a/simmetrie | associazione italiana
per lo studio delle asimmetrie economiche

Sectoral balances and financial crises

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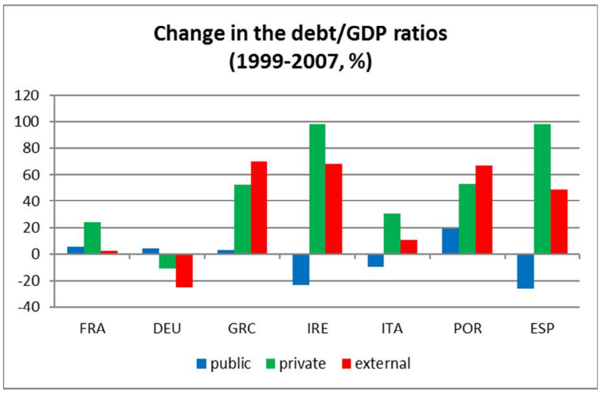
2 Public, private and external debt before financial crises



3 Stylized facts in the Eurozone

1. Public debt **rises** in «virtuous» countries and **decreases** in most «distressed» countries
2. Private debt does the opposite
3. The rise in private debt is correlated to a rise in external debt
4. 1+2+3 = financial crises follow from the accumulation of private debt, financed by foreign creditors
5. Is that a general phenomenon?
6. Can we predict financial crises?

4 The simple arythmetic of sectoral balances

$$Y = C + G + I + X - M$$

Take everything to the left-hand side:

$$Y - C - G - I - X + M = 0$$

Add and subtract net direct taxes T and rearrange:

$$Y - T - C - I + T - G + M - X = 0$$

Substitute the definition of private saving S = Y-T-C:

$$S - I + T - G + M - X = 0$$

5 The interpretation of sectoral balances /1

$$\boxed{S - I} + \boxed{T - G} + \boxed{M - X} = 0$$

Balance of the external sector

Balance of the government sector

Balance of the private sector

1. Our **imports** are the external sector's **revenues**
2. Our **exports** are the external sector's **expenditure**
3. The balance of the external sector is the **opposite** of our current account balance (CAB = X – M)

6 The interpretation of sectoral balances /2

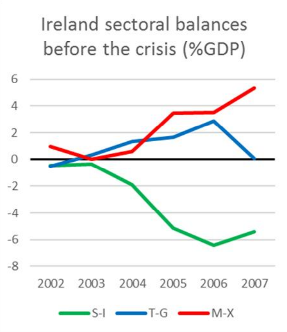
$$S - I + T - G + M - X = 0$$

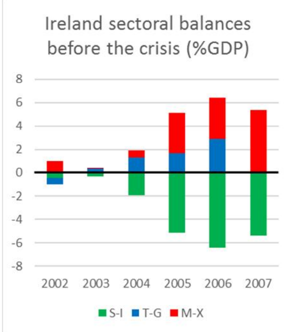
1. A **positive** balance means that a sector has a net saving (is accumulating wealth/reimbursing debts)
2. A **negative** balance means that a sector has a net indebtedness (is accumulating debt/decumulating wealth)
3. The balances **must** add to zero: we cannot be all in surplus nor in deficit at the same time
4. If you get money from someone (financial **deficit**), someone is giving money to you (financial **surplus**).

7 What we know about financial crises /2

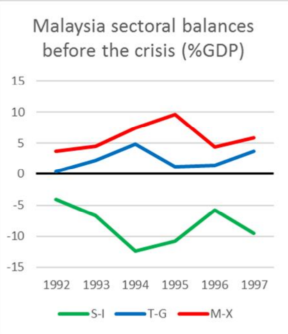
1. They mostly depend on **private** debt accumulation, financed by external creditors
2. This gives rise to a **typical pattern** before the crisis
3. **S – I decreases** (decreasing accumulation of net saving by the domestic private sector)
4. **M – X increases** (the external sector uses its increasing surplus to finance our private sector)
5. **T – G is stable** or increasing (public debt is not an issue)

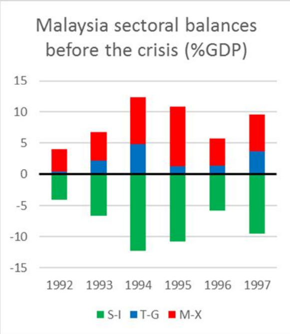
8 Some examples /1



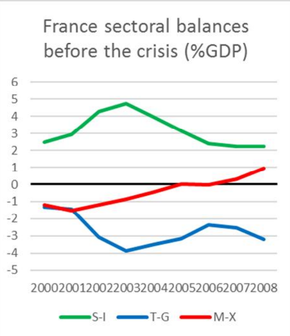


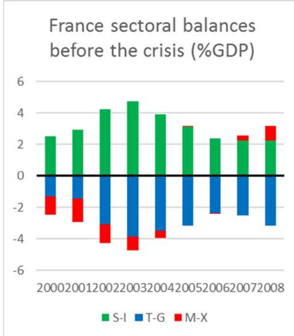
9 Some examples /2





10 Some examples /3

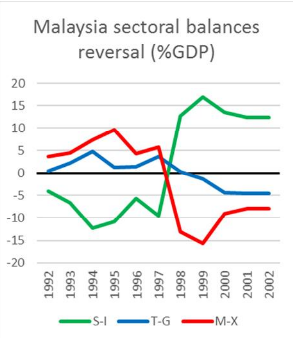


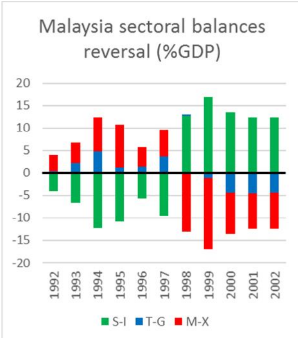


11 What happens when the crisis arrives?

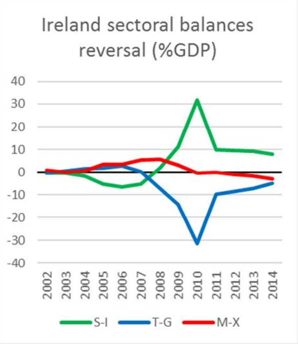
1. The foreign creditors stop financing the economy: **sudden stop**
2. They want to be reimbursed: **current account reversal**
3. The public sector intervenes to sustain the private sector deleveraging: **government deficit**
4. **S – I increases** (increasing accumulation of net saving by the domestic private sector)
5. **M – X changes sign** (from external indebtedness to esternal debt reimbursement)
6. **T – G decreases** (private debt is transformed into public debt, which becomes an issue)

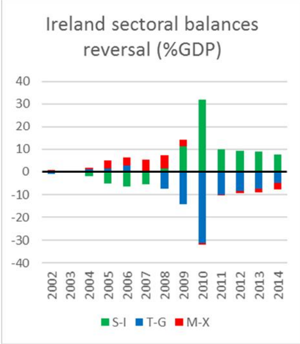
12 Some examples /1





13 Some examples /2





14 What's next?