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# Macroeconomics II

## Lecture 13

Finance and credit
The economics of debt

Debt is increasing,
although the level of international flows of capital are smaller than before the last crash

Why is this essential for economic evolution?

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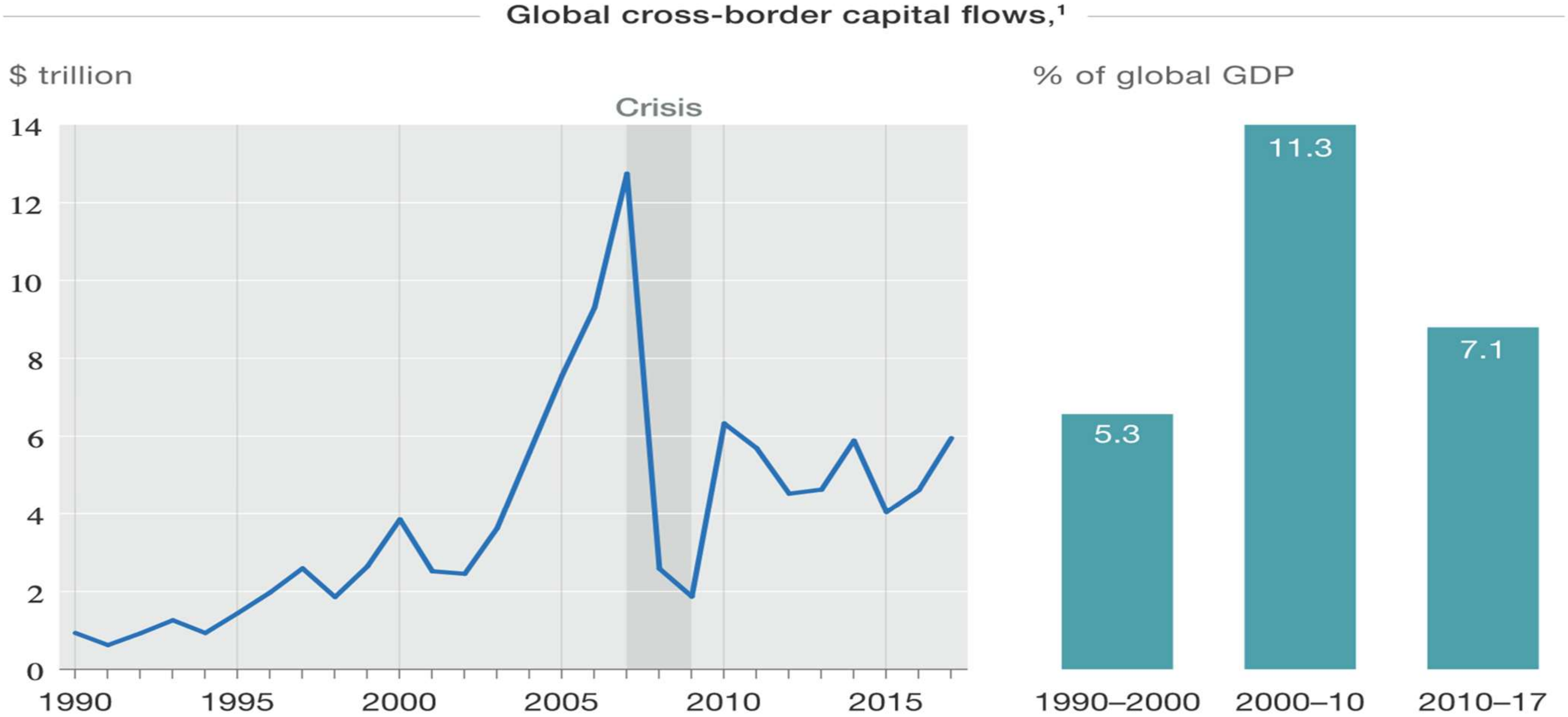
Global cross-border capital flows have declined 53 percent since the 2007 peak.




[1]Gross capital inflows, including foreign direct investment, debt securities, equity, lending, and other investment.
**Source:** IMF balance of payments statistics; McKinsey Global Institute analysis

# What is financialisation?

## Definition

“Financialization is a **process** whereby financial markets, financial institutions and financial elites gain greater influence over economic policy and economic outcomes. Financialization transforms the functioning of economic system at both the macro and micro levels. Its **principal impacts** are to (1) elevate the significance of the financial sector relative to the real sector; (2) transfer income from the real sector to the financial sector; and (3) increase income inequality and contribute to wage stagnation. There are reasons to believe that financialization may render the economy prone to risk of debt-deflation and prolonged recession.

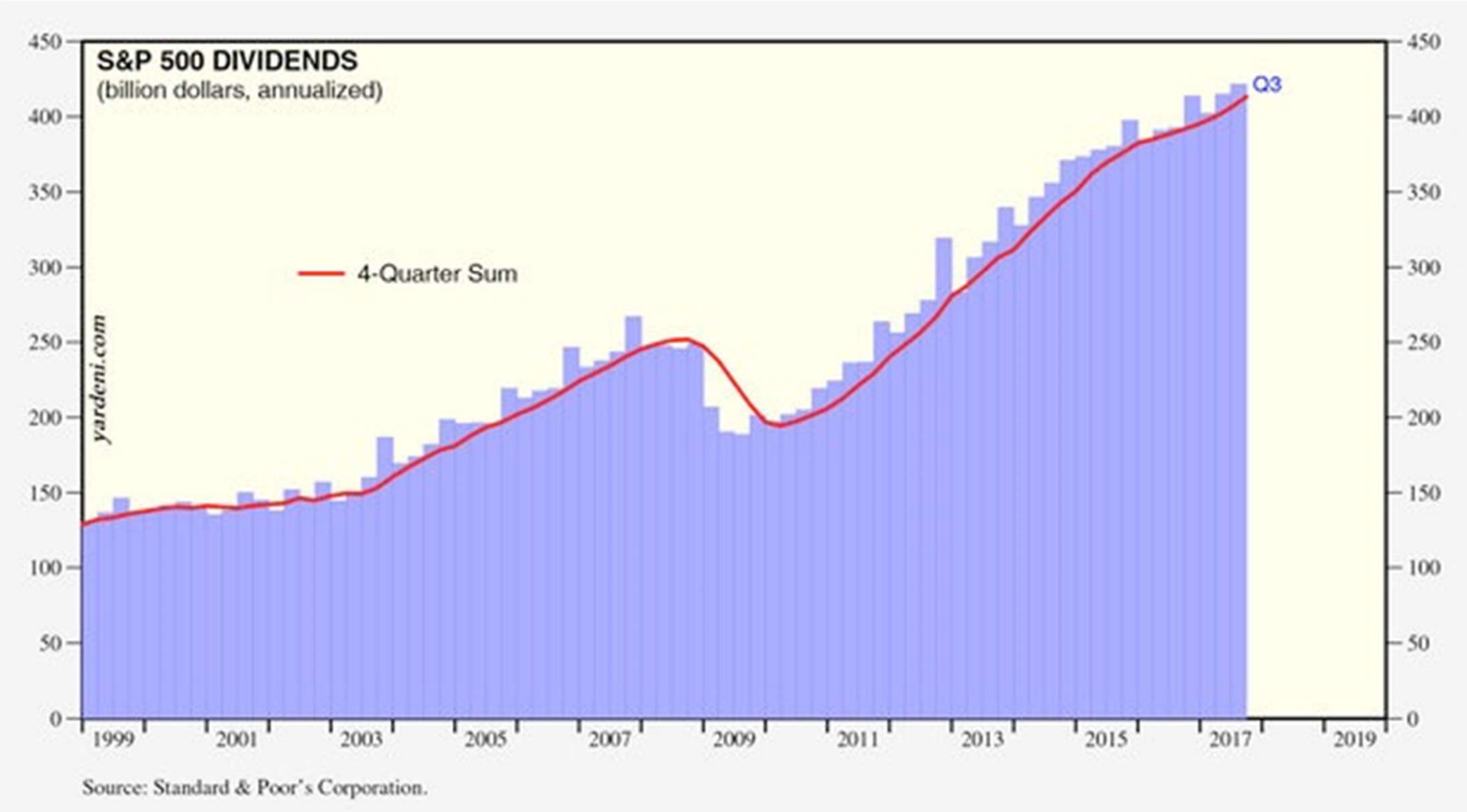
**Financialization** operates through three different conduits: changes in the structure and operation of financial markets; changes in the behavior of non-financial corporations, and changes in economic policy.”

Thomas Palley, 2007. "**Financialization: What It Is and Why It Matters**," Working Papers wp153, Political Economy Research Institute, University of Massachusetts at Amherst.

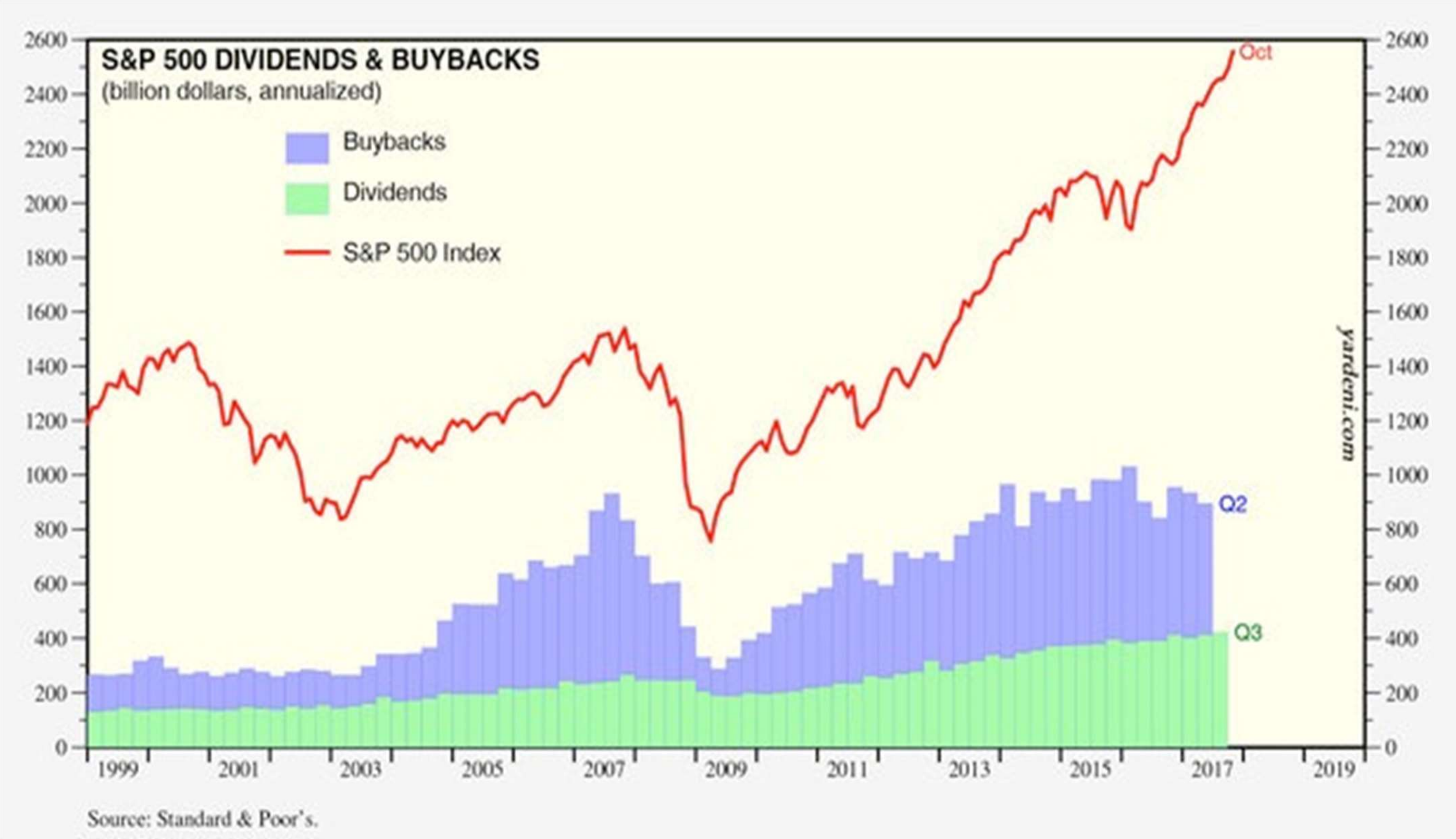
# Financialisation:

## big firms buybacks (purchase of its own stock)

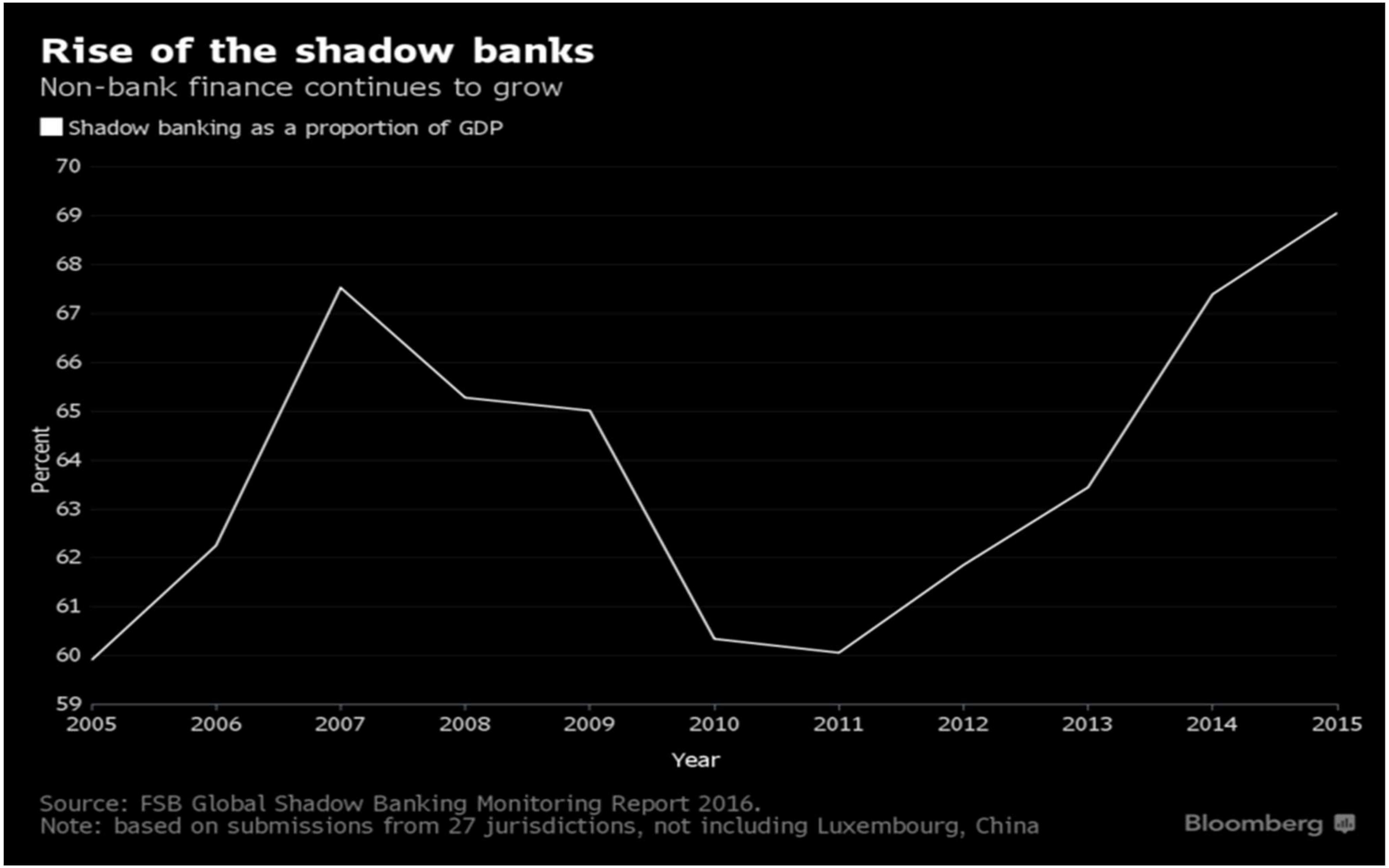
# S&P500 Dividends



# A summary of financialisation

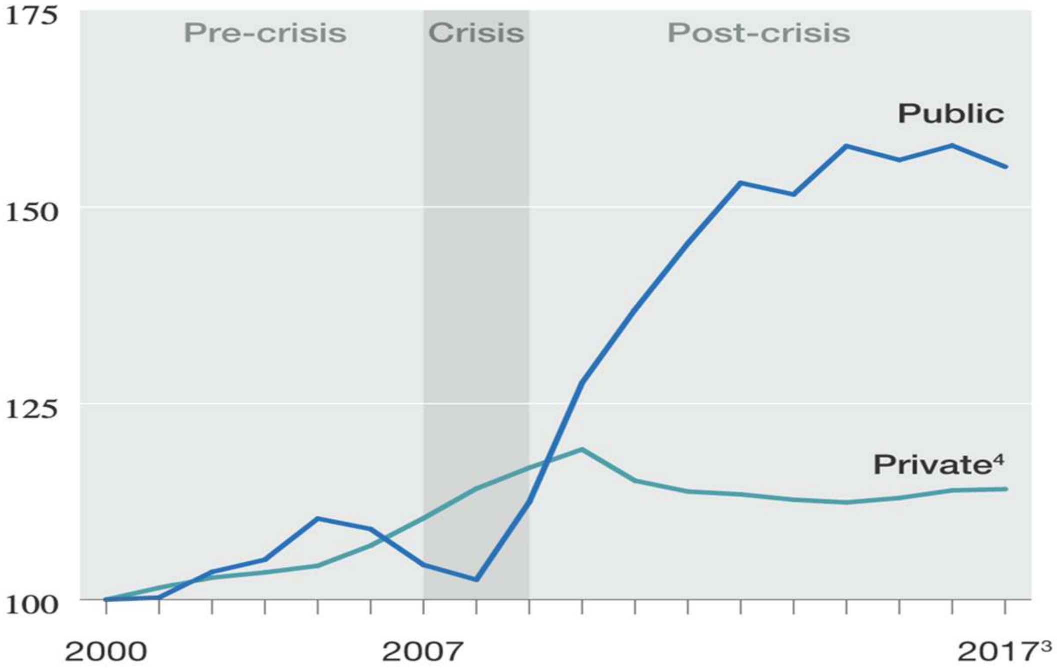


# The result: growth of shadow banking (credit outside central bank regulation)

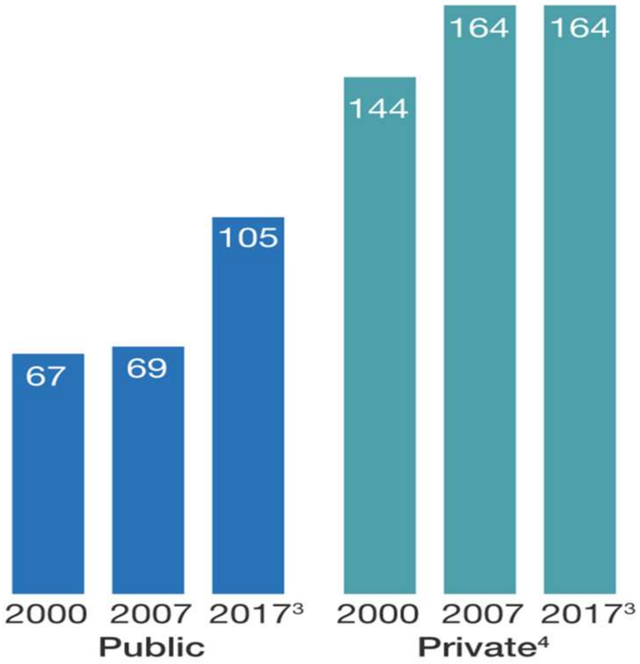


# Public debt increased rapidly after the crisis in advanced economies.

**Debt in advanced economies[1] by sector,**
% of GDP,[2] Index: 100 = 2000




**Actual debt-to-GDP ratio in advanced economies, %**




[1]Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Singapore, South Korea, Spain, Sweden, Switzerland, United Kingdom, and United States.
[2]Debt as percent of GDP is indexed to 100 in 2000; numbers are not actual figures.
[3]First half of 2017.
[4]Includes household and nonfinancial corporate-sector debt.
**Source:** Bank for International Settlements; McKinsey Global Institute analysis

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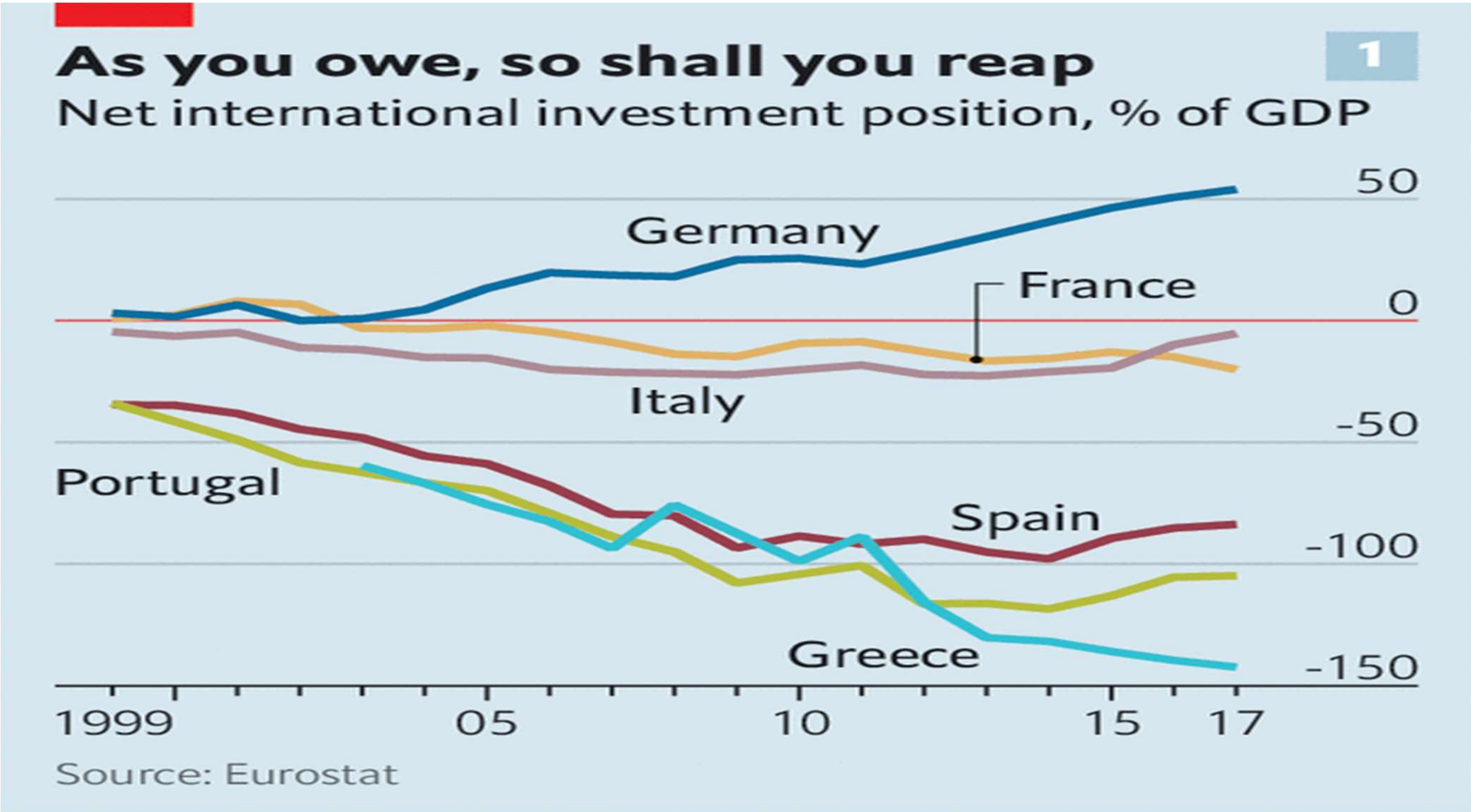
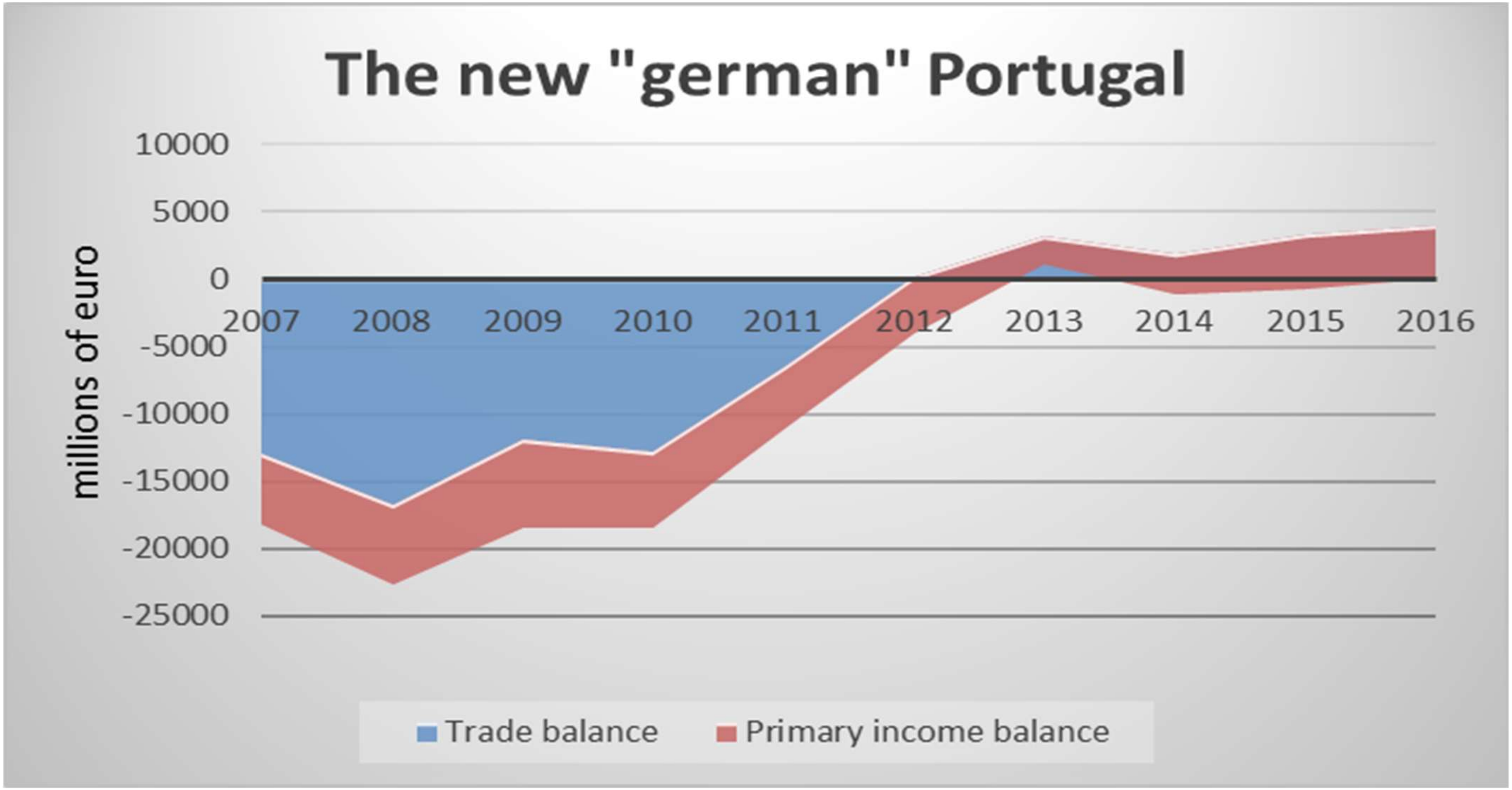
# Portugal in the global financial world

# Portugal and the European periphery's debts as compared to the core countries




The Economist

# But this was before the corona-recession (march-april 2020)



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# Why was a new recession probable

## (and this was pointed out before covid19)

# The Great Recession (2008-9)

- 2008-9, the worst recession of the last 80 years (before that of 2020)
- The first time since WWII that World GDP declined
- Provoked by "Irrational exuberance", or financial and housing bubbles (**Robert Shiller)**
- And the regulators and central banks contributed to generate the crisis

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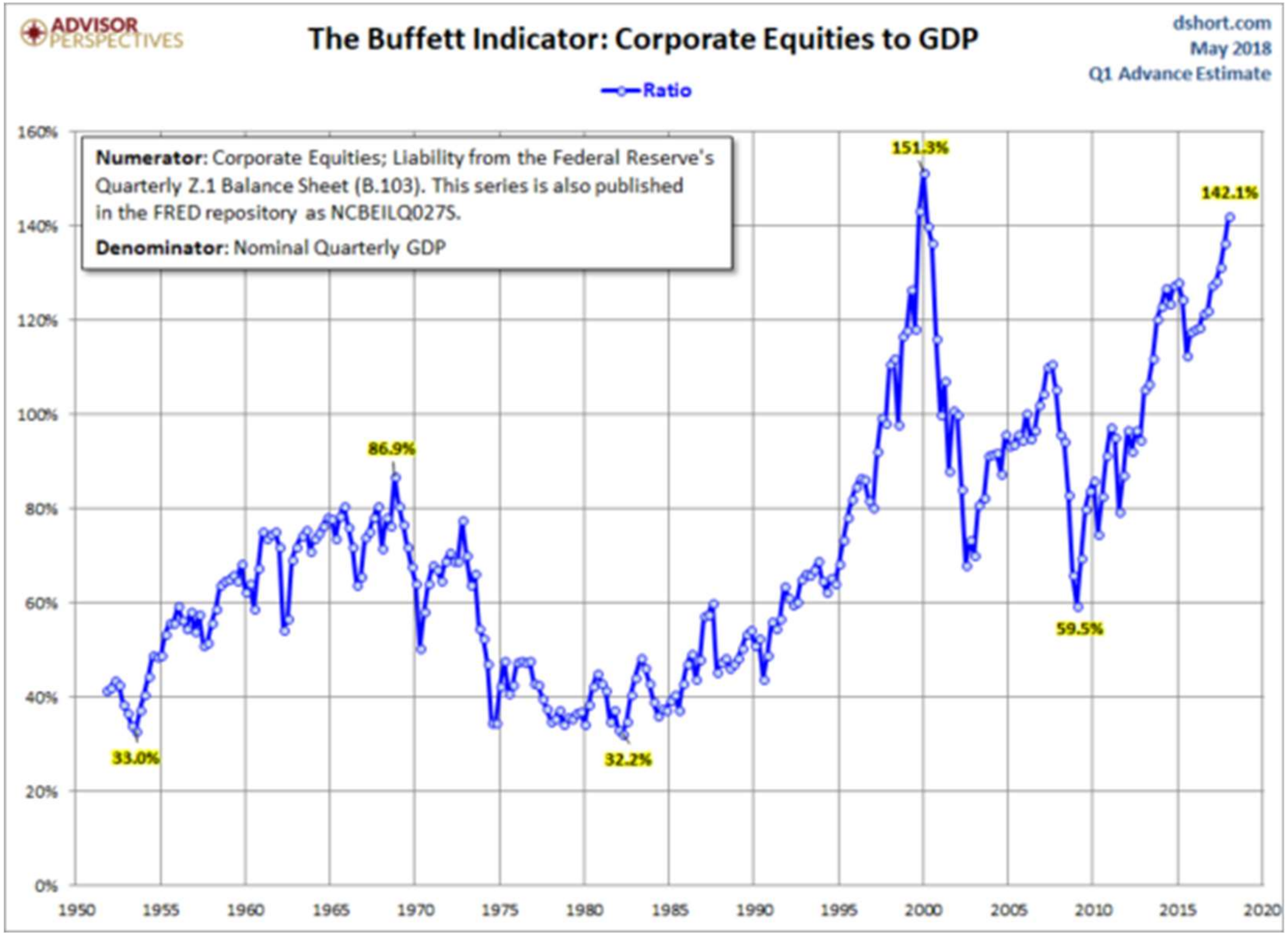
# Deregulation dominated

Ben Bernanke, future president of the FED, states in 1997:

"As we move into a new century, the **market-stabilizing private regulatory forces** should gradually **displace** many cumbersome, increasingly ineffective government structures. This is a likely outcome since governments, by their nature, cannot adjust sufficiently quickly to a changing environment"

# 31st january 2018: According to Greenspan, there were not *one* but *two* bubbles

# Market capitalisation-to-GDP ratio: signs of danger before Covid19



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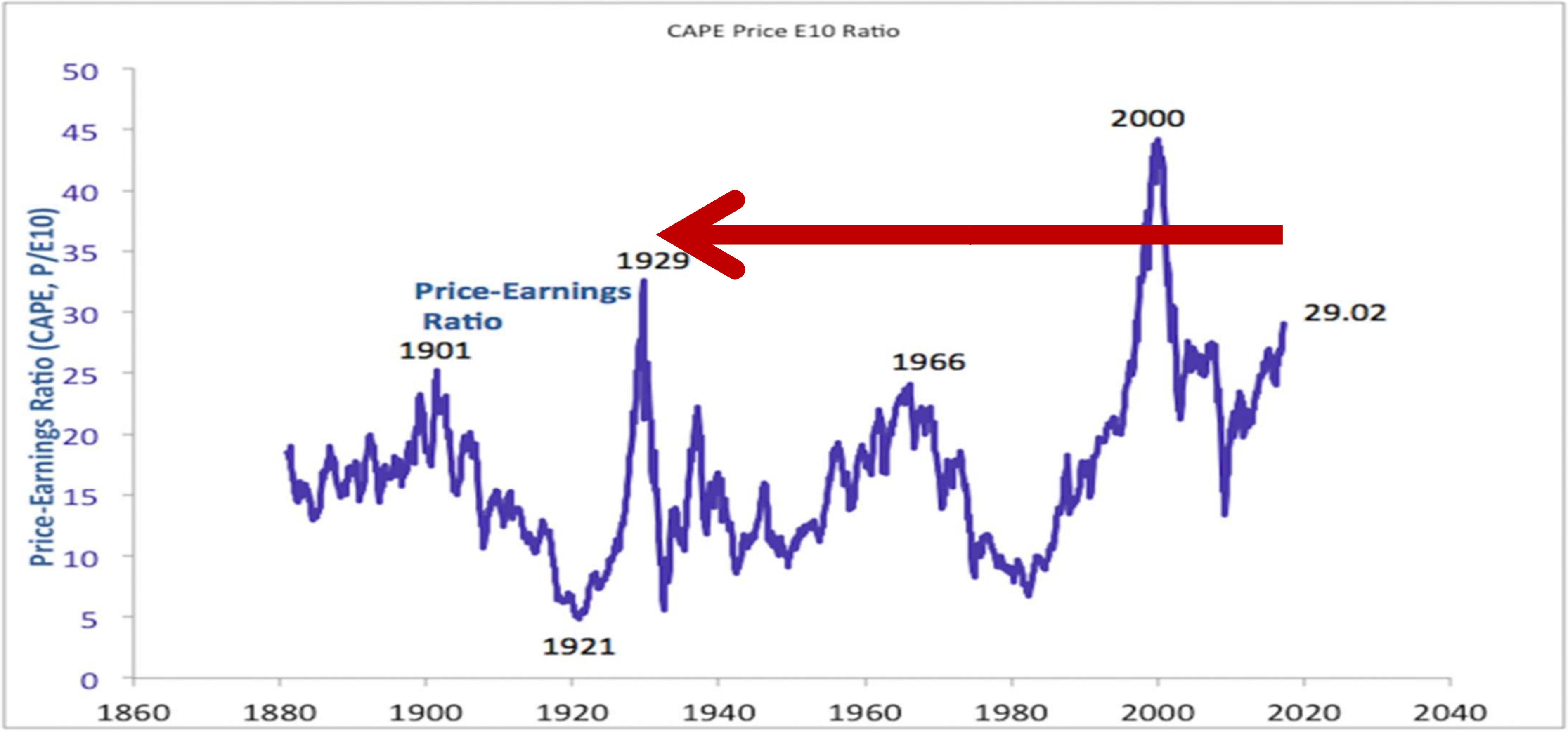
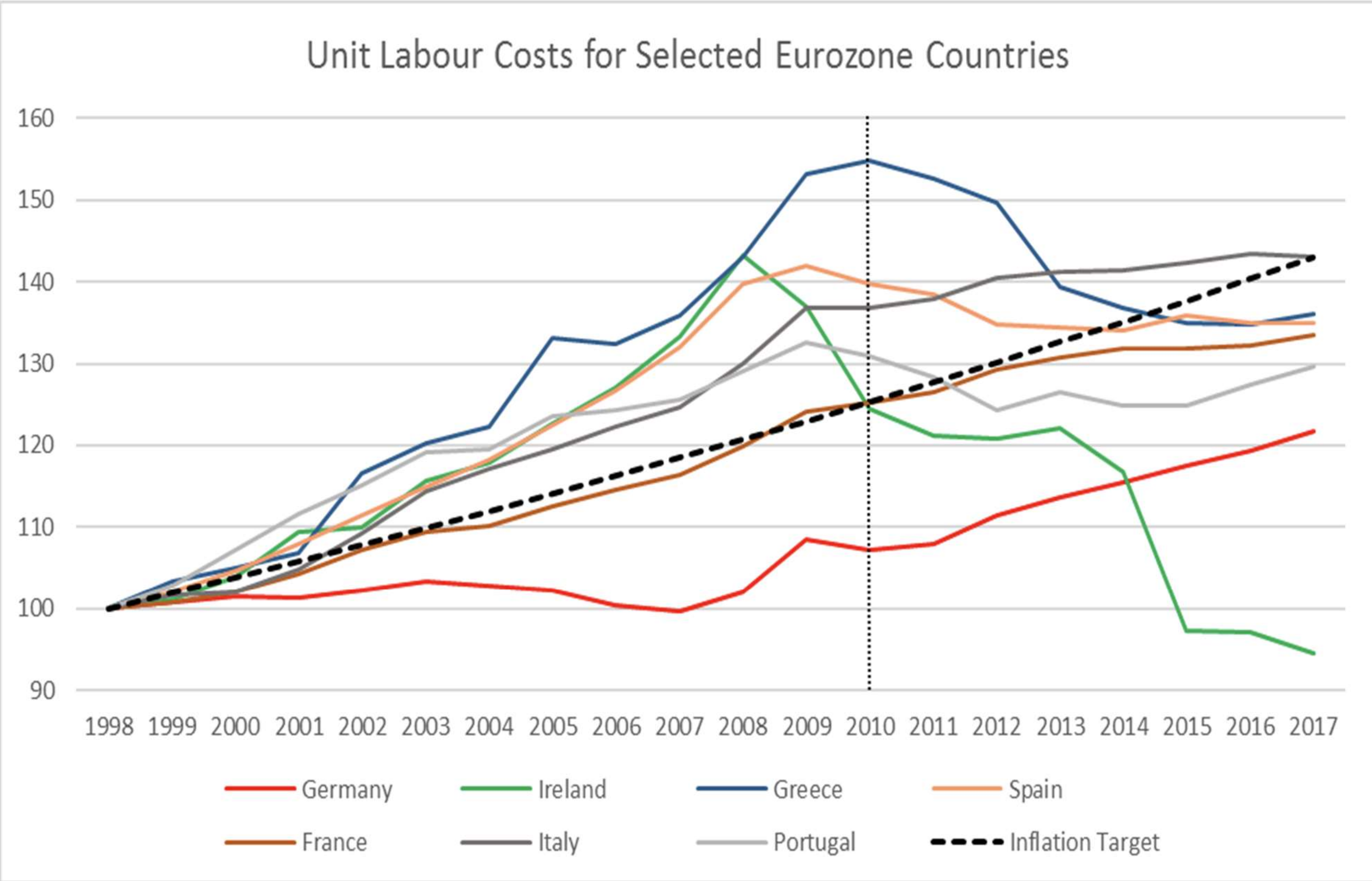
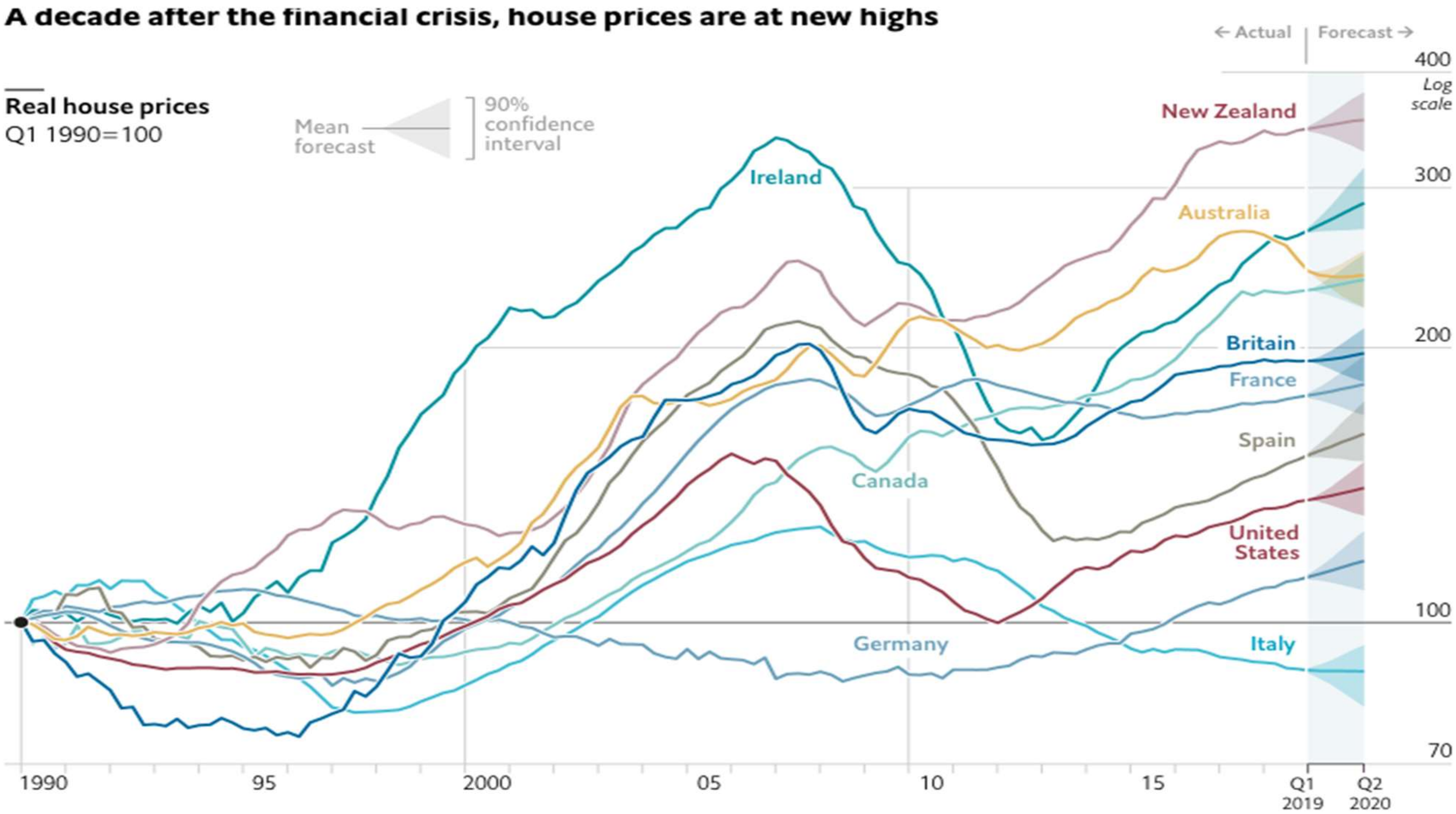
# Shiller's CAPE (cyclically adjusted price-earnings, or the disconnection between capitalization and results) index: signs of danger noted by early 2020



# Labour costs went down before the crash



# Ten years after the subprime, there was a new housing bubble



# The fear of the next recession
## *The Economist*, 2015 and 2018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# Conclusion


A sudden investors’ panic, poorly-timed Central Bank action or a politically-motivated incident, such as a commercial war, were already imminent dangers before Covid19