

STRUCTURAL CHANGES IN THE GLOBAL FINANCIAL SYSTEM AND NEW CHALLENGES FOR CENTRAL BANKS

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ROADMAP

- 1. Some evidence on bank disintermediation**
- 2. Temporary and permanent drivers**
- 3. Issues for discussion**

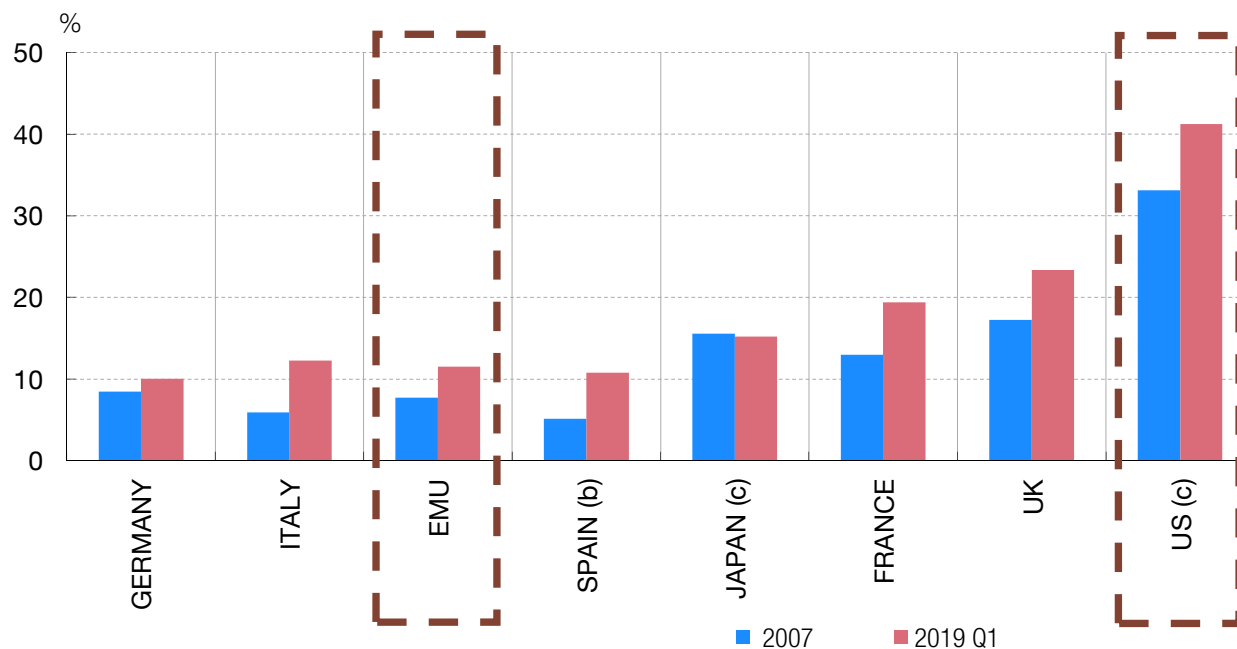
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BANK DISINTERMEDIATION HAS INCREASED IN THE EURO AREA SINCE THE GLOBAL FINANCIAL CRISIS ...

- Yet, the degree of market financing in the EA remains below that in the US
- High reliance on bank financing (i.e., low diversification in funding sources) increases firms' vulnerability to banking sector shocks [De Fiore and Uhlig, 2015; Tengulov, 2016]

SHARE OF FIXED INCOME SECURITIES IN NON-FINANCIAL CORPORATIONS' DEBT (a)



Sources: European Central Bank, Bank of International Settlements, Banco de España and Eurostat

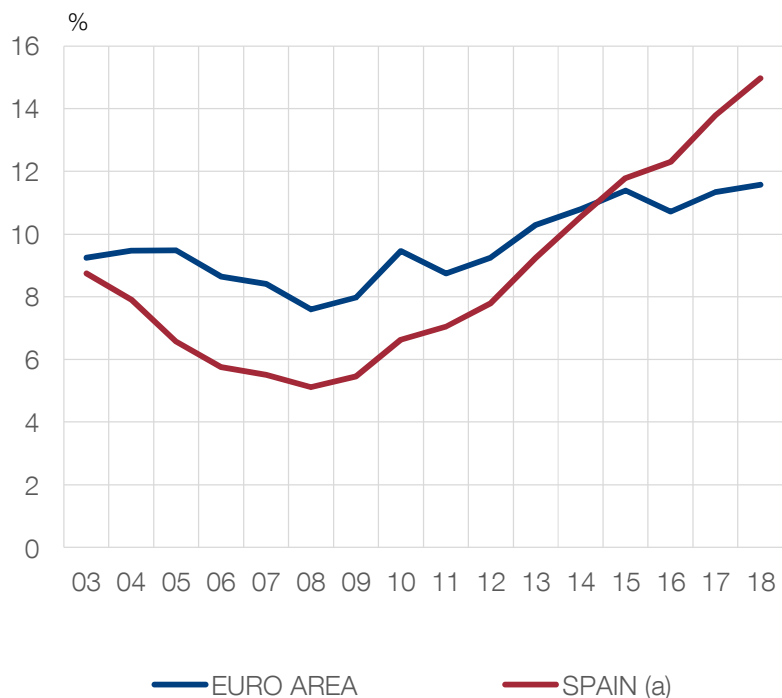
a. The debt includes fixed income securities and total loans

b. Spanish fixed income includes issuances made by resident and non-resident subsidiaries at market prices, which are subtracted from loans obtained by the sector. The issuances of German non-resident subsidiaries are also high, but the data cannot be adjusted due to lack of information

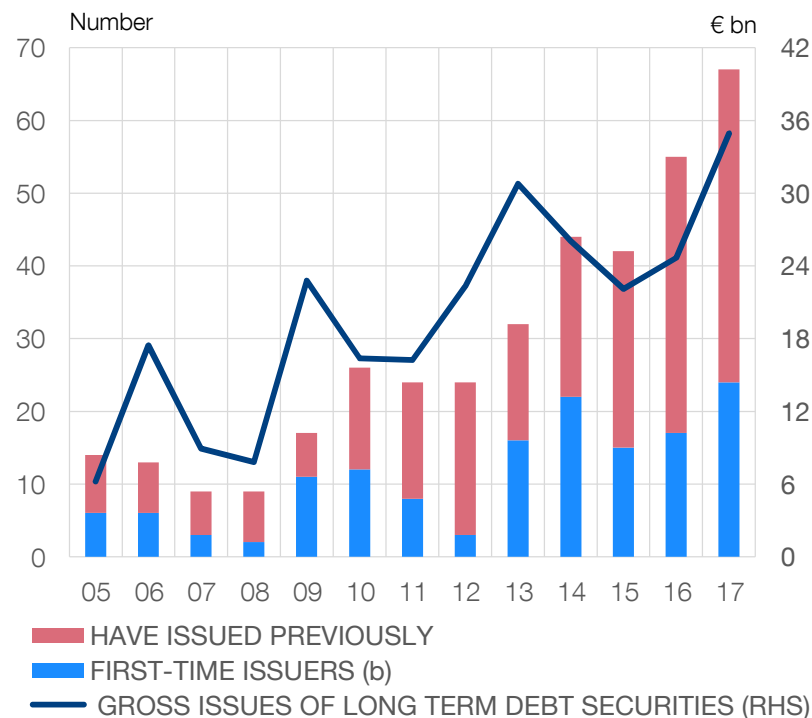
c. Data as of December 2018

... THIS PROCESS HAS BEEN PARTICULARLY INTENSE IN COUNTRIES HIT MORE INTENSIVELY BY THE FINANCIAL CRISIS, E.G. SPAIN

DEBT SECURITIES AS A PROPORTION OF DEBT (NFC)



ISSUANCE OF DEBT SECURITIES IN SPAIN by NFC



Sources: ECB and Banco de España

a. Debt securities include issuance by resident and non-resident subsidiaries

b. Owing to the lack of historical data, first-time issuers are considered to be those firms issuing debt securities for the first time since 2005, with no outstanding balances in 2005 of prior years' issuance

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THE RECENT INCREASE IN NON-BANK FINANCING HAS BEEN DRIVEN BY BOTH PERMANENT AND TEMPORARY FACTORS

- **Permanent factors**

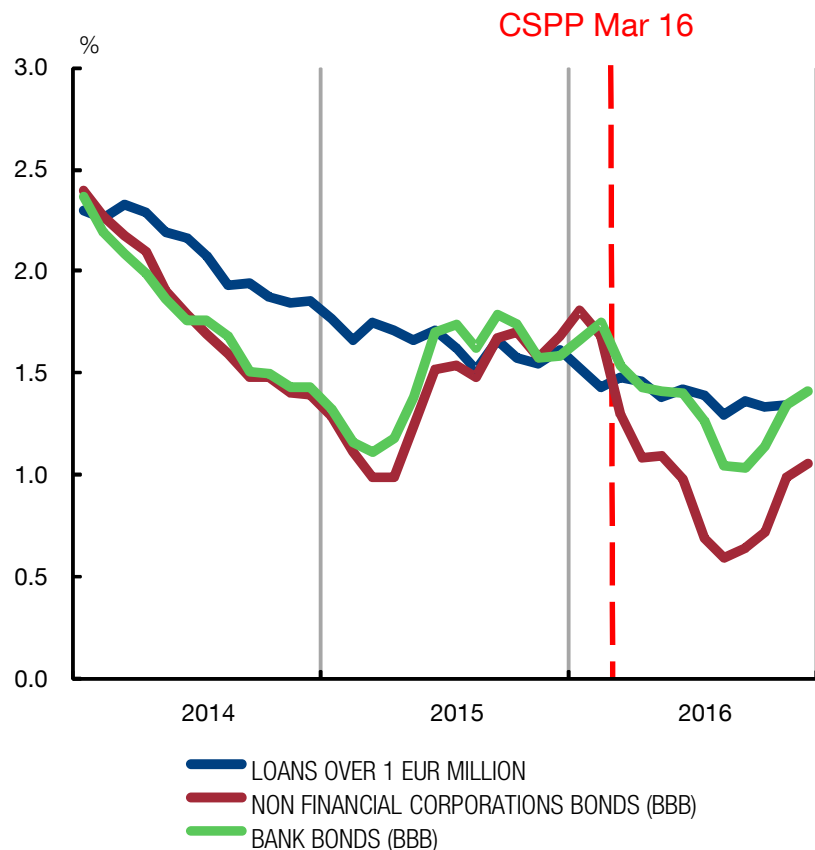
- The new international banking regulation (and uncertainty around it)
 - *Higher capital requirements enhance financial stability, but they may also tighten credit supply [Francis and Osborne, 2009; Cosimano and Hakura, 2011; Hyun and Rhee, 2011; Aiyar, Calomiris, and Wieladek, 2014; Aiyar et al, 2014; Bridges et al., 2014; Schoenmaker and Peek, 2014; Fraise, Lé, and Thesmar, 2015]*
- EU's Capital Markets and the development of alternative financing platforms
 - *For instance, P2P and the MARF experience in Spain*
- The irruption of the *Fintech* and *Bigtech* (non bank) players

- **Temporary (but persistent) factors**

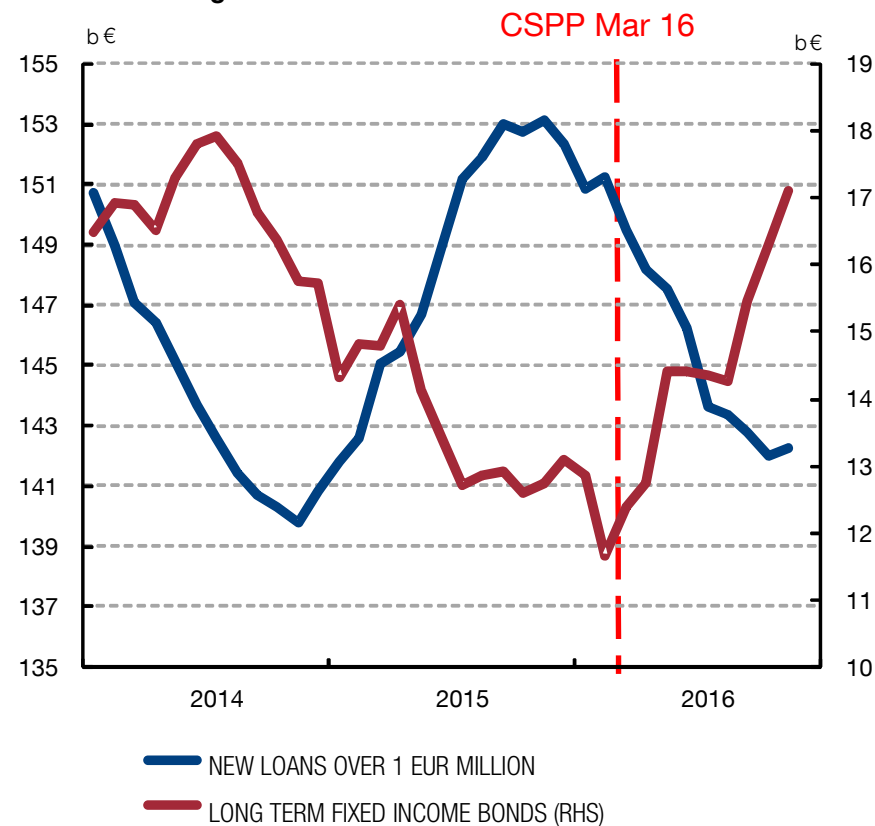
- The low level of interest rates
 - *The bond yields/loan rates differential is a key driver of bond issuance*
- The role of some unconventional monetary policies
 - *The ECB's Corporate Sector Purchase Programme (CSPP)*

CSPP DIRECT EFFECTS: CORPORATE BOND YIELDS FELL SHARPLY AND BOND ISSUANCE INCREASED AFTER THE ANNOUNCEMENT

INTEREST RATES. NF CORPORATIONS (SPAIN)



LOANS AND FIXED INCOME GROSS ISSUANCE (SPAIN) 12 month average

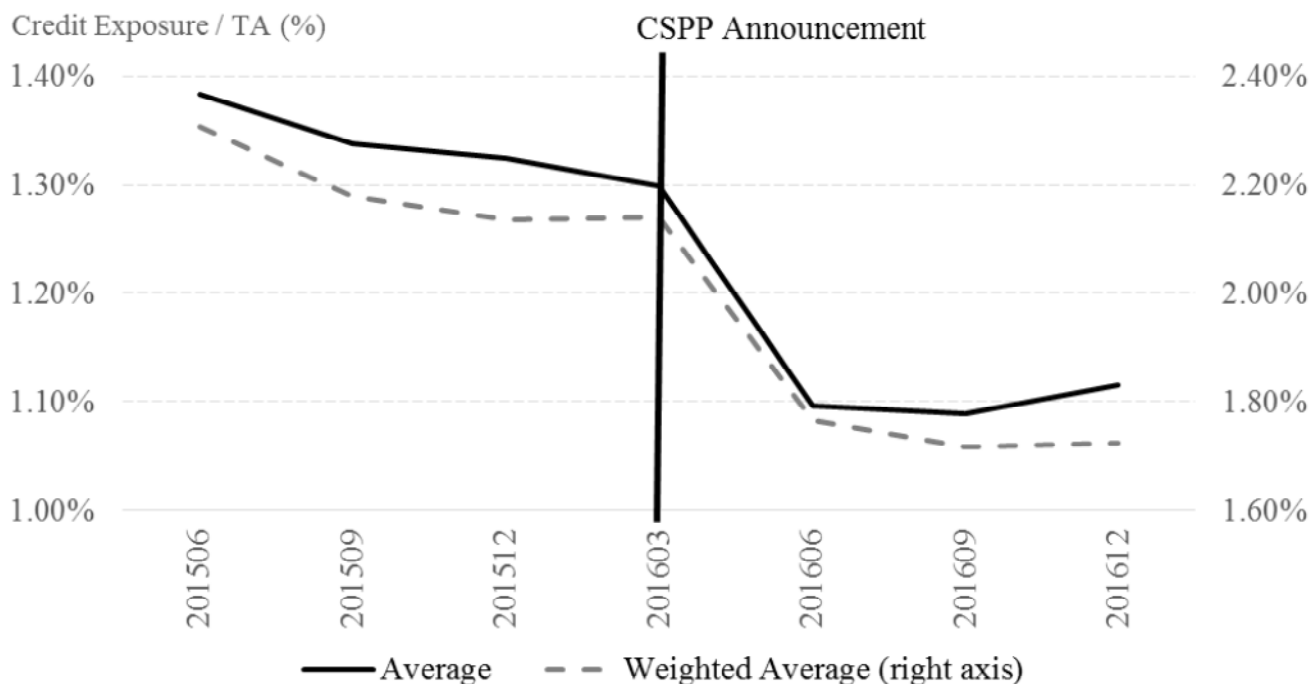


Source: Banco de España

CSPP DIRECT EFFECTS: SIGNIFICANT BOND-LOAN SUBSTITUTION BY ELIGIBLE FIRMS (DISINTERMEDIATION EFFECT)

- For each 1% increase in the net amount of bonds outstanding, the credit balance of non-financial groups diminished by 0.4%

RELATIVE CREDIT EXPOSURE OF RESIDENT CREDIT INSTITUTIONS TO DEBT ISSUER GROUPS AROUND AND AFTER THE ANNOUNCEMENT OF THE CSPP

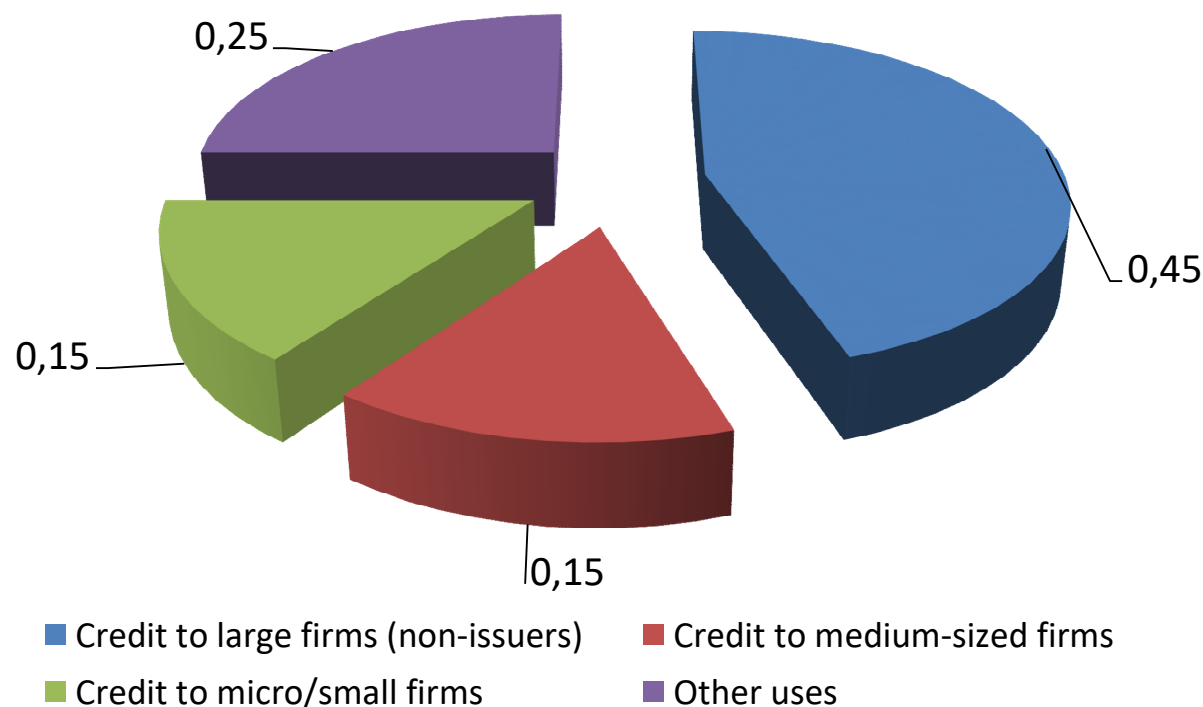


Source: Arce, O., Gimeno, R., and Mayordomo, S. (2017) "Making room for the needy: The credit-reallocation effects of the ECB's Corporate QE". Banco de España Working Paper

CSPP INDIRECT EFFECTS: BANKS REACTED BY REDISTRIBUTING THEIR CREDIT TO OTHER FIRMS

- A lower demand for bank credit by large borrowers gave rise to an increase in the supply of credit available for SMEs, hence, positive spillovers from this kind of disintermediation....

CREDIT TO FIRMS GIVEN AN OUTFLOW OF ONE EURO IN THE LOAN PORTFOLIO OF LARGE FIRMS THAT ARE BOND ISSUERS



Source: Arce, O., Gimeno, R., and Mayordomo, S. (2017) "Making room for the needy: The credit-reallocation effects of the ECB's Corporate QE". Banco de España Working Paper

- ...as indeed intended by the policymaker:

*“Let me again underline that the CSPP benefits not only to large companies with direct access to the bond market, but also smaller companies, as favourable bond market conditions have **positive spillover effects to small and medium-sized enterprises (SMEs)** through various channels. **For instance, the fact that large corporations rely more on funding from bond markets leaves more space in the balance sheet of banks to provide loans to SMEs.**”*

Letter from Mr. Mario Draghi (ECB President) to several Members of the European Parliament (June, 2017)

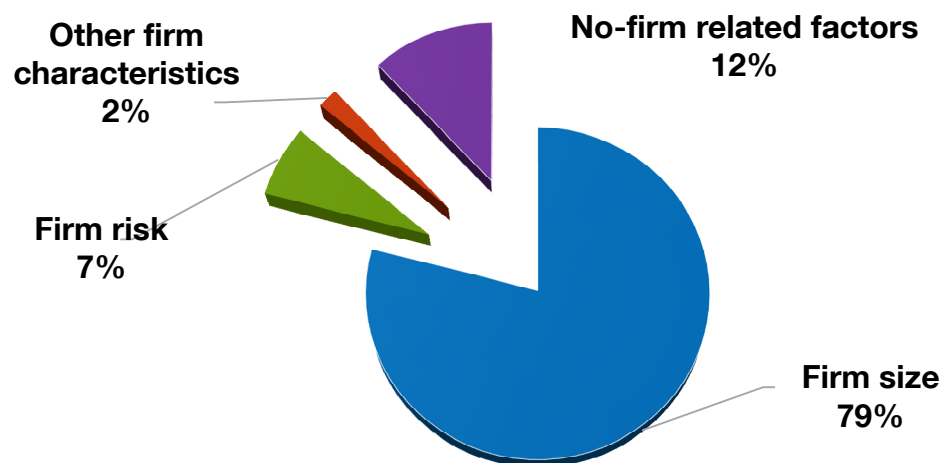
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BANK DISINTERMEDIATION IS DESIRABLE, BUT ... NEED TO PRESERVE THE STRENGTH OF THE BANK-LENDING CHANNEL

- **Firm size is the single most relevant factor in explaining corporate bond issuance, ... but SMEs are prevalent in the euro area** (about 60% of value added and 70% of employment)
- **Monetary policy needs to “safeguard favourable bank lending conditions and will continue to support access to financing, in particular for small and medium-sized enterprises.”** [ECB Introductory Statement, 12/09/19]

MAIN DETERMINANTS OF BANK DISINTERMEDIATION*

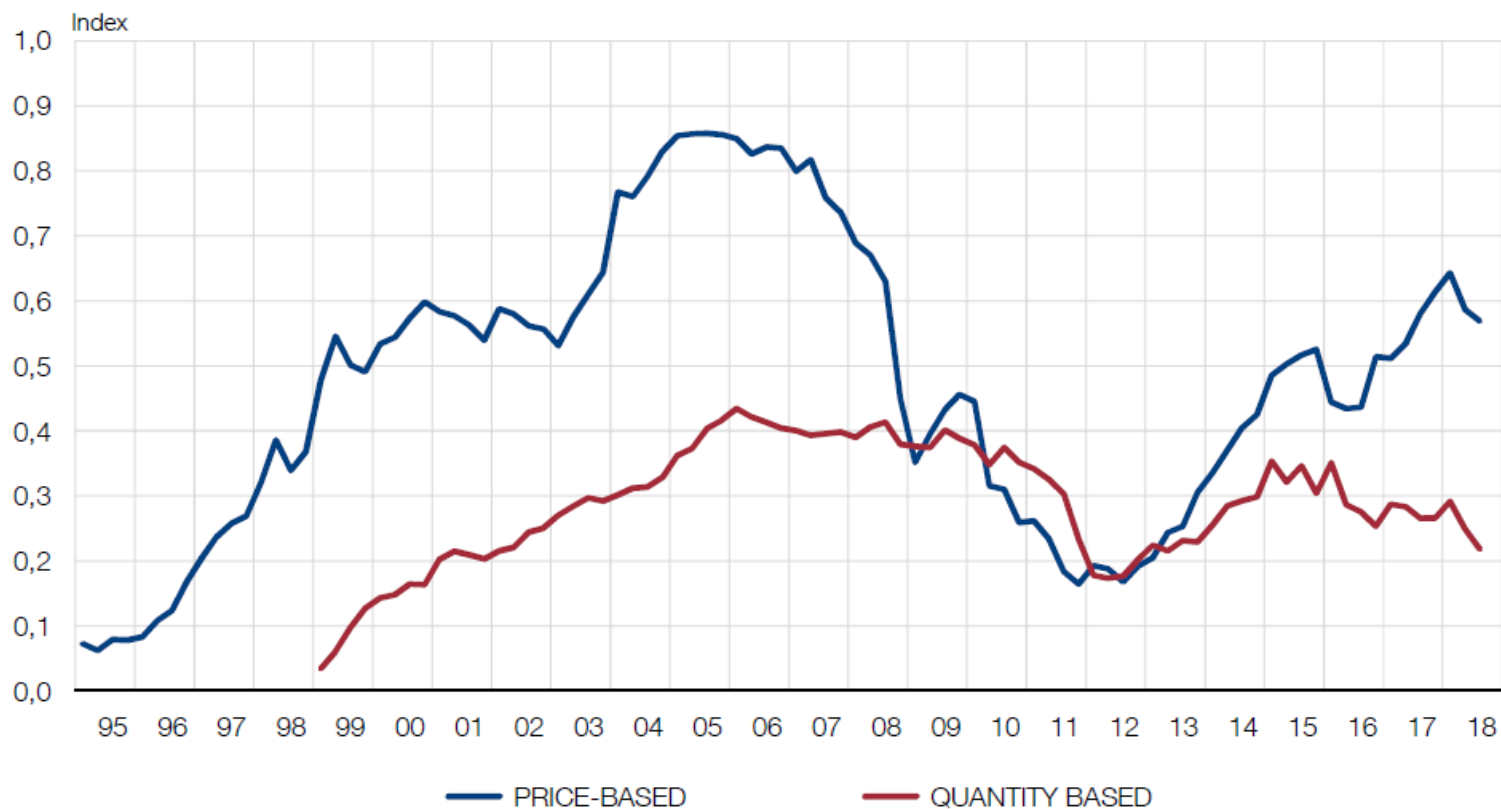


*Explanatory power, in terms of R^2 , of each determinant to account for the degree of firms' non-bank financing (i.e., Bonds / (Loans + Bonds))
Source: Informe Anual 2016. Banco de España

BANK DISINTERMEDIATION IS DESIRABLE, BUT ... INCREASING FINANCIAL INTEGRATION WITHIN THE EURO AREA IS MORE RELEVANT

- **Completing the Banking Union, together with the CMU, will also benefit the financing conditions in the euro area and ...**

INDICATORS OF FINANCIAL INTEGRATION IN THE EURO AREA

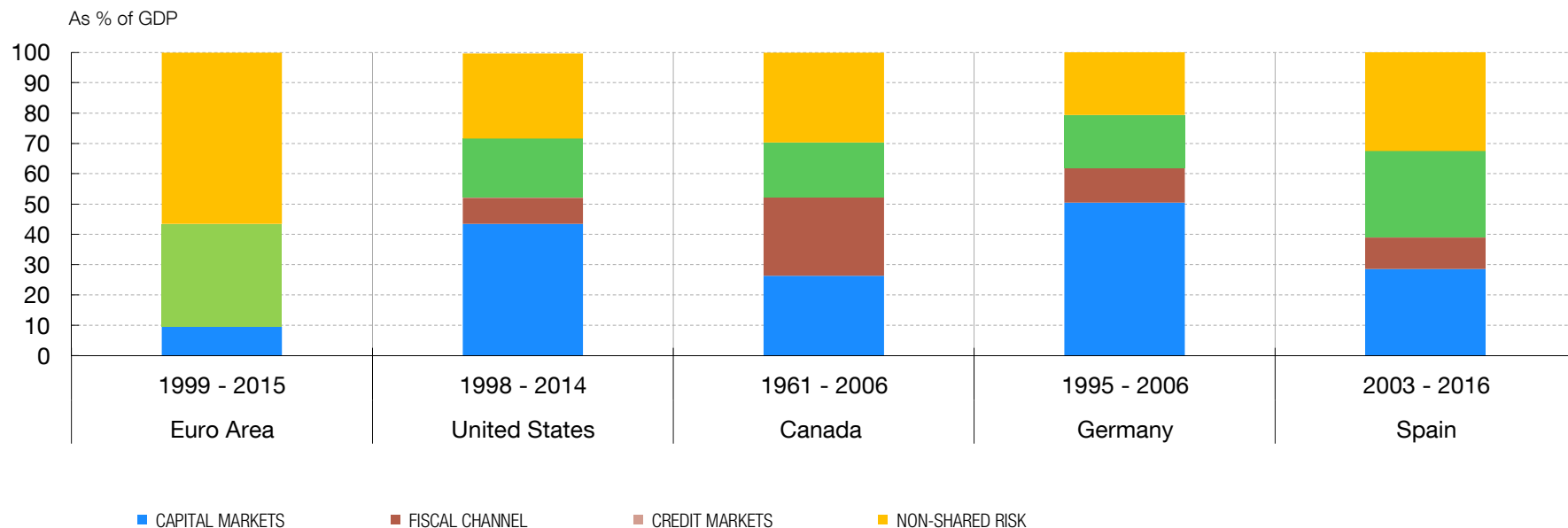


Source: ECB

BANK DISINTERMEDIATION IS DESIRABLE, BUT ... INCREASING FINANCIAL INTEGRATION WITHIN THE EURO AREA IS MORE RELEVANT

- ... strengthen the region's risk absorbing capacity

STRENGTH OF RISK-SHARING CHANNELS (a) INTERNATIONAL COMPARISON



(a) Estimated following the methodology of Asdrubali et al (1996), which approximates the percentage of shocks recorded in an economy's GDP that pass through to that economy's residents' income and consumption decisions. The channels that enable the impact of the shocks to be softened are, firstly, the capital markets channel whose strength depends on the income that residents obtain from other countries not affected by the shock because they hold shares in the companies of those countries and obtain income from labour and from other financial assets. Secondly, the shock may be softened by public intervention through fiscal transfers from the federal budget, as in the case of the United States, or from other regions (fiscal channel). Finally, households and firms in that economy may smooth their consumption by resorting to their savings or to the credit market (credit channel)

Source: Banco de España Annual Report 2016 and Burriel (forthcoming)

BANK DISINTERMEDIATION IS DESIRABLE, ... BUT WE NEED TO UNDERSTAND THE STRENGTHS AND WEAKNESSES OF THE NEW ENVIRONMENT

- **How stable (i.e., shock resilient) are the financing flows coming from non-banks?**
 - Bank-oriented systems may allow for a better smoothing of business cycle fluctuations [Gambacorta et al, 2014]: Drawing on their long-term relationships with clients, banks are more likely to supply loans during a "normal" downturn, whereas transaction lenders, who do not invest in information about the borrower, typically pull back during a recession
- **Are non-banks properly pricing the risks they are engaging?**
 - For instance, some evidence points to stretched valuations in the US high-yield corporate bond market and in the leveraged loan market
- **Enough data and tools available to evaluate and mitigate those risks?**
 - Towards a more comprehensive regulation and supervision of the financial sector -> macroprudential framework only developed for banks
 - Need to improve our understanding on (i) how monetary and macroprudential policies interact, and (ii) how monetary policy is transmitted in a less bank-oriented system

THANK YOU FOR YOUR ATTENTION

