

WEEK 9

Read the article on Financialization by Stockhammer for
this part !

Hyman Minsky

- "Stability is destabilizing"
- During the expansionary periods, stability can enhance confidence and raise the willingness to get new loans
- Increased optimism and sense of security can reduce risk perception
- Given that people behave like herds, stable boom periods may result in debt accumulation which may generate financial fragility

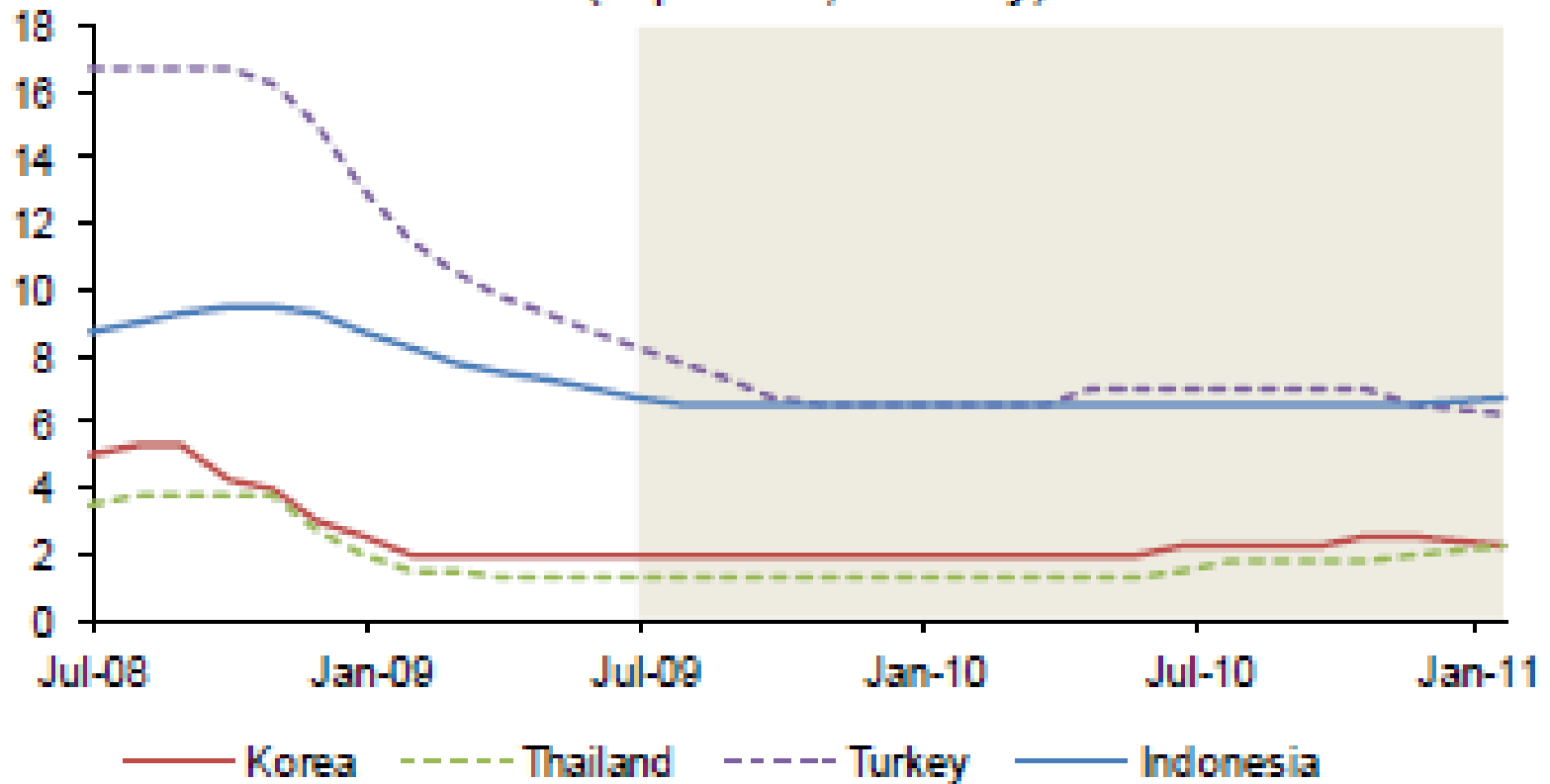
- Financial fragility is created endogenously
- Financial positions of the firms, banks and households can switch from hedge to speculative and then from speculative to Ponzi
 - Hedge: expected cash flows are more than enough to cover all debt commitments
 - Speculative: they cover only the interest payments
 - Ponzi: they do not cover even the interest payments
- Financial liberalization and international capital movements exacerbated the above link because they are pro-cyclical

What is to be done?

- Monetary policies
- International reserve accumulation
 - Not available for productive uses
 - Costly (return to reserves is less than its cost) for Deficit countries
- Regulation of the financial sector
 - Focus on the balance sheet of financial corporations
 - How to manage the balance between assets and liabilities (e.g. Currency mismatch or reliance on debt rather than equity)
 - Basel I, II, and III or limits on foreign loans etc.
 - Capital controls (e.g. Tax on capital flows)

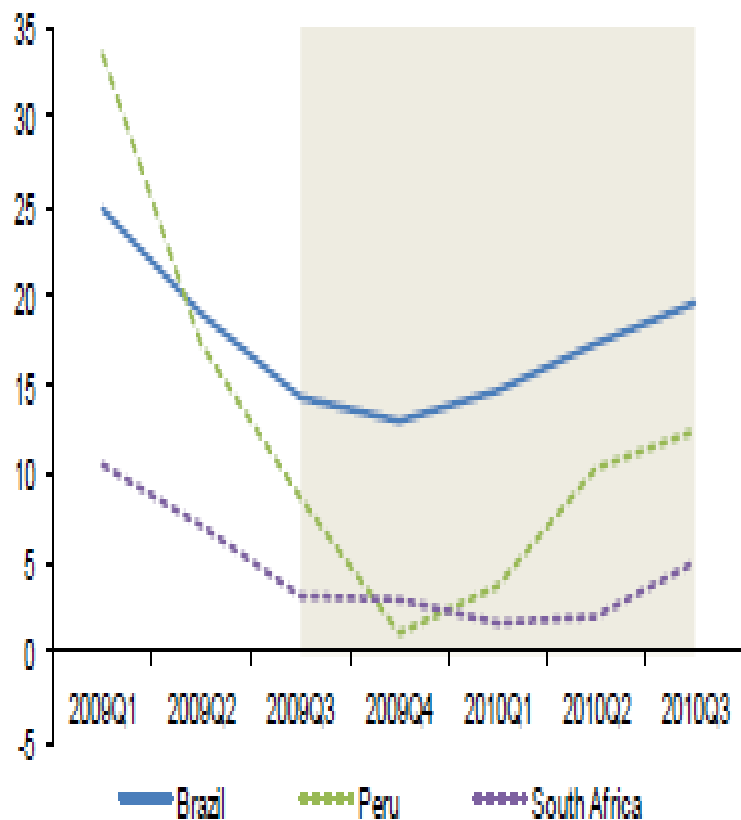
- Monetary policies
- Pre-emptive central bank response through short-term interest rate
 - Procyclical: lower interest rate in good times
 - Countercyclical: higher interest rates in good times
- Can countercyclical policies avoid the problems?
 - Problem: overheated economy along with a current account deficit
 - Suppose that the central bank rises interest rate to slow down economy in the presence of capital inflows
 - cost of borrowing would rise
 - However, higher interest rates can attract more capital inflows and lead to further appreciation
 - More foreign debt, worsening currency mismatch and growing balance of payment deficit.

Monetary Policy Rates (In percent, monthly)



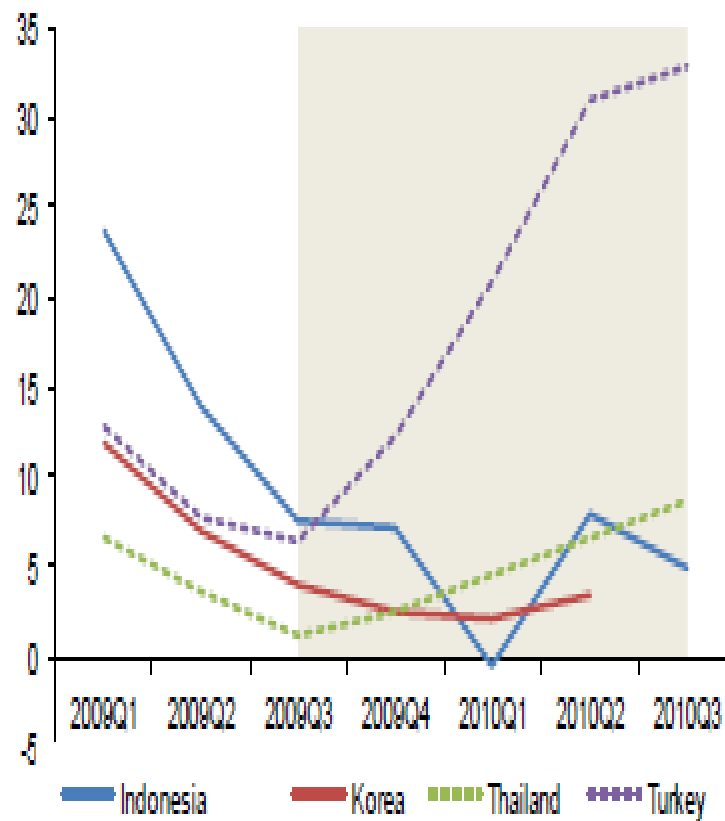
Credito Private Sector

(y/y - In percent)



Credito Private Sector

(y/y - In percent)



**Figure 1. Foreign Exchange Reserves Held by Non-industrial Economies
(in trillions of U.S. dollars)**

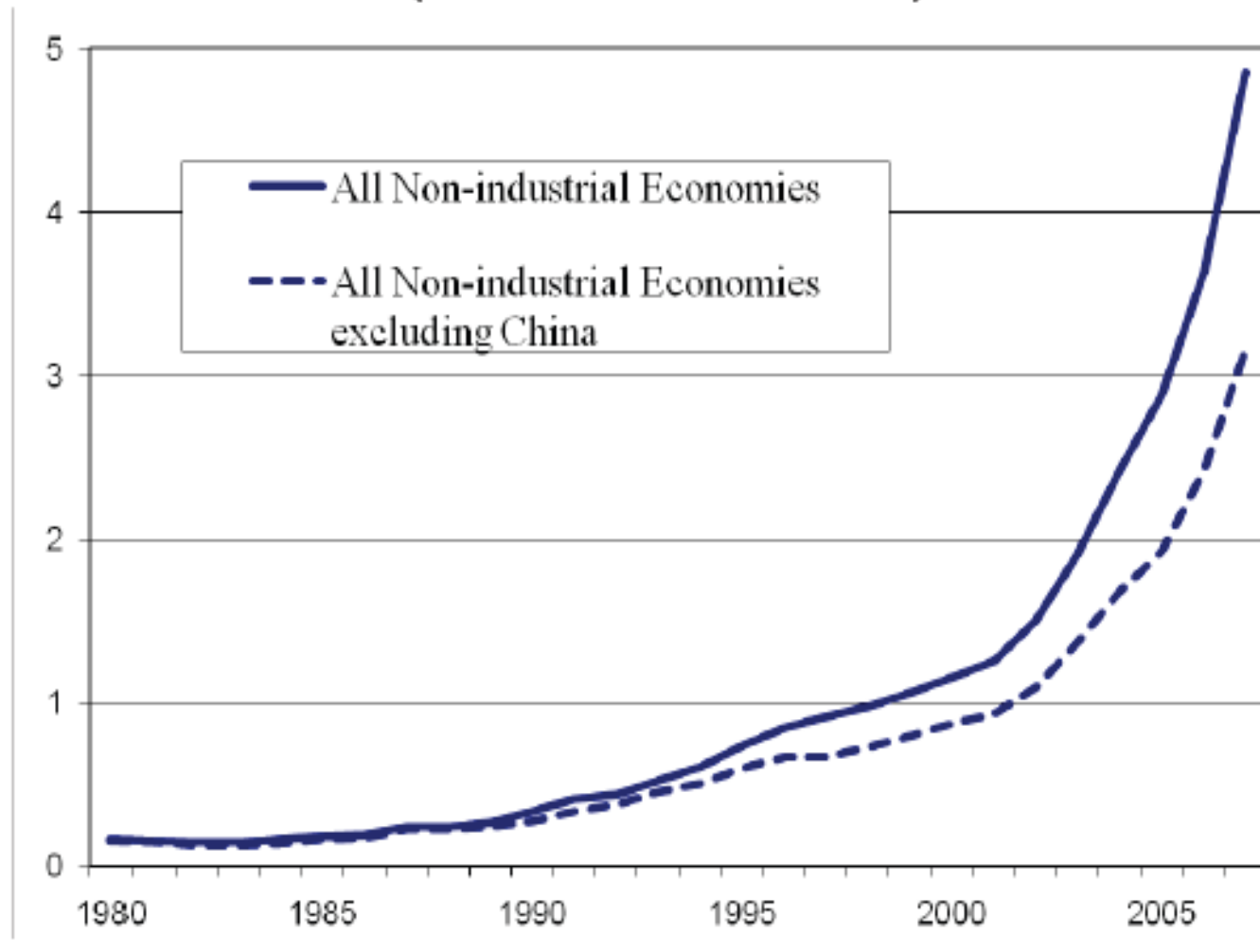


Table 2:

Balance of payments, reserves and growth in selected emerging markets

	<i>CA 2002-06</i> <i>Billion U.S. \$</i>	<i>NCF 2002-06</i> <i>Billion U.S. \$</i>	<i>ΔR 2002-06</i> <i>Billion U.S. \$</i>	<i>Borrowed</i> <i>Reserves^a</i> <i>(per cent)</i>	<i>R/M 2001</i> <i>(months)</i>	<i>R/M 2006</i> <i>(months)</i>	<i>Average Growth</i> <i>2002-06</i> <i>(per cent)</i>
Brazil	35.7	10.8	49.8	21.7	4.19	5.9	3.2
China	560.6	260.7	853.2	30.5	6.6	10.5	10.1
India	- 0.7	108.0	125.0	86.9	5.4	6.0	7.6
Mexico	- 37.0	73.5	31.5	100.0	2.0	2.2	2.8
Russia	303.8	0.6	263.1	0.0	3.7	11.3	6.5
Turkey	- 79.7	95.6	42.2	100.0	5.2	5.1	7.2
Venezuela	87.6	- 62.4	20.30	0.0	4.9	9.5	4.4

Source: IMF World Economic Outlook Database

Notes:

CA: Cumulative current account balance

NCF: Cumulative net capital flows

ΔR: Changes in international reserves

R/M: Reserves as a proportion of imports of goods and services

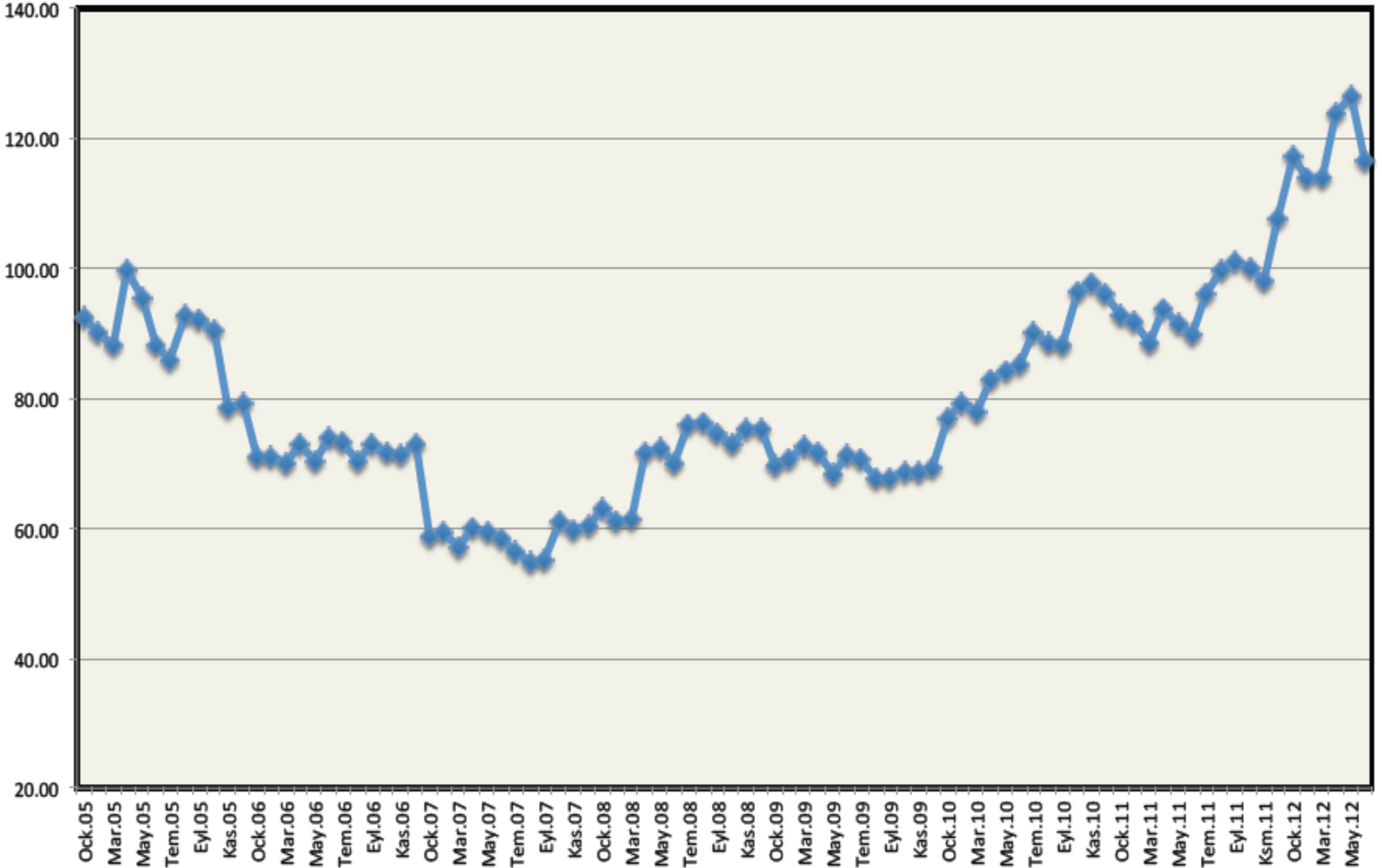
% of GDP

% of GDP



- " Merkez Bankamızın en son döviz rezervleri açıklandı ve yeni rakamlarla tarihimizin yeni ve çok yüksek bir rekorunu elde ettik. Yıl sonu itibarıyla 100 milyar dolar hesabını yaparken, 2002 yılında, biz göreve geldiğimizde 27,5 milyar dolar olan Merkez Bankası rezervlerimiz, şu an itibarıyla 103 milyar 114 milyon dolara ulaştı. Bu, Türkiye'nin gücünü, Türkiye ekonomisinin gücünü ve krizlere karşı dayanıklılığını ifade eden rekorun da ülkemize, milletimize hayırlı olmasını diliyorum" (R.T.Erdoğan, August 11, 2012)
- Görevi devraldıklarında Türkiye'nin Uluslararası Para Fonu'na (IMF) olan borcunun 23,5 milyar dolar seviyesinde olduğunu ifade eden Erdoğan, bu borcun bugün itibarıyla 1,7 milyar dolara indiğini söyledi.

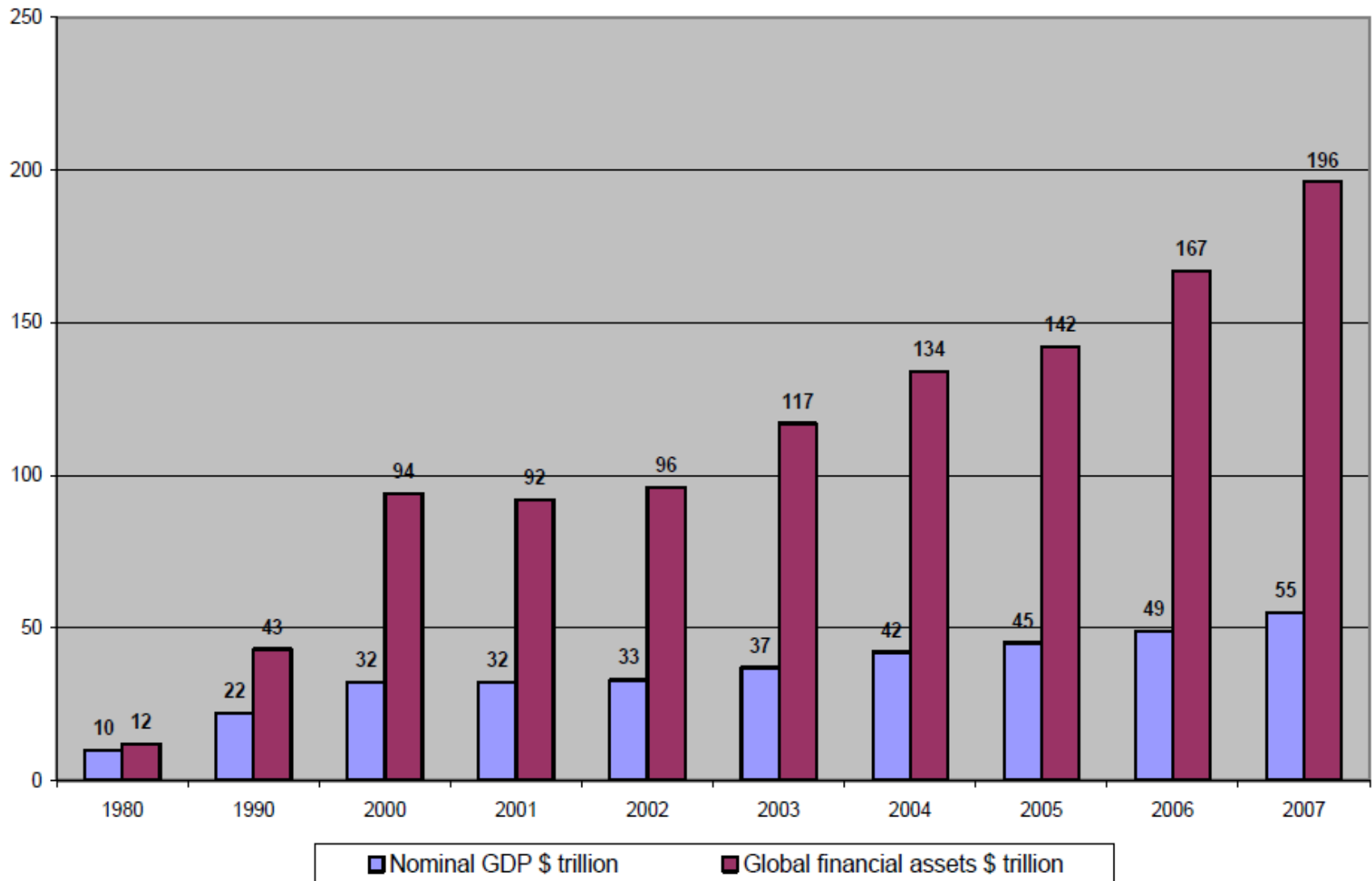
Kısa Vadeli Dış Borç Stoku / MB Döviz Rezervleri



Financialization

- "Financialization refers to the increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operation of the economy and its governing institutions, both at the national and international level (Epstein 2001)."
- The term has been used to include events as diverse as shareholder value orientation, increasing household debt, changes in attitudes of individuals, increasing incomes from financial activities, increasing frequency of financial crises, and increasing international capital mobility

Financial and Real Wealth

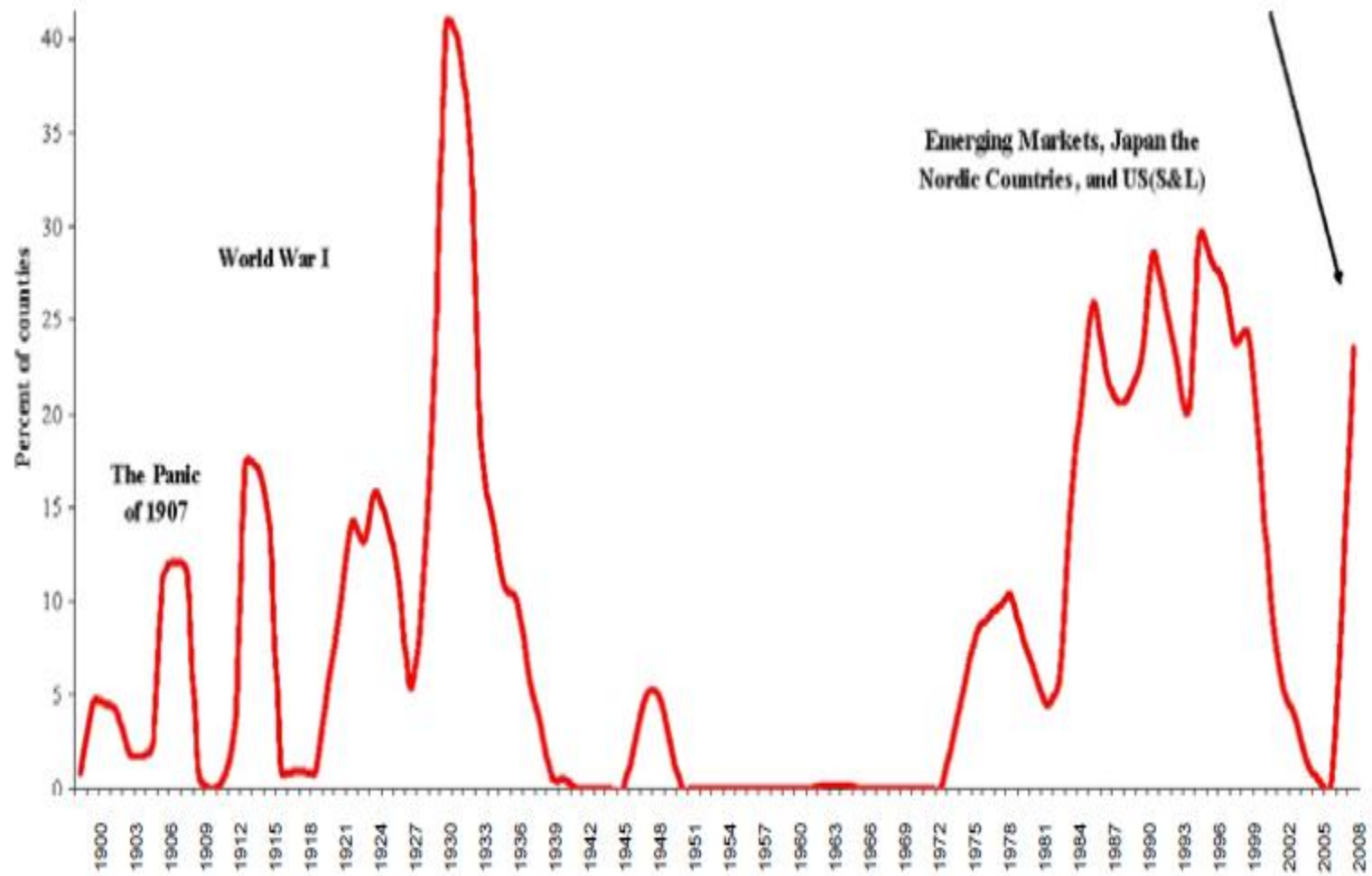


- Financialization is good...
 - Better allocation of resources
 - Smoothing economic downturns
 - Higher consumption and investment due to better access to credit

- Why is it a problem?
 - Growth volatility
 - Frequent crisis
 - Low Investment
 - Financial fragility (high debt-income and debt-equity ratios)
 - Rising share of finance in total income
 - International imbalances

The Great Depression

The First Global Financial Crisis of 21st Century



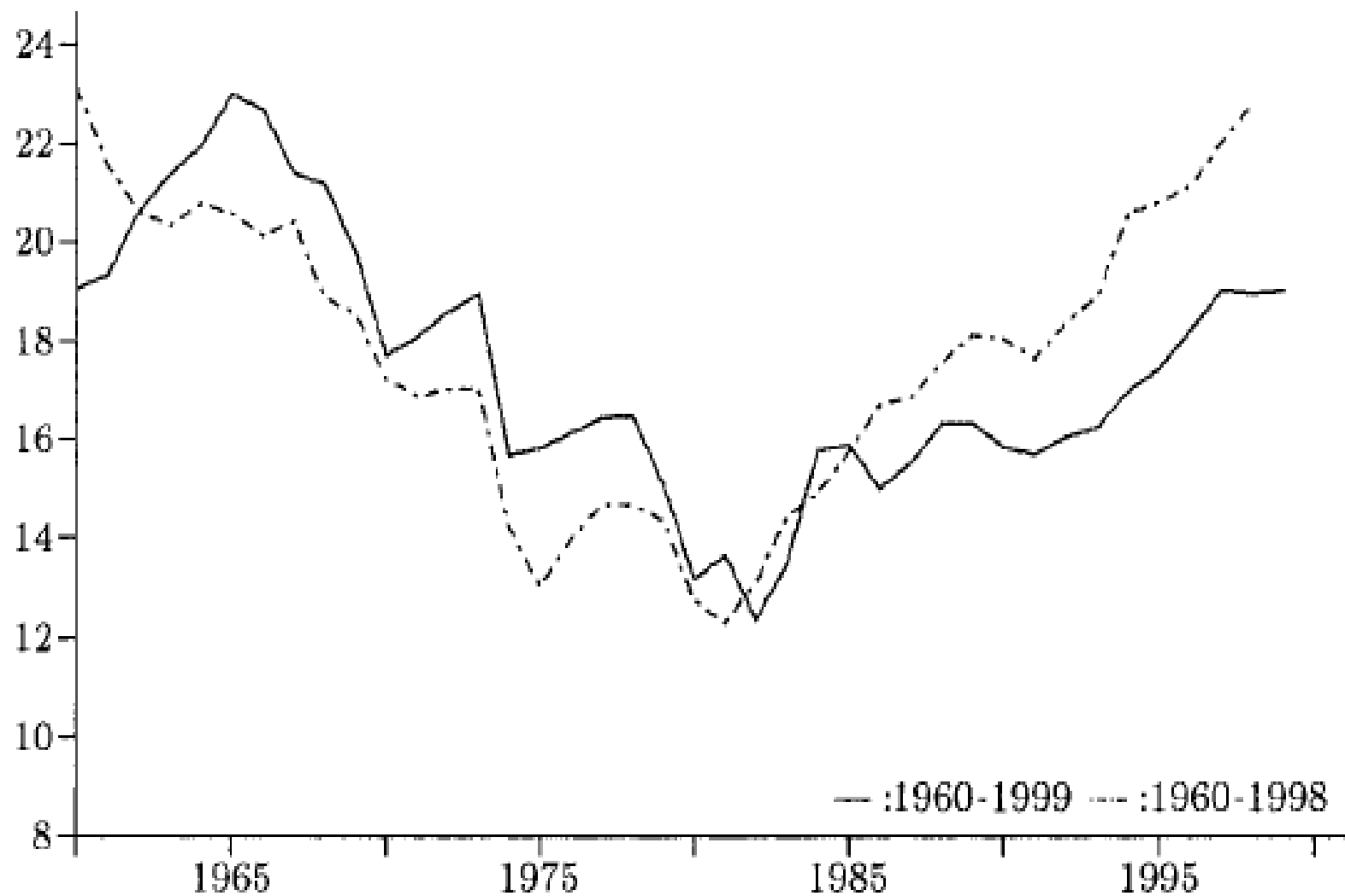


Figure 1 US (—) and the average of three European countries, Germany, France, and the UK (· - · -): profit rate, %

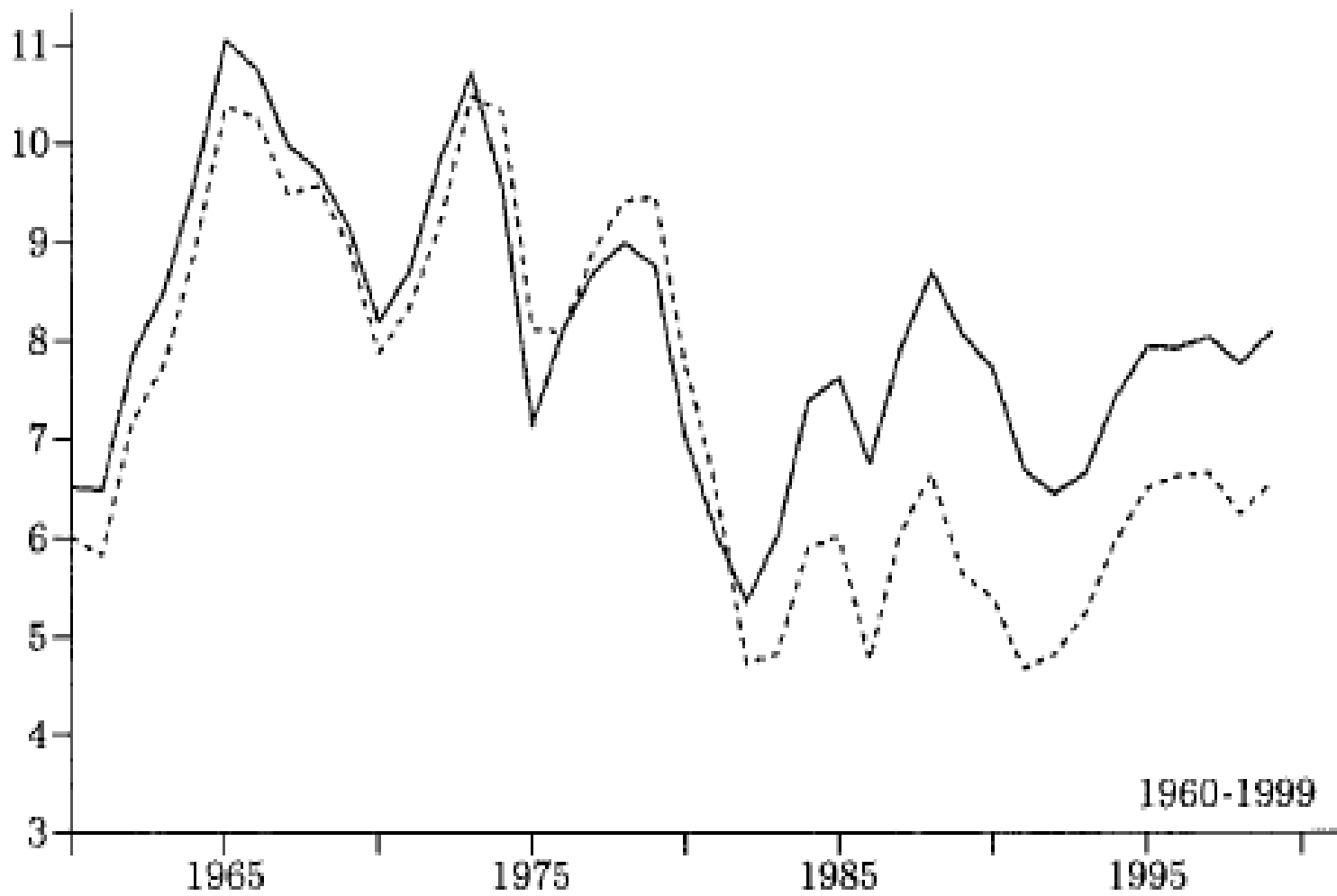


Figure 3 US, non-financial corporations: profit rates prior to the payment of real interest (—) and after (---), %

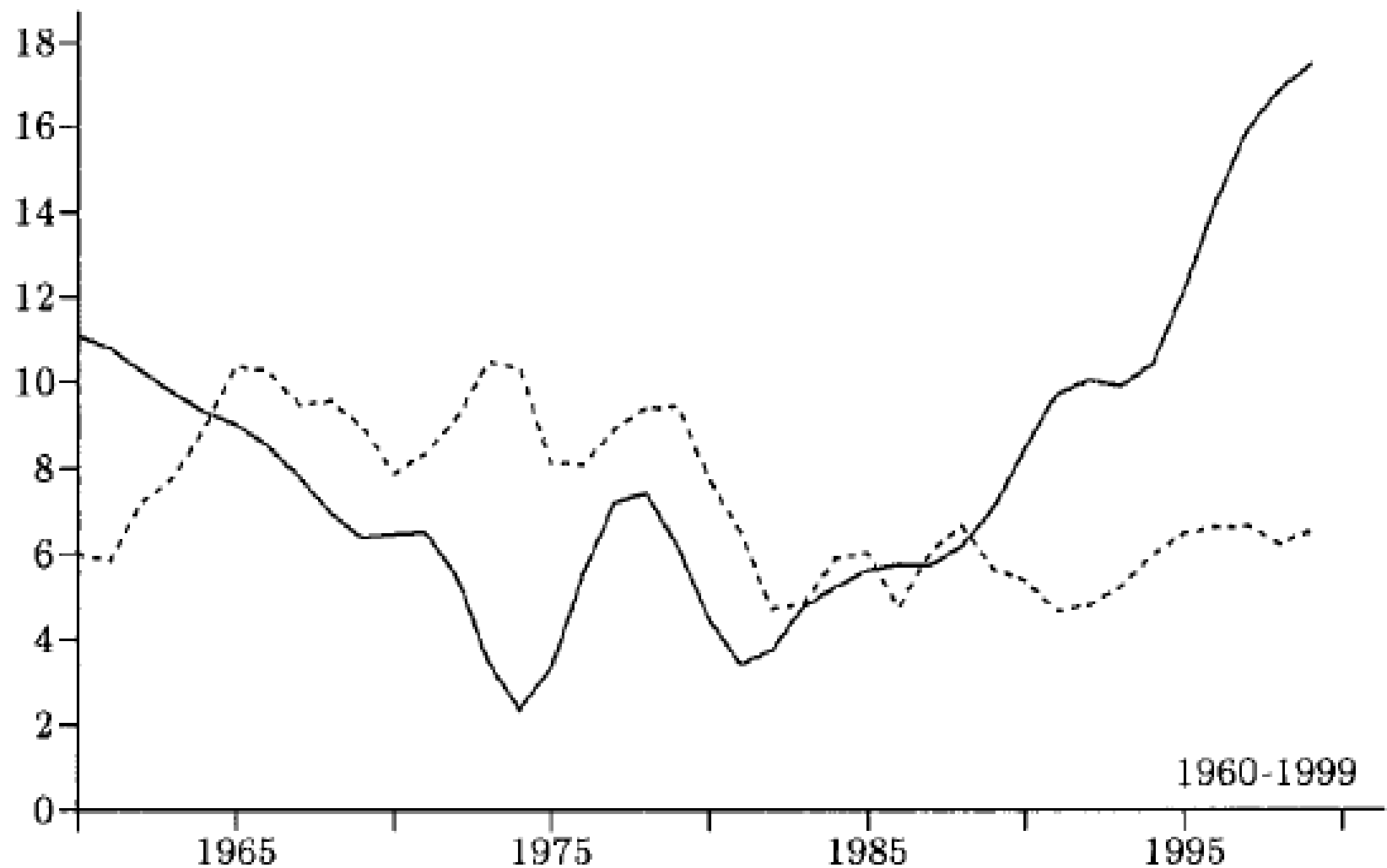


Figure 11 US: profit rate of non-financial (---) and financial corporation (—), %



Figure 2 France, non-financial corporations: profit rates prior to the payment of real interest (—) and after (---), %

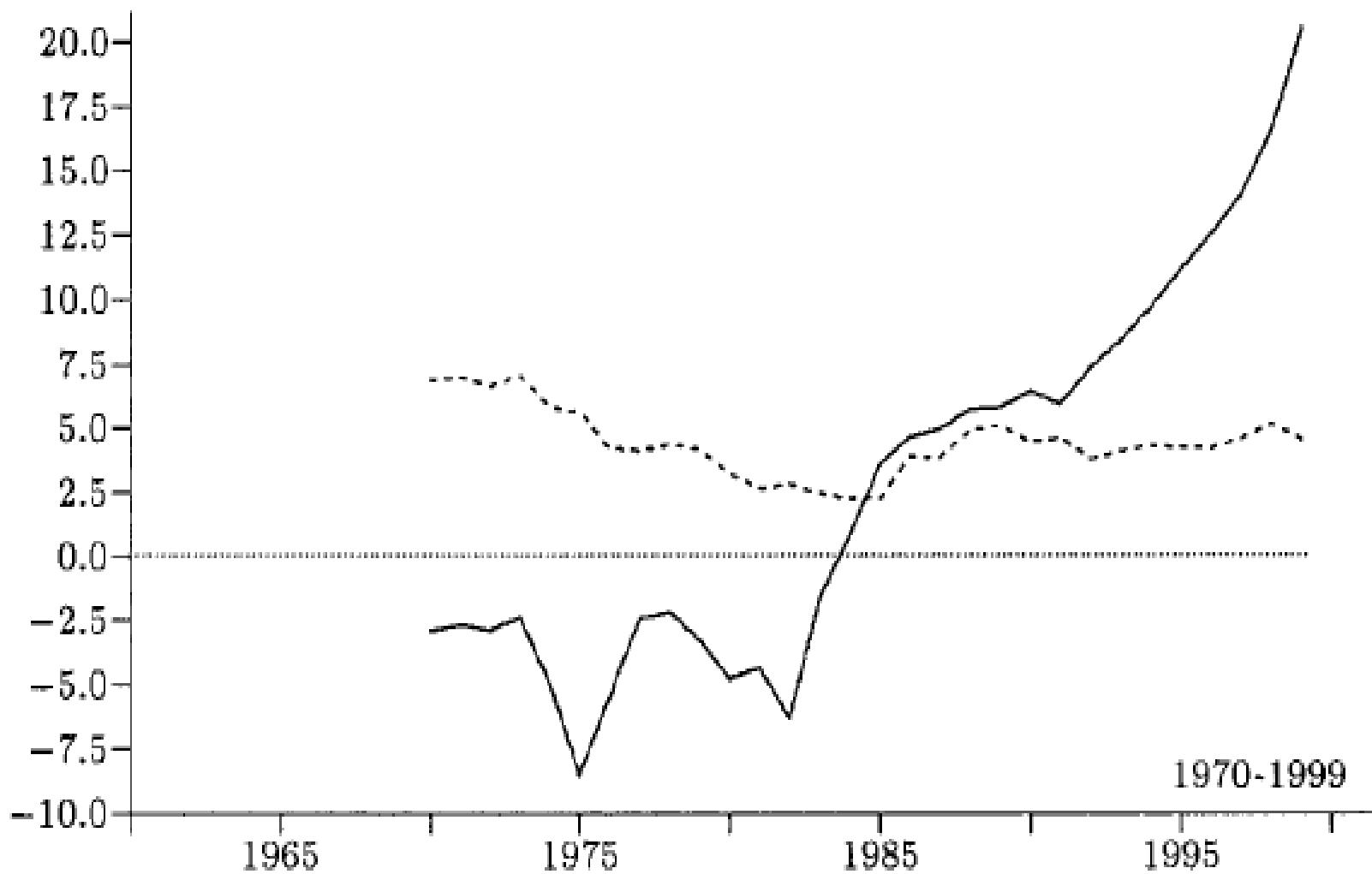


Figure 10 France: profit rate of non-financial (---) and financial corporations (—), %

Figure 2.1 Income share of the top 1% in English-speaking countries

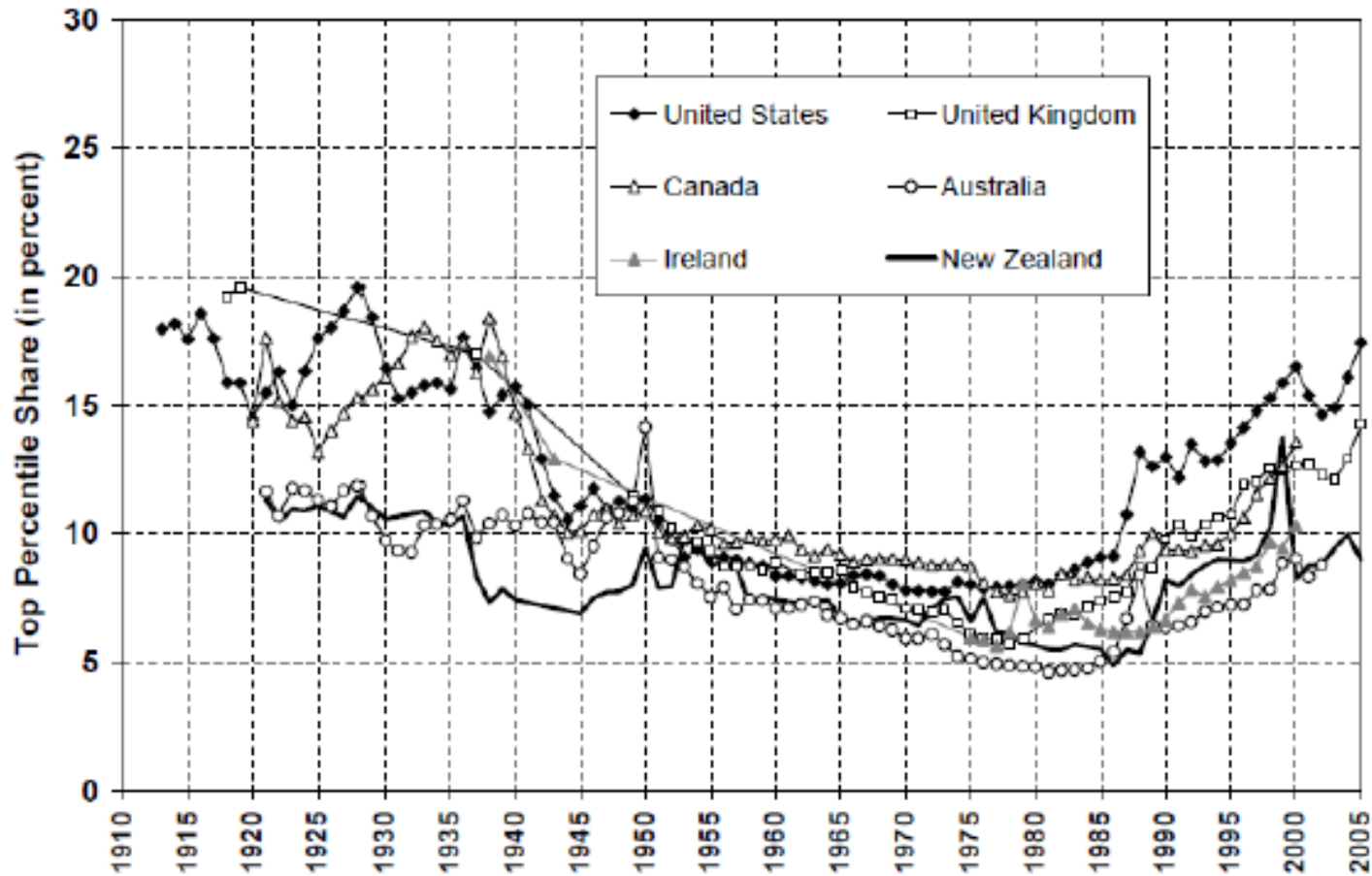
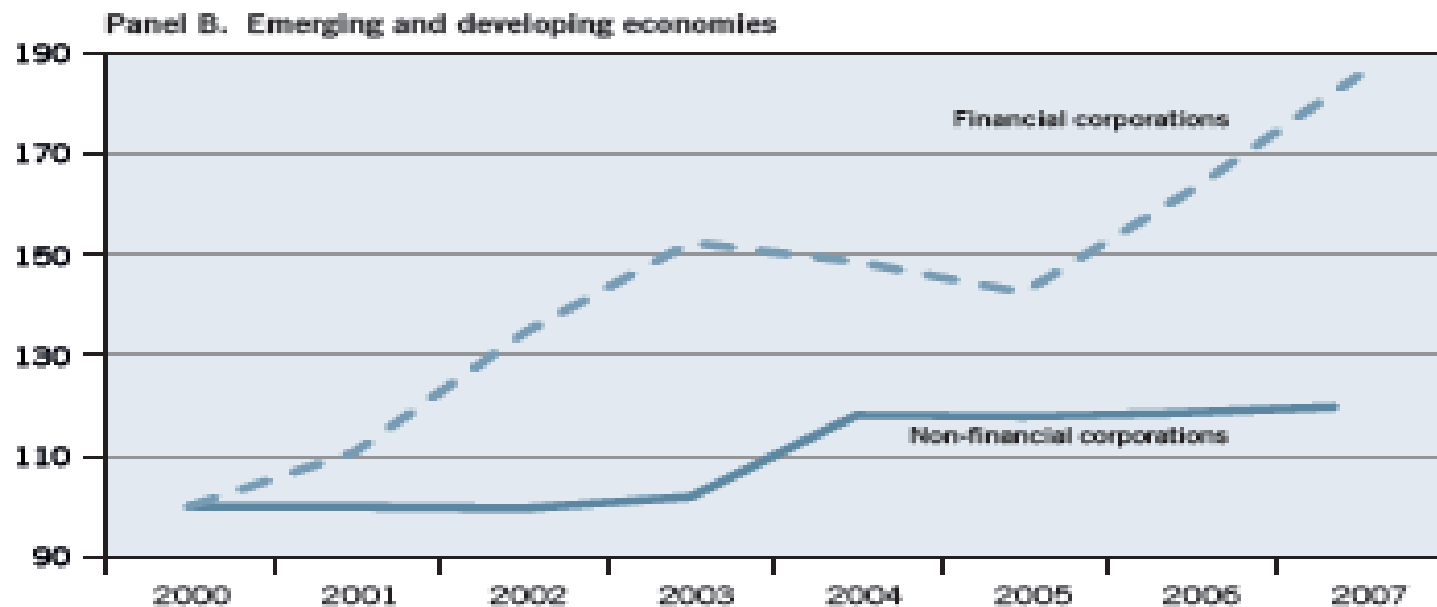
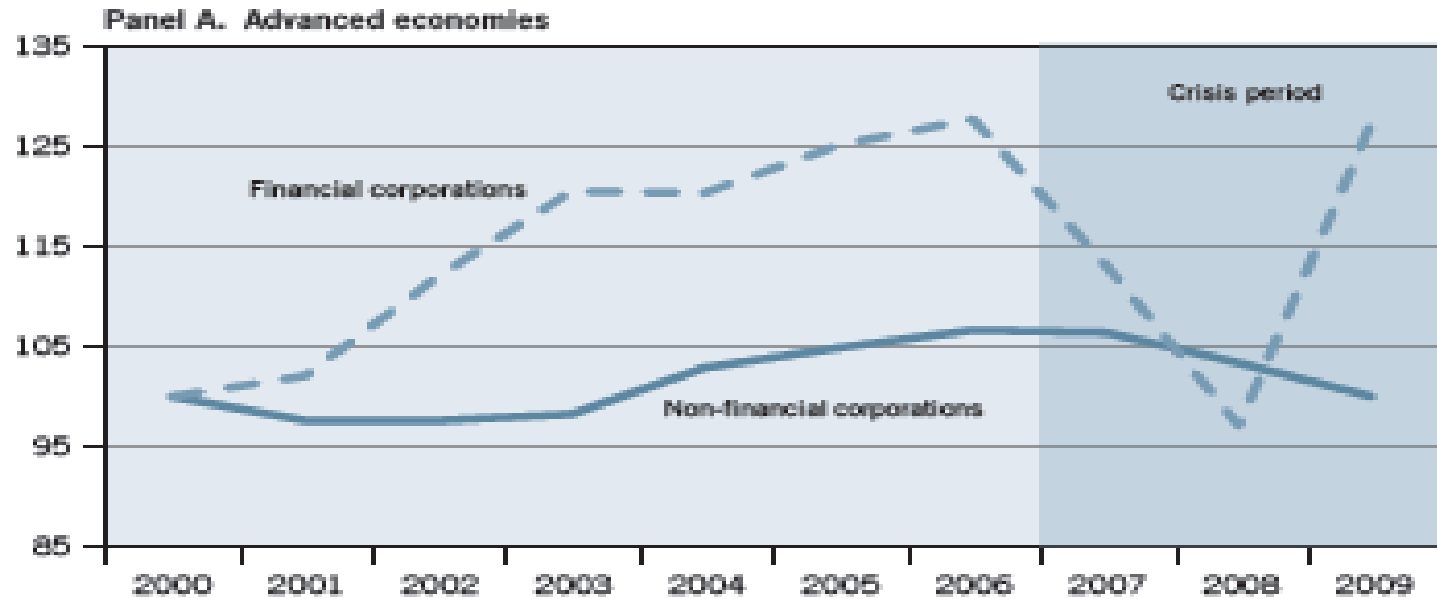


Figure 2.3 Evolution of capital shares by type of corporations, 2000 to 2007/09 (2000=100)



Adjusted wage share

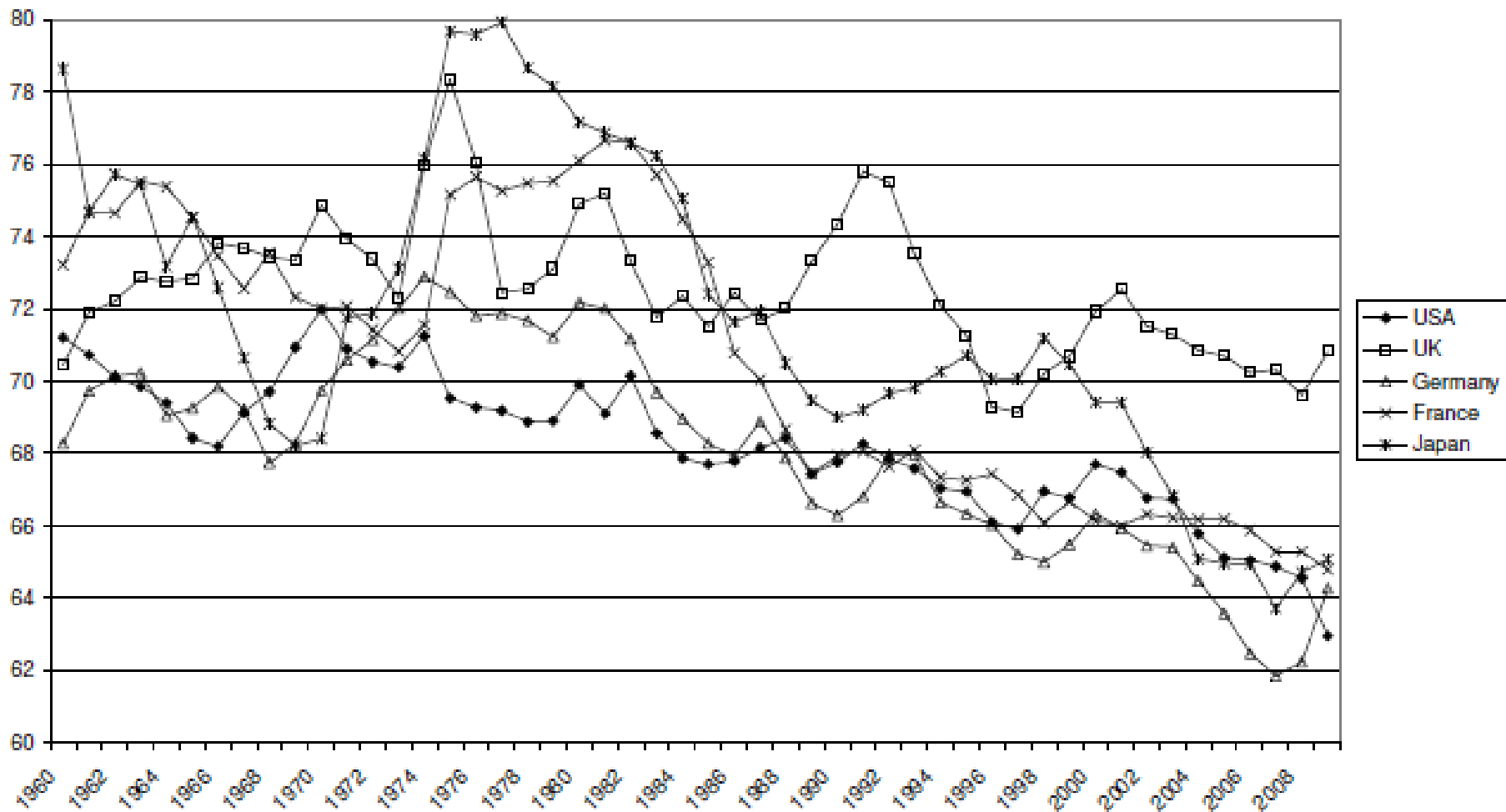
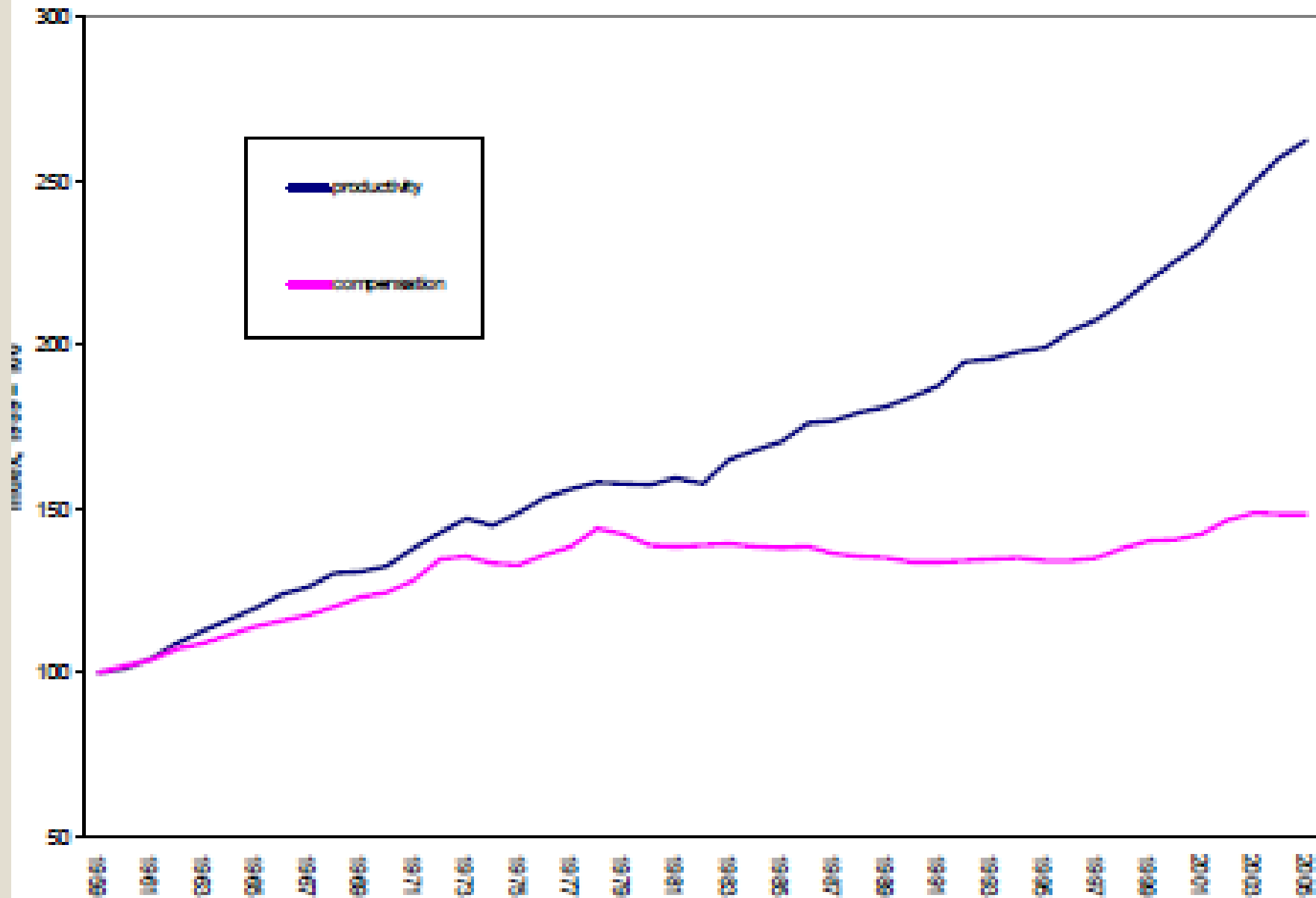


Figure 1. Index of productivity and hourly compensation of production and non-supervisory workers in the U.S., 1968-2005. Source: Economic Policy Institute.

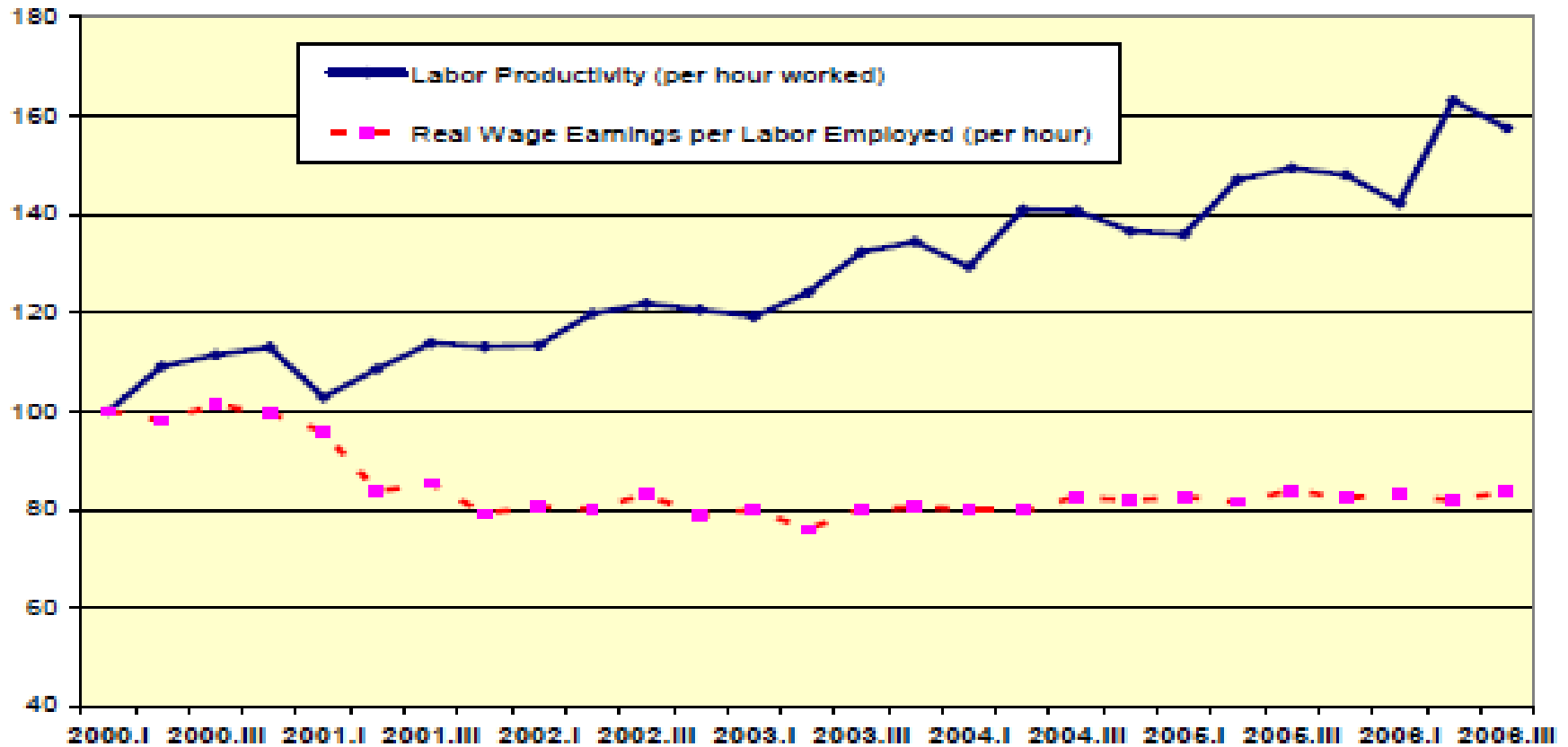


- How is the distribution of income is related to financialization?
- Wage incomes are associated with higher propensities to consume rather than profit or interest incomes
- Therefore lower wages mean lower consumption and lower demand
- Consumption expenditures can at times become the driving force for growth as households gain improved access to credit.
- However this creates new potential for instability as servicing high debt levels may become difficult in recession

Household debt as percent of disposable income

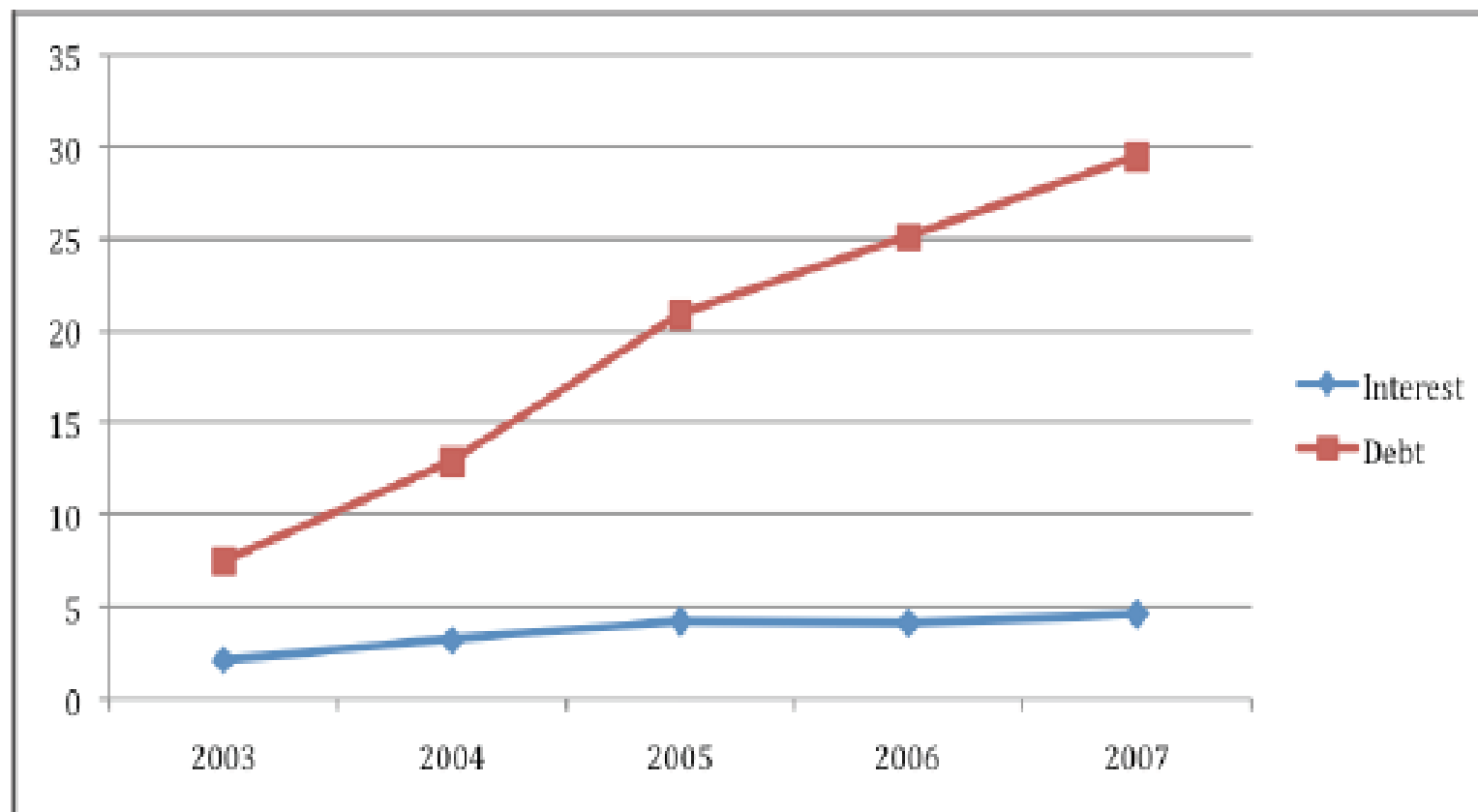
	1995	2000	2005
Germany	97	111	107
France	66	78	89
Italy	32	46	59
United Kingdom	106	118	159
Denmark	188	236	260
Finland	64	66	89
Ireland		81	141
Netherlands	113	175	246
Spain	59	83	107
Sweden	90	107	134
<i>unw. mean EU countries</i>	<i>91</i>	<i>110</i>	<i>139</i>
United States	93	107	135
Japan	113	136	132

Figure 6. Real Wages and Labor Productivity in Turkish Manufacturing Industry



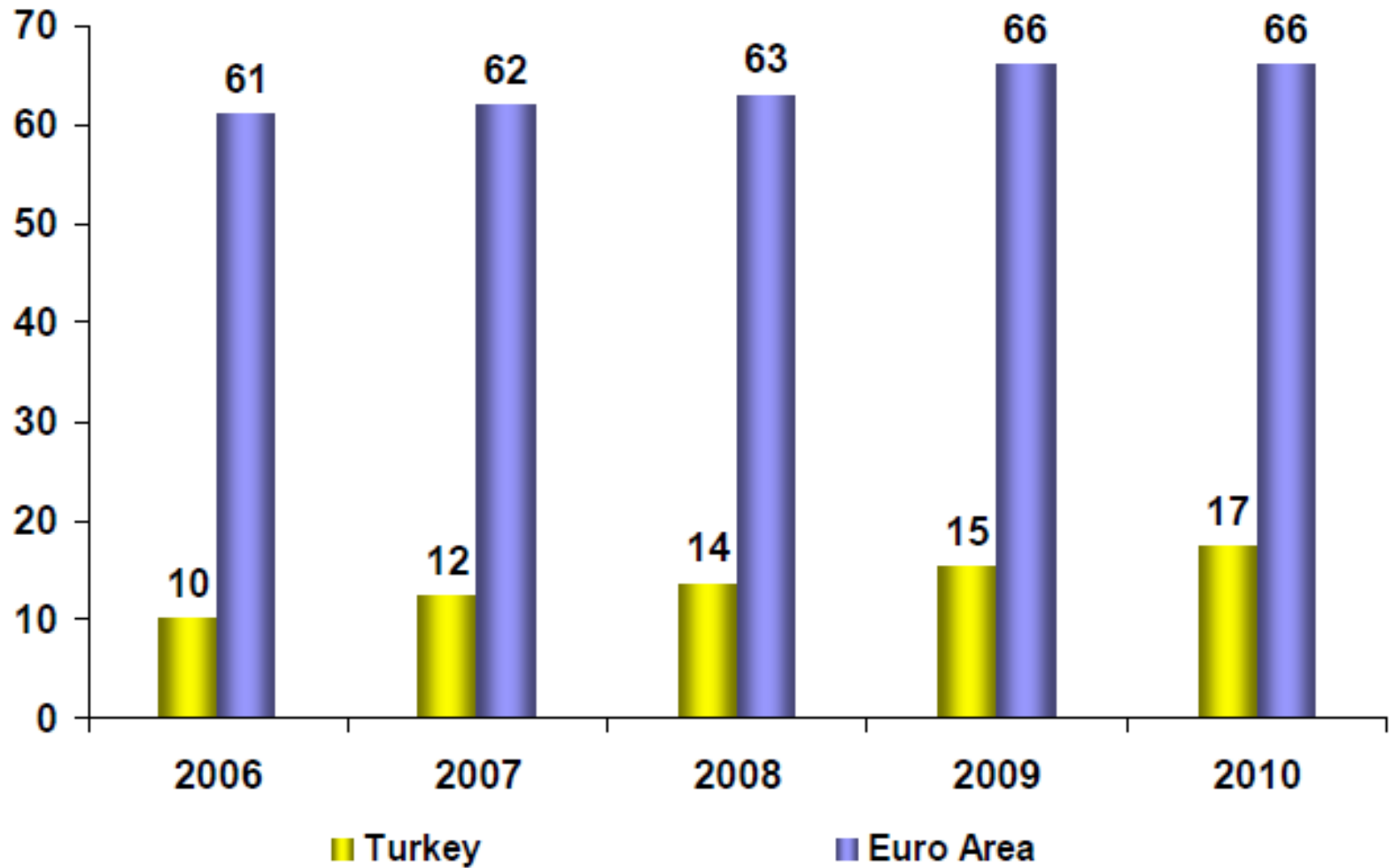
Source: Turkish Statistical Institute (TURKSTAT)

Fig. 10 Debt and interest payments, % of household disposable income, Turkey.



Source: CBRT 2008

Household Liabilities (% of GDP)



- Financialization tends to lead to lower investment, lower growth, and high unemployment
 - increased investment in financial assets can have a 'crowding out' effect on real investment
 - Short-term financial gains in the presence of uncertainty
 - Shareholder revolution i.e. Investment decisions by managers can be affected by short-termism and herd behavior in the financial markets
 - Real investment in non-financial sector (i.e. manufacturing, service and agriculture) is crucial given that it accounts for more about 90% of all employment

Investment to operating surplus

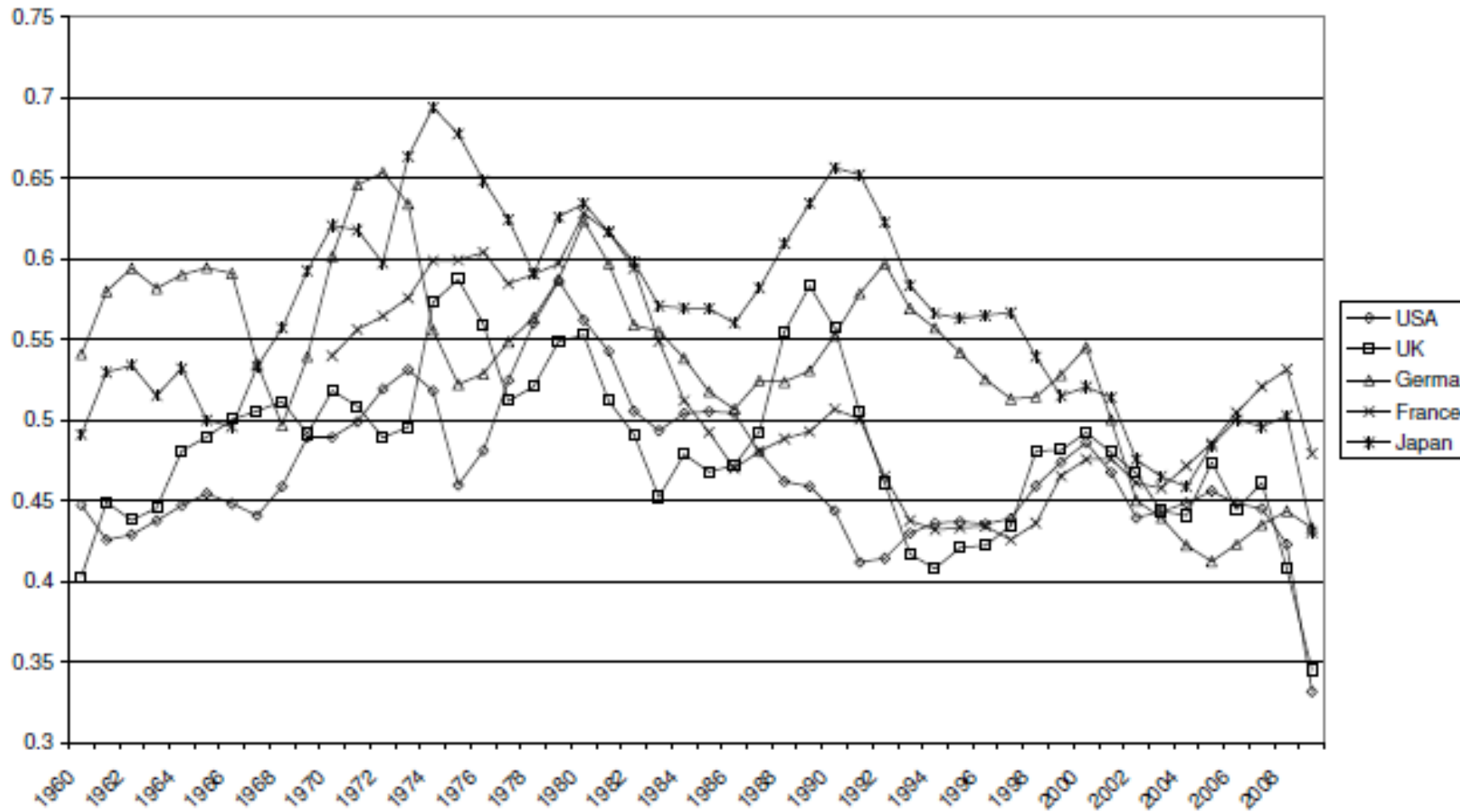
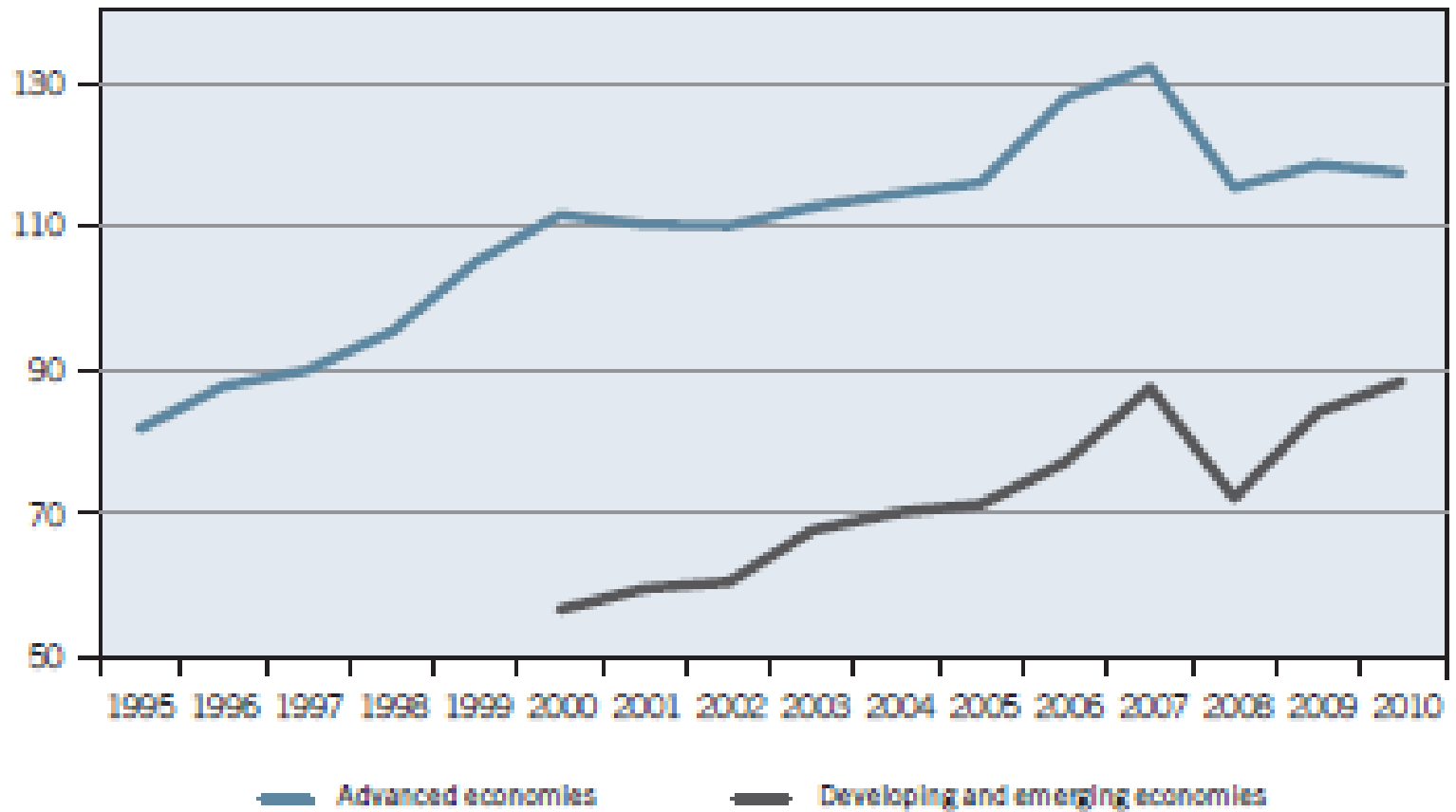
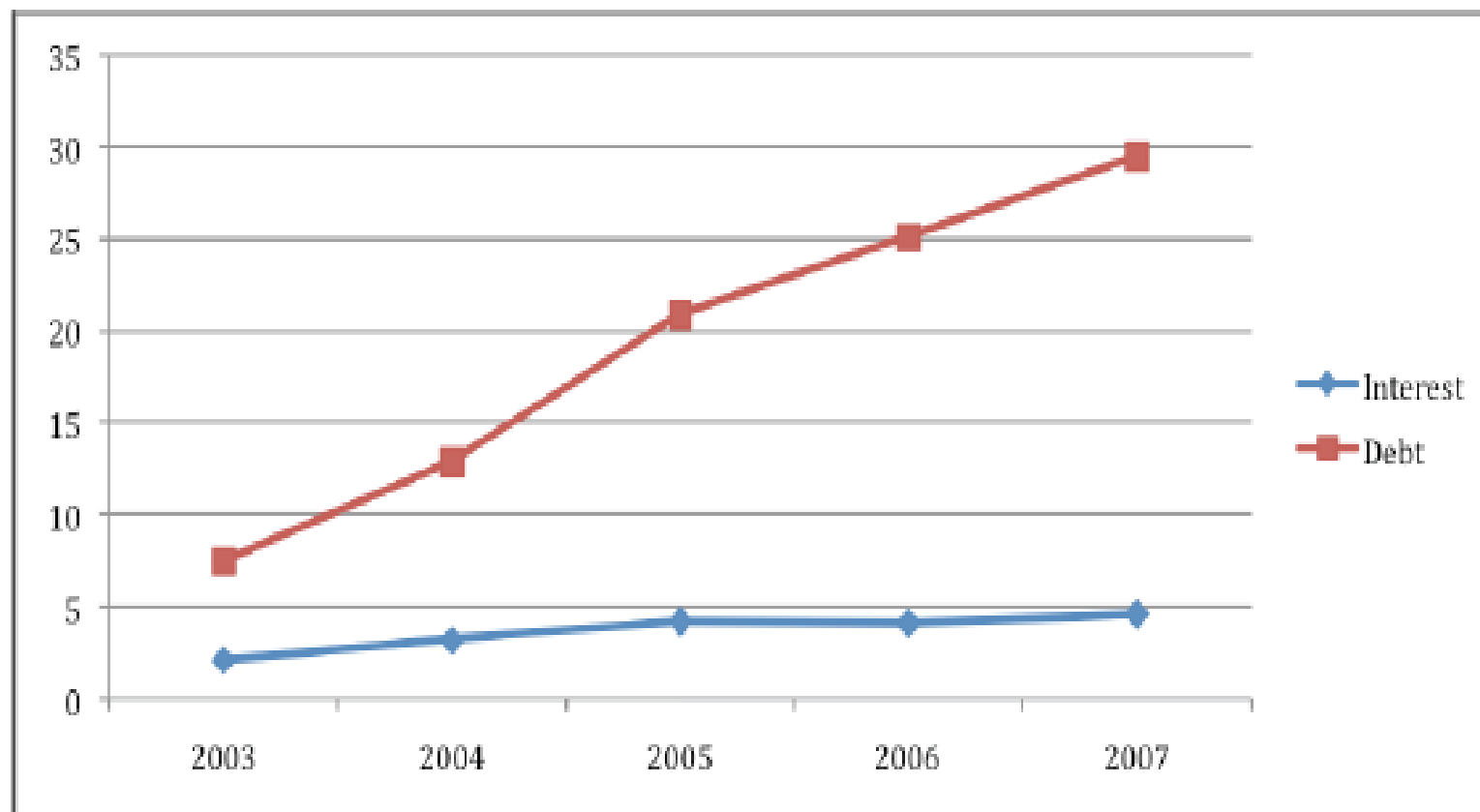


Figure 2.7 Total financial assets of non-financial firms as a share of GDP (percentages)



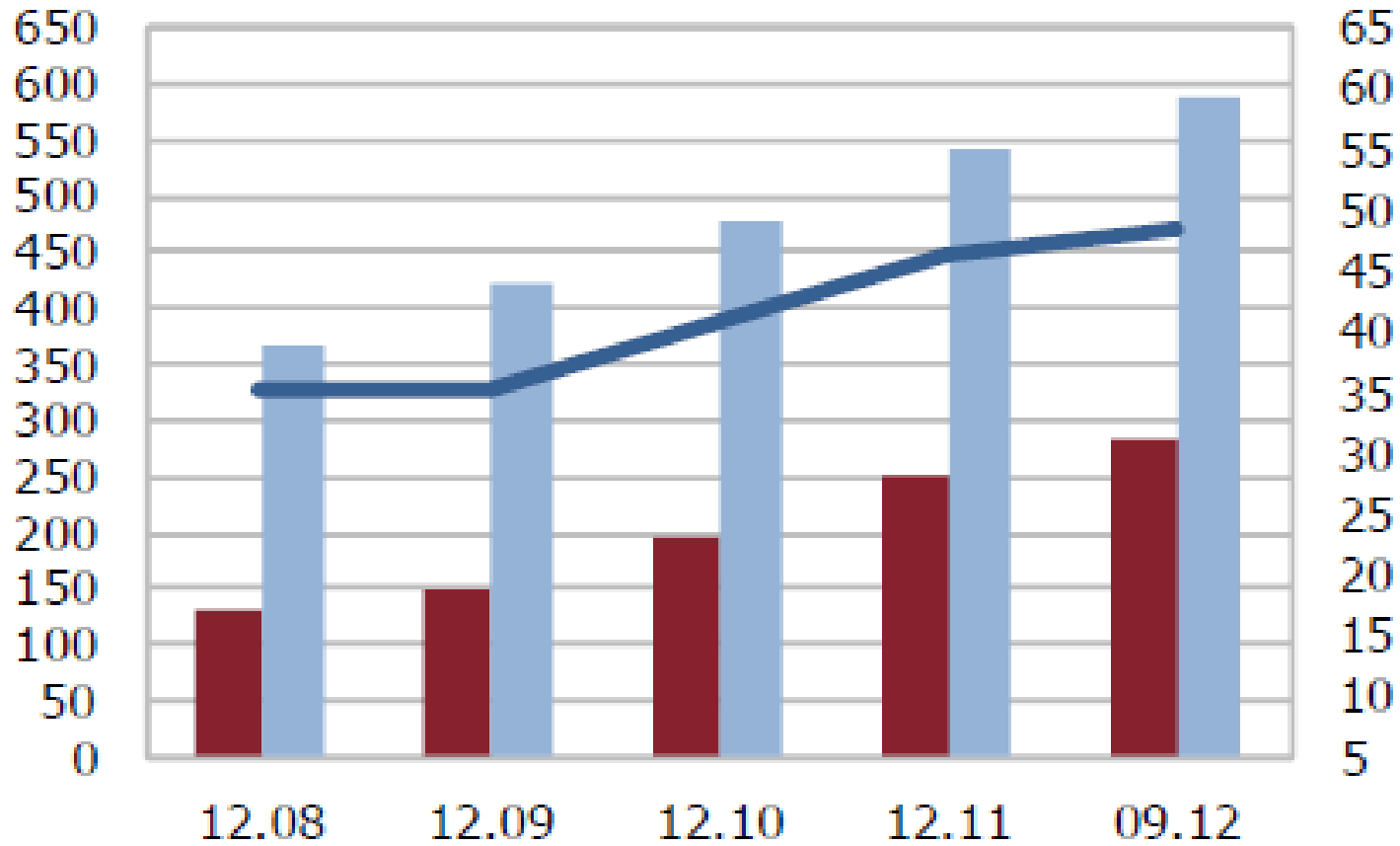
- Deregulation of financial markets leads to an increase of capital flows and, as a consequence, volatile exchange rates, which lead to an increase in uncertainty and repeatedly to severe currency crises.
- Volatility on financial markets has increased substantially in the course of financial deregulation
- As a consequence firms face a higher degree of uncertainty which may make physical investment project less attractive. In particular volatility of exchange rates seems to have had some effects on manufacturing investment.

Fig. 10 Debt and interest payments, % of household disposable income, Turkey.



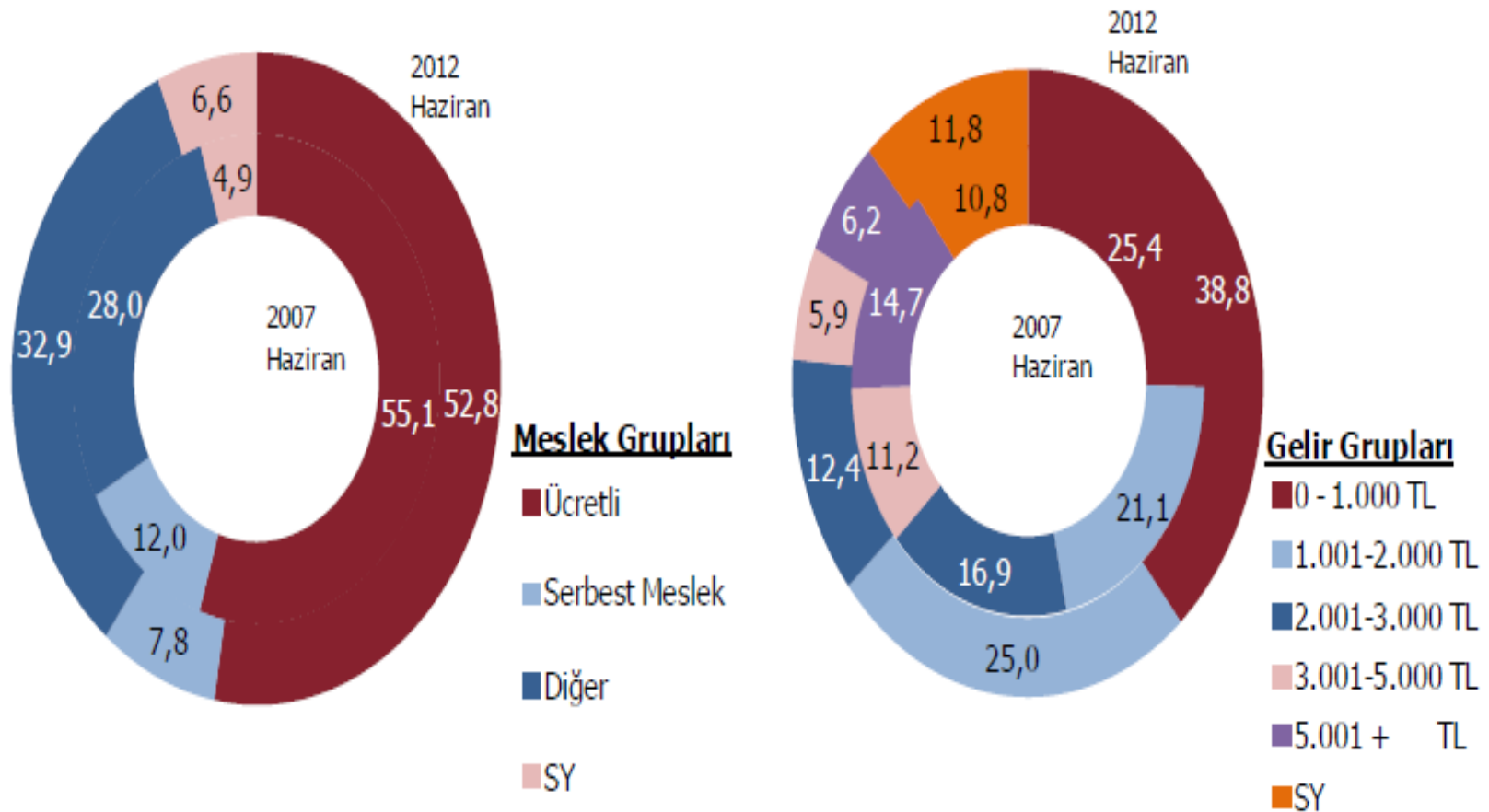
Source: CBRT 2008

Grafik II.59. Hanehalkı Finansal Varlıklarının ve Yükümlülüklerinin Gelişimi (Milyar TL, %)¹



- Toplam Yükümlülük
- Toplam Varlık
- Hanehalkı Yükümlülükleri/Varlıkları (Sağ Eksen)

Grafik II.58. Tüketici Kredisi Borcu Bulunan Hanehalkının Meslek ve Gelir Durumuna Göre Miktar ve Kişi Bazında Dağılımı (Haziran 2012,%)^{1,2}



Kaynak: TBB

(1) Türkiye Bankalar Birliği üyesi 46 bankadan tüketici kredisi kullandıran 36 adet bankanın bilgilerinden oluşmaktadır.

(2) SY, sınıflandırma yapılmayanları ifade etmektedir.

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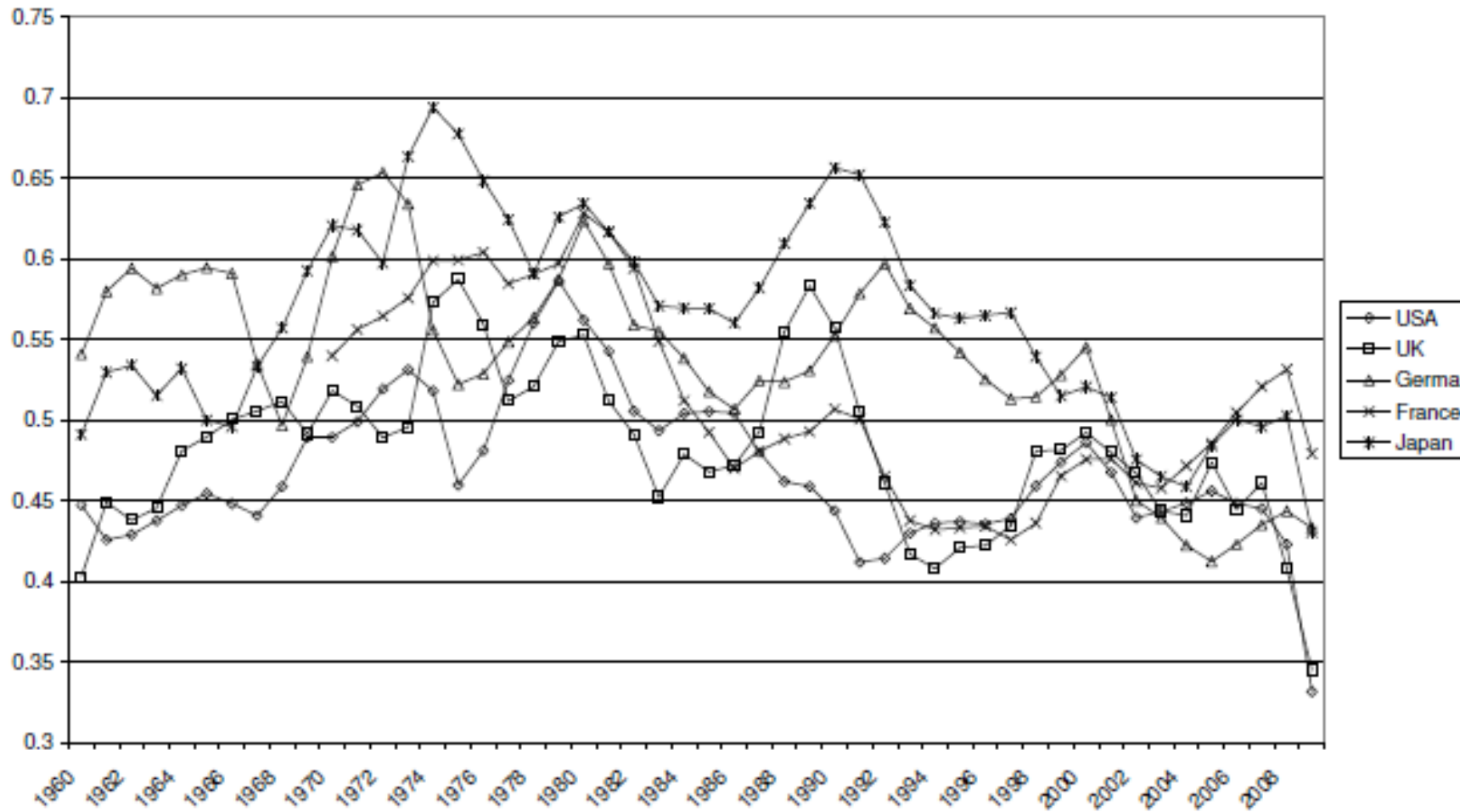
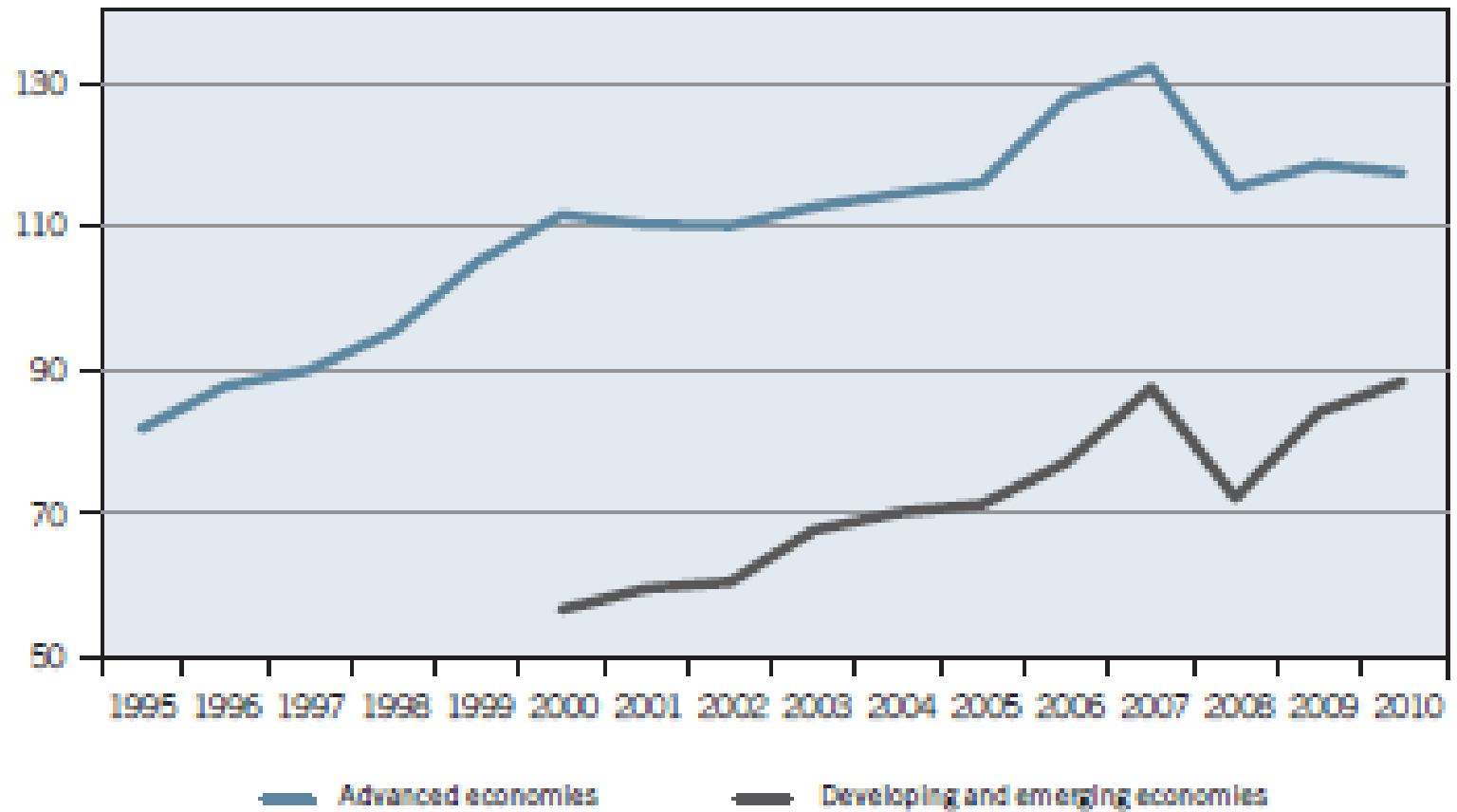


Figure 2.7 **Total financial assets of non-financial firms as a share of GDP (percentages)**



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