

On the macroeconomic effects of financialization

Presentation for the Grenoble Post-Keynesian & Institutional
Conference: Instability, Growth & Regulation

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1 Introduction

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- Other studies have emphasized the link between financial development and entrepreneurship.
- In line with Epstein (2005), we define financialization as a "pattern of accumulation in which profit making occurs increasingly through financial channels rather than through trade and commodity production".
- Some empirical works show that the relation between economic growth and finance is a U-shaped curve (Rousseau et Wachtel, 2011).

- The growing complexity of the financial landscape makes regulation and the political economy response less efficient, which increases moral hazard and systemic vulnerability (Buttiglione et al, 2014).

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- Over the past two decades, the banking sector has abandoned its 'credit culture' in order to adopt a 'universal bank' model.
- The development of financial innovations has considerably improved the complexity of the intermediation schemes.
- We have witnessed a strong intensification of mergers and acquisitions in the banking sector, which creates a size problem for a few banks considered "too big to fail".

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Financialization and theoretical model

Stock-Flow Consistent model (1)

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- The model contains 41 equations that respect accounting identities in both spheres, via real variables (GDP, investment, profits, wages) and financial variables (credit, equity, interest rate, equity price).

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- The model contains 41 equations that respect accounting identities in both spheres, via real variables (GDP, investment, profits, wages) and financial variables (credit, equity, interest rate, equity price).
- We show that an increase in the demand for credit has a positive effect on financial profitability of banks, but at the expense of long term growth and private non-financial investment.

Financialization and theoretical model

Stock-Flow Consistent model (2)

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- Caiani et al (2016) and Seppecher (2014) propose models that combine a SFC structure with that proposed by the *agent-based* literature.

Financialization and theoretical model

Stock-flow consistent model: Uses-resources table and matrix of flows

	H	F	B	CB	G	
Wages	WB	$-WB$				$= 0$
Profits		$-\Pi$	Π			$= 0$
Interests	$-Int^H$	$-Int^F$	Int		$-Int^G$	$= 0$
Dividends		$-Div$	Div			$= 0$
Taxes	$-T^H$	$-T^F$			T	$= 0$
Consumption	$-Cons^H$	$Cons$			$-Cons^G$	$= 0$
Investment	$-I^H$	$I - I^F$			$-I^G$	$= 0$
Saving	S^H	S^F	$-S + S^B$	0	S^G	$= 0$
Deposits	$p_D \Delta D^H$	$p_D \Delta D^F$		$-p_D \Delta D$		$= 0$
Credit	$-p_L \Delta L^H$	$-p_L \Delta L^F$	$p_L \Delta L$		$-p_L \Delta L^G$	$= 0$
Equity		$-p_E \Delta E$	$p_E \Delta E$			$= 0$
Refinancing			$-\Delta RF$	ΔRF		$= 0$

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Stock-flow consistent model: Permanent inventory method

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$$Stock_t = Stock_{t-1} + Flow_t + Revaluation_t$$

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- I is total investment, q is the ratio of the value of equities with respect to non-financial assets, Y is GDP and Π are profits.

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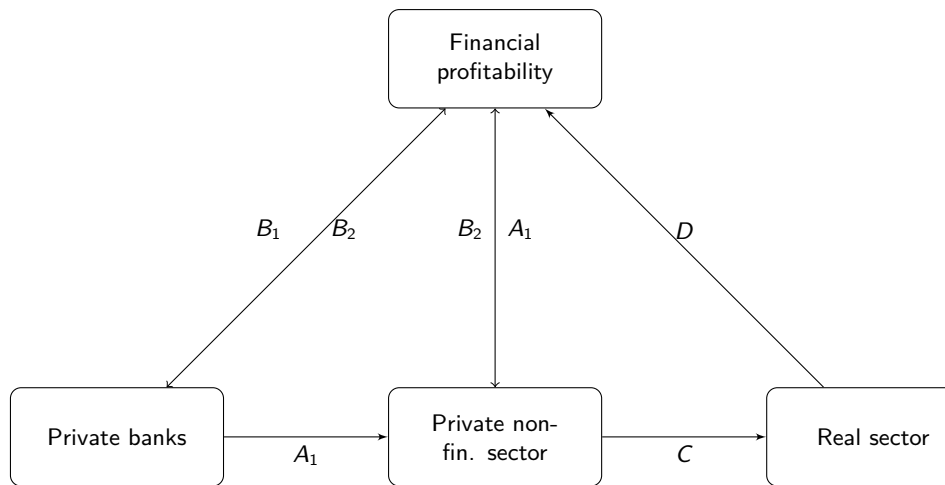
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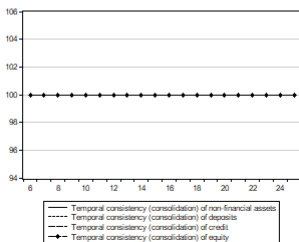
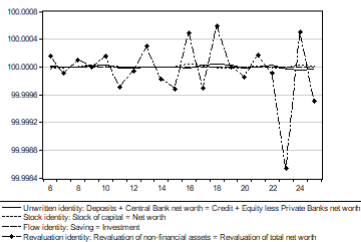
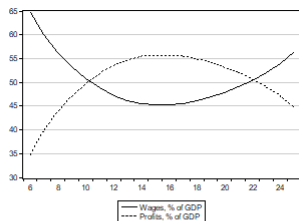
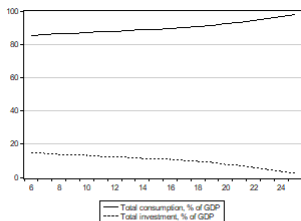
Financialization and theoretical model

Stock-flow consistent model: a simplified diagram



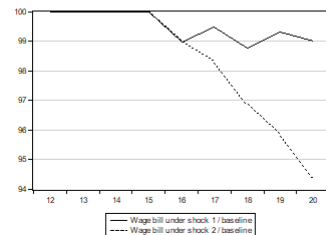
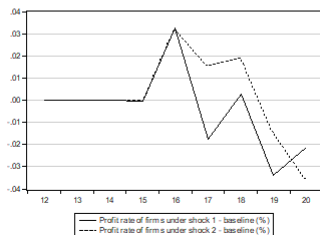
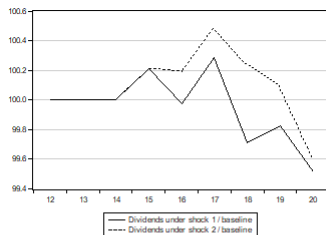
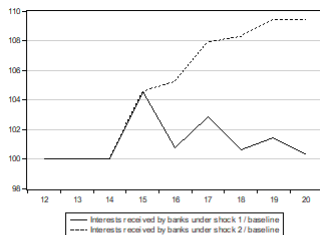
Financialization and theoretical model

Stock-flow consistent model: baseline results



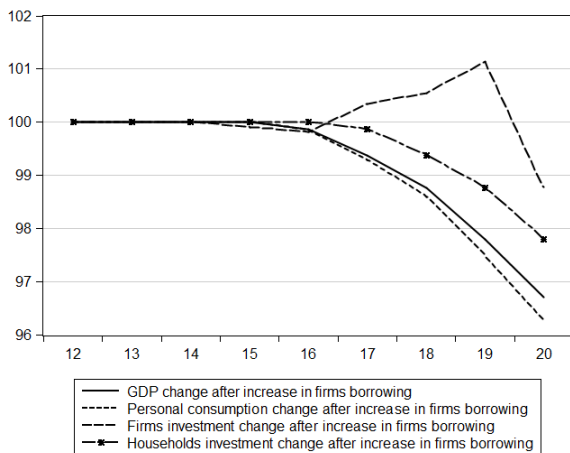
Financialization and theoretical model

Stock-flow consistent model: after shock results (1)



Financialization and theoretical model

Stock-flow consistent model: after shock results (2)



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- In doing so, we calculated a financialization index as follows:

$$FINANCIALIZATION_{i,t} = \left(\frac{1 + ROA_{i,t}}{1 + LIQ_{i,t}} \right) (1 + CONC_{i,t})$$

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- *ROA* is the average annual yield of the banking sector, *LIQ* is a liquidity ratio and *CONC* is a measure of concentration in the banking sector.
- We integrate this index in a Bayesian structural panel VAR.

- One of our variables of interest is credit demand by the private sector.

Financialization. Empirical model

Results

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- The other variables included in the system of simultaneous equations are the index of financialization, the wage share, GDP and private investment.

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- The other variables included in the system of simultaneous equations are the index of financialization, the wage share, GDP and private investment.
- Our results confirm that GDP is negatively associated to excessive credit demand and to the financialization index, and positively to wages and profits.

Thank you for your attention

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