E31, E58,

1. Introduction

The analyses performed by the Bank for International Settlements (BIS) and described in the last two Annual Reports (BIS, 2018, 2019a) show an unusual pattern of recent economic growth, characterized by an economic activity reinvigorated to some extent after the global financial crisis, by moderate levels of inflation, and by modest increases of wages, against the background of a gradual reduction in unemployment, both in advanced and emerging countries. However, the determinants contributing to this situation are not yet clearly identified. It is considered that such a situation is generated by the joint action of several factors: investments that keep growing, especially in the case of emerging economies, contributing to the increasing of the economic potential; a more flexible labour market in terms of firms' access to the labour force, given that after the global financial crisis, the older labour force segment participation rate (over 55 years) has increased, without the firms having to offer higher wages; an increase in the recruitment pool of labour beyond the borders of the country, as an effect of the globalization, which allows companies to outsource production in countries where the cost of labour is lower; structural changes in the labour market, as a result of using new technologies that allow the automation of some activities, thus weakening the bargaining power of employees. In principle, it is noticeable that the low levels of core inflation (the stable component of inflation) are registered under the conditions of weak, below average, increases of the real wage, a phenomenon better highlighted in the advanced countries.

A general picture drawn from these reports shows that the largest contributions to economic growth are given by the private consumption and fixed investments, both in developed and emerging economies (BIS, 2018 and 2019a). A contribution to the global economy recovery has largely been the concerted actions of major central banks, by applying either unconventional monetary policies or macroprudential measures, a topic developed in previous works (Criste and Lupu, 2016; Criste, 2017). At the same time, inflation, both in developed and emerging countries, remains at relatively low levels, but without the risk of deflation, following a slightly upward slope, in the positive area. After 2015, there is a slight tendency for inflation to converge on the two categories of economies, that will continue for the next two years, according to the IMF forecasts (IMF, 2018b). However, in a more detailed analysis of emerging economies, there are differences between countries, also reflected by different levels regarding the formation of long-term inflation expectations (IMF, 2018b).

The global economic growth has a trajectory relatively similar to those on the long-term, before the global financial crisis, accompanied by a decreasing in unemployment, and the evolution of inflation is most often near the target pursued by the central bank. Recent developments in the global economy seem to invalidate the hypothesis of secular stagnation, and the analysis of the financial side shows the existence of latent risks.

Based on these general remarks, the article focuses on the financial perspective of economic growth, given its rising importance in recent decades. Understanding factors that influence the post-crisis economic growth, from the financial perspective is useful for the political decision makers, since it helps to identify potential macroeconomic and financial risks.

2. Theoretical background

The relationship between the economic growth and the financial factor is complex and nonlinear. Recent theory and experience support the idea that financial vulnerabilities increase the risks to economic growth (Claessens et al., 2011). When the investment opportunities are abundant and the means for financing are accessible (including as a price), there is a proclivity towards increasing the financial vulnerabilities.

The analysis is based on the interaction between the financial cycle and the economic cycle, considering the increasing role of the financial factor in the economy and its influence on the economic activity, recorded since the 1980s, with the expansion of financial liberalization. In this respect, financial factors have become the main determinants of business fluctuations, while inflation has diminished its importance as an indicator of signalling unsustainable trends in economic growth. The period of the Great Moderation confirms such a situation, taking into account that at that time the macroeconomic environment was characterized by low levels of inflation and of its volatility, while the leverage of the financial and non-financial sectors were increasing, notifying the accumulation of financial risks. Thus, based on the financial cycle, one went through a period of financial stress based on which, subsequently, the global financial crisis started, with implications on the economic activity (recession). The measurement of the aggregate financial cycles offers a general picture regarding the economies' position, being a support for identifying both the influence of the financial factors on the economic growth (whether or not they have a positive contribution to the economic growth) and the potential risks.

The mechanism of interaction between the financial and business cycle operates on the basis of debt accumulation and the subsequent increase in debt service. Thus, in the upturn phase of the financial cycle, the new loans and the increase in the assets' prices stimulate the economic growth. At the same time, the gradual accumulation of debt implies extending the commitments regarding the debt service payment, which have a negative and lasting impact on the spending of the private sector. Gradually, the positive effects of the new loans diminish, while the negative effects of debt service payment increase (BIS, 2019 and BIS, 2018).

An important factor influencing economic growth is the level or the status of the financial conditions, and in the current context of globalization, the internal financial conditions are increasingly influenced by the global financial conditions. According to a recent study (IMF, 2017), global financial conditions are moving in the same direction as those of the US and the standard global risk indicators (the volatility index - VIX).

Other relevant factors that influence the economic growth refer to the price developments of the real estate assets and the degree of house price synchronization. Empirical research (Drehmann et al., 2012) shows that financial cycles that tend to worst affect the economy are associated with medium-term fluctuations in property prices and lending activity.

The financial integration at the global level has produced, among other things, the financialization of the real estate assets, a tendency of both the synchronization of the house price fluctuations, and the house price determination at the global level. The price synchronization in these markets can be entailed by the business cycles synchronization, worldwide, with a history of several decades, and by the global financial conditions influence, following the economies' engagement in the global network of production, trade, financial transactions, etc. The synchronization leads to contagion in times of crisis, but implications are much broader and critical for the real economy, given that this market has multiple links with other sectors of the economy (the private sector balance sheet has a structure based on real estate and mortgages, and financial institutions are largely exposed to house prices dynamics). A high level of global prices synchronization in these markets can signal the increased risk of impairing economic activity (at least as a result of the likelihood of spreading a potential shock in the housing market from abroad to the internal market, with adverse effects on the local economy), especially in an environment characterized by high levels of lending and borrowing.

3. Research methodology

Based on the above, and considering the paper objective, we detail some of the relevant indicators that reflect the influence on the post-crisis economic growth. As a rule, the post-crisis period is considered after the Lehman Brothers shock, with an early stage (2009-2011), characterized by high inflation and a slowdown in economic activity in almost all developed countries, followed by the post-crisis stage, after 2011. This stage is characterized by the persistence of an "anaemic" economic activity, the uncertainty and the propensity of central banks to have an accommodative behaviour. In this paper the post crisis period is that after 2013.

The analysis is carried out on two categories of countries: advanced economies (AEs) and emerging economies (EMEs), as to identify differences and similarities. In the first category are included: Spain, France, Italy, United Kingdom, United States (the GFC countries), Germany, Australia, Canada, Switzerland, Finland, Norway and Sweden (other AEs). The considered emerging economies (EMEs) are: Brazil, Chile, Colombia, Hong Kong SAR, Indonesia, Korea, Mexico, Malaysia, Singapore, Thailand, India.

The data were taken from the BIS database, as well as from the last two BIS Annual Reports (2018 and 2019). The post-crisis economic growth is described in a financial perspective based on the aforementioned elements:

- The financial cycle
- The private consumption
- The degree of indebtedness and the debt service, including that denominated in dollars
- The house price synchronization
- The financial conditions

4. Findings

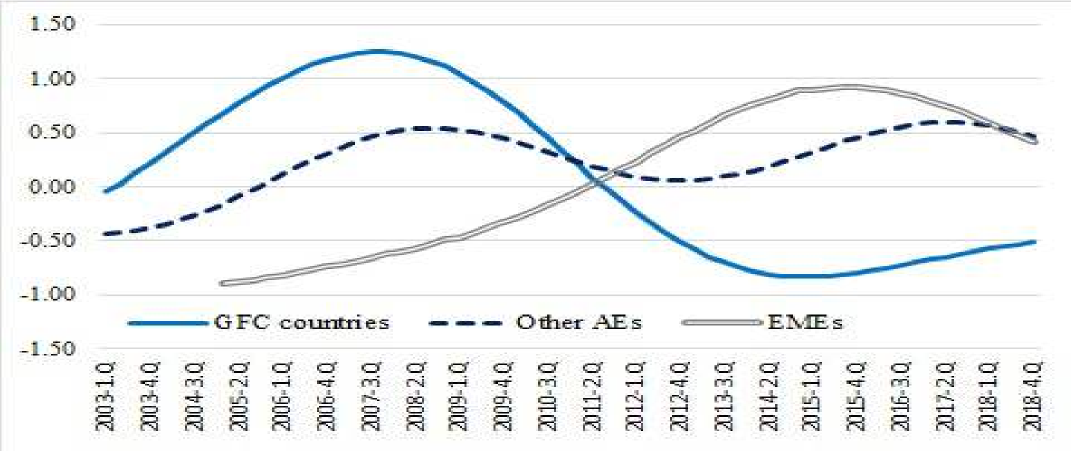
Analysed from a financial point of view, the post-crisis economic growth acquires new attributes that give important interpretations for the macroeconomic policy.

4.1. The financial cycle

Based on the data provided by BIS (2019), the aggregate financial cycles of the developed/advanced countries, affected by the global financial crisis, are in the early stage of expansion (see Figure no.1), with a lower probability of impairing the economic growth in the near future. Instead, emerging economies are on the downward slope of the financial cycle. In some advanced economies that were not directly affected by the global financial crisis (Australia, Canada, Finland, Switzerland, Sweden), the expansion of the financial cycle, which continued even after the crisis, is about to stop, given that a slowdown in the growth rate of the private sector lending is noted (from 2016), and the growth rate in property prices has significantly slowed down in recent years. Thus, in the post-crisis stage, although some developed countries are in an early phase of expansion of the business cycle, they face certain financial vulnerabilities, as a result of both the continuous deterioration of the companies' balance sheets (especially in the USA and the United Kingdom), and the rising prices in the real estate market, mainly on the commercially-owned properties, which are particularly vulnerable to long-term yield growth.

Figure no. 1. The financial cycles in advanced and emerging economies

- standard deviation –



Source: BIS, Annual Report, 2019

4.2. Influences on post-crisis economic growth - Consumer financing

One of the major contributions to economic growth in the post-crisis period is the consumption of the private sector. Despite the low level of employment, as well as the constraints related to the production capacity, the private consumption remains quite high. Such a situation is explained by the using of an alternative channel for financing consumption, not from own resources, but from loans.

Maintaining the high level of the private sector indebtedness, both in the emerging and advanced economies, represents a vulnerable factor for the future economic growth. In the post-crisis period, the debt of the private sector (as a share of GDP) has increased, more or less significantly, in emerging economies (see Table no. 1). In contrast, in some developed countries (Italy, United Kingdom and Spain), the debt of the private sector, as a share of GDP, is lower in 2018, compared to 2013.

Table no. 1 Credit to private non-financial sector (%GDP)

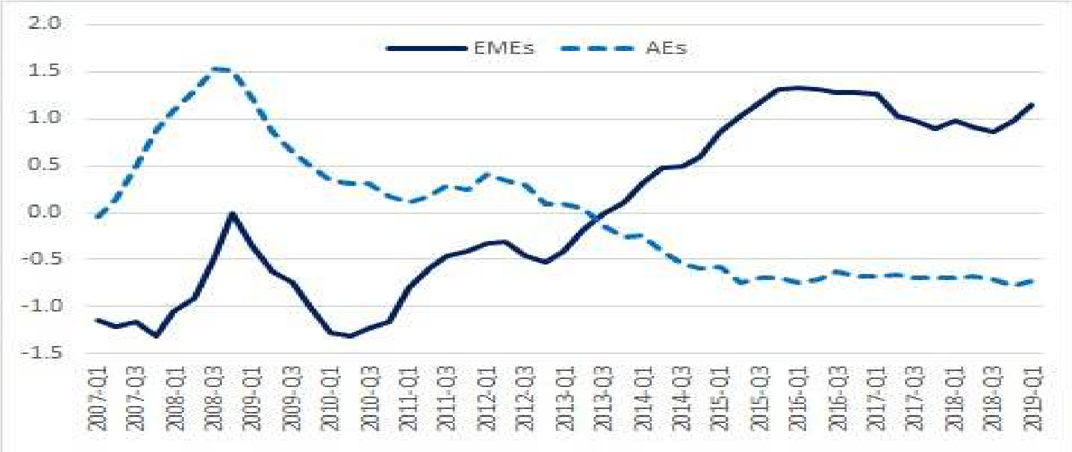
EMEs	2008	2013	2018	AEs	2008	2013	2018
Indonesia	27,0	36,8	39,9	**Canada**	164,4	188,6	216,5
Thailand	91,0	112,7	116,3	**Finland**	151,0	177,2	181,2
Hong Kong SAR	184,2	246,2	298,8	**Sweden**	206,6	234,5	245,5
India	56,1	61,7	56,1	**France**	162,1	181,9	199,9
Mexico	28,7	33,4	41,8	**Norway**	209,8	225,7	238,0
Malaysia	106,3	128,1	135,8	**Italy**	116,7	126,0	111,0
Korea	162,5	177,1	185,4	**United Kingdom**	190,3	177,5	170,5
Brazil	52,0	67,3	68,1	**Spain**	207,6	200,8	154,2
Chile	102,1	119,7	139,8	**United States**	169,3	149,2	150,7
Colombia	43,3	53,2	61,9	**Australia**	189,1	181,8	195,7
Singapore	124,2	152,8	167,3	**Germany**	117,6	110,6	110,2
				Switzerland	194,2	223,9	246,6

Source: BIS data, 2019

The debt accumulation does not necessarily create problems, provided that the balance sheets of firms and households are balanced, with adequate levels of reserves and assets evaluated at optimum levels. But when it becomes excessive, the debt service ratio increases, engendering financial stress.

In emerging economies, there is an increase in the debt service of the private sector, between 2013 and 2016 (see Figure no.2). The advanced economies have a better position in this regard, since 2011. In this context, a more detailed analysis of private debt shows an increasing relevance of household indebtedness levels to economic growth.

Figure no. 2. Evolution of the private sector debt service by categories of economies



Note: The evolution is based on the difference between the average of the period chosen (2007-2017) and the quarterly value of debt service, as a share of GDP.
Source: BIS data, 2019

Following the onset of the global financial crisis, the increase in household debt is to some extent the effect of the easing monetary policy promoted by central banks in developed countries. Given that the inflation and wage growth are low, there is a risk of impairing the long-term economic growth through the effects they can have on financial stability. The household debt and access to credit can stimulate the aggregate demand and contribute to the increase of wealth, but the over-indebtedness can be a source for financial vulnerability that induces the risk of harming the economic growth. The short-term economic growth is supported by an increase in the household loans, but at the same time, the financial leverage of households increases, so that a macroeconomic shock can affect both the employment (rising unemployment) and economic activity over medium-term, due to financial difficulties and nominal rigidities.

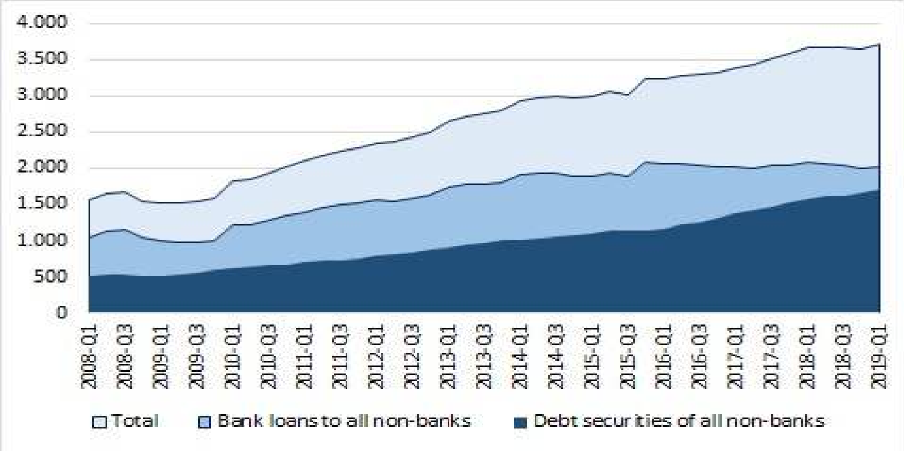
As a rule, increasing household debt stimulates short-term economic activity, but it generates risks to macroeconomic and financial stability in the medium term. According to the analysis of the International Monetary Fund (IMF, 2017), the real GDP initially reacts positively as a channel for increasing consumption, employment, prices on the real estate market and securities, but after one or two years the relationship between them becomes negative, and the household debt is associated with a higher incidence of banking crises.

The macroeconomic and financial risks generated by the increase of the household debt is different from country to country, depending on the level of economic development, the phase of the financial cycle or the institutional characteristics. In this context, some emerging economies are in a more vulnerable situation, given the limited financial and institutional capacity: the liberalized capital account; a less developed financial system; the lack (or a lower level) of transparency and consumer financial protection regulations; poor quality of financial supervision; large disparities between incomes and the predominance of small incomes. On the other hand, the households' debt in these countries is lower compared to that of the developed countries (see Table no. 1), reflecting a greater presence of financial frictions that diminish the access of households to loans.

The financial and institutional capacity of an economy to manage the problems generated by the higher level of households' indebtedness show the extent to which the debt of this sector influences the economic growth and financial stability, in a shorter and longer time horizon.

In emerging economies, economic growth is largely supported by significant accumulations of loans denominated in foreign currency, a tendency noticed especially in the case of non-bank loans denominated in dollars, the expansion of the financial cycle being correlated with this phenomenon. According to the global liquidity indicators calculated by the Bank for International Settlements, the stock of loans to the emerging countries in the non-banking sector has doubled since 2008 (see Figure no. 3), and the recent dollar depreciation further emphasize the trend of growing the US dollars denominated loans.

Figure no. 3. The US dollar denominated debt in emerging economies



Source: BIS data, 2019

4.3. Influences of the house price synchronization

One of the contributions to the economic recovery of many countries in the post-crisis time was the rising level of house prices, as a result of the easing monetary policies at the global level. According to the "Global Report on Financial Stability" (IMF, 2018a), the trend of synchronizing the prices in the housing market is noticeable worldwide. The synchronous movements of prices on this market can be determined by the business cycles synchronization and other non-financial economic fundamentals, as well as by financial factors, such as the degree of financial openness of the economy. The higher the financial openness, the higher the degree of synchronization, economy being more exposed to the action of global factors. In fact, the house price synchronization can be analysed in a broader framework of asset price synchronization.

It is noted that the price synchronization in the housing market during post-crisis has been a benefit for many economies, meaning that the local transmission (at the level of property prices) of the loosened global financial conditions has contributed to the economic recovery. On the other hand, the house price synchronization allows the faster and more direct transmission of the global financial conditions, influencing the dynamics of the real estate market and the prices of housing at the local level, which in fact shows an increased exposure to external shocks.

4.4. The financial conditions and economic growth

The major role of the financial factor on economic activity is also confirmed in the post-crisis time, considering that the main determinant of the economic growth during this period refers to the persistence of relaxed financial conditions, both in developed countries (especially in the USA) and in emerging ones.

The global financial conditions are also relaxed, even during the "normalization" of the monetary policy applied by the Fed (the central bank with global influence), as the conduct of the other major central banks (ECB, Bank of Japan, Bank of England) remains "accommodative", keeping monetary policy interest rates at low levels and implementing asset purchase programs. Recently, since mid-2019, the Fed has adjusted the conduct of its monetary policy and has become relaxed, amid weak economic activity, target inflation and fluctuations in financial markets. It is noteworthy that in addition to reducing the monetary policy rate by 2.5 pp, applied since the end of July, financial market participants have expectations that the Fed will maintain this behaviour in the next period (BIS, 2019b). And the ECB also lowered the monetary policy interest rate and resumed the asset acquisition program.

The relaxation of the global financial conditions is reflected by the maintenance of low risk premiums, the low volatility of the assets price, but also the increased risk appetite of investors. Furthermore, the US dollar depreciation has led to a loosening of financial conditions, especially in emerging economies, which typically have higher levels of loans denominated in foreign currency (mainly, in US dollars).

The tendency to increase lending and indebtedness of the private sector, including the one in foreign currency, which is prevalent in emerging economies, as well as the rising prices on the housing markets and synchronizing of their trajectories at the global level, spurred by relaxed financial conditions, support the short-term economic growth. On the other hand, they may contribute to the accumulation of financial imbalances, excessive risk taking and inaccurate risk assessment, which could determine the materialization of risks to the medium-term economic growth.

Given the array of the influencing factors of economic growth "pattern" in the recent post-crisis period, largely risk factors, it arises the question of identifying the macroeconomic instruments that can contribute to its orientation on a sustainable path. This challenge is all the greater as the room of manoeuvre for macroeconomic and structural policies has narrowed significantly.

5. Conclusions

The global economic growth is on a slightly upward trajectory, but the factors that generate it print certain risks. The loosening financial conditions encourage the lending activity (including lending from the non-banking financial institutions), which is directed to the final consumption. Likewise, the level of the private indebtedness remains high, and the prices in the housing market, synchronized between countries, shows an emphasized development.

During the global financial crisis and after that, the central bank has contributed to the economic recovery through its special levers (conventional and unconventional policies), as well as by extending some responsibilities. In the recent post-crisis period, the monetary authority is still subject to challenges caused by the financial factors evolving, with impact on economic activity.

At the level of the political decision-makimg authorities, in the recent post-crisis period, the sustainable economic growth requires creating room for manoeuvre that allows to apply countercyclical measures, as a solution to counteract or limit the debt accumulations and imbalances in the financial system. In this regard, there is an increasing emphasis on the role that macro-prudential policy can play in sustaining the long-term economic growth, but the framework configuration of such a policy is still working, not only at local (national) level, but also at regional and global level, from the perspective of ensuring cooperation between countries, in this direction.

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