

2017-8 Lecture Series:

Blueprint for Brexit Britain: Mobilising Savings for Investment

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GRESHAM COLLEGE



National Institute of Economic and Social Research

Chaucer's Shipman's Tale provides a warning

Upon the third day this good trader rises,
And on his needs discreetly he advises;
And up into his counting-house goes he
To reckon up his books, as well may be,
For the past year, to learn how matters stood
And what he'd spent, and whether it were good,
And whether he were wealthier than before.
His books and bags, all that he had in store,
He put before him on his counting-board;
He was right rich in goods and rich in hoard,
For the which cause he bolted fast his door;
He'd have no one disturb him while before
Him stood his books and monies at that time;
And thus he sat till it was well past prime.

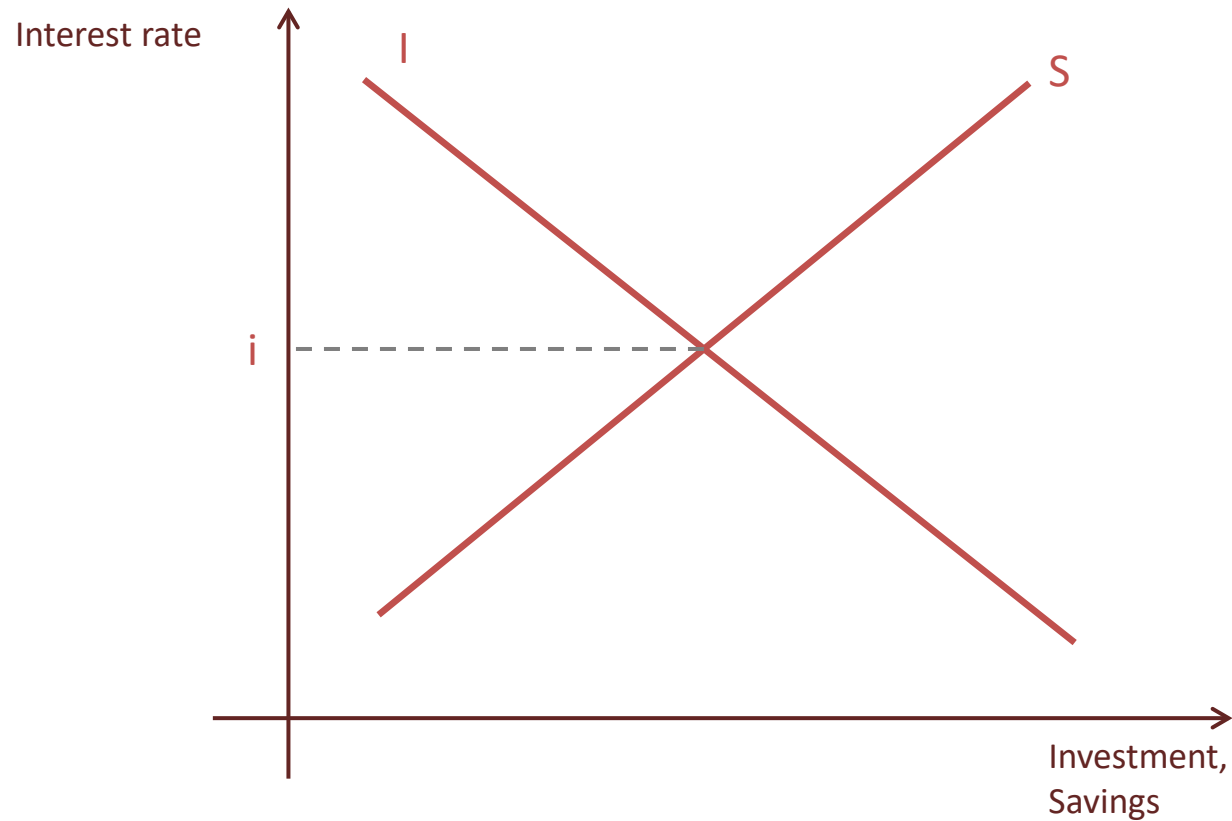


Main Arguments

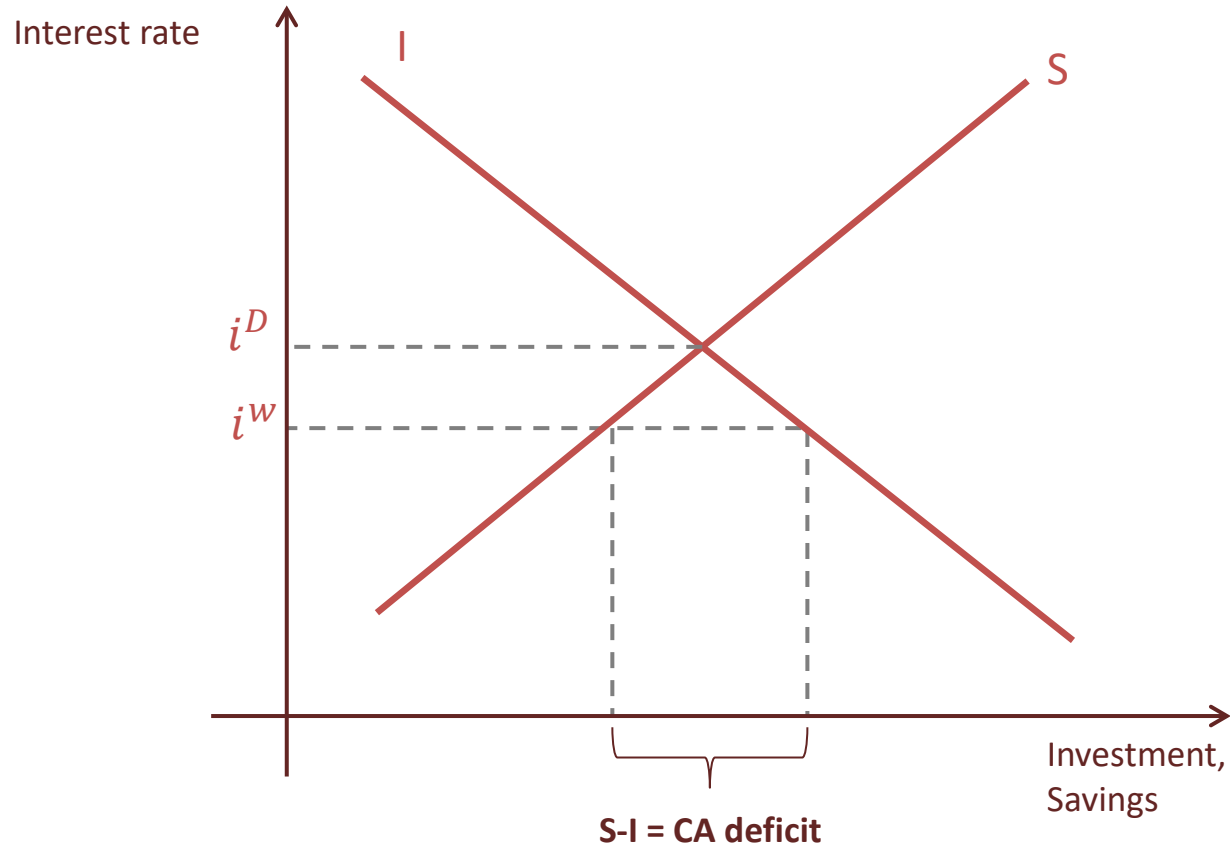
- Households save and firms borrow – not quite
- Households are indebted but yet have net wealth
- Firms are should be borrowing to invest but are “cash rich” – how to match supply of savings with demand for investment
- Examine theory of saving with and without constraints
- Decline of real investment growth and possible reasons
- Use of macro-prudential policies to control quantity and quality of lending
- Problems remain



Saving and Investment in a closed economy



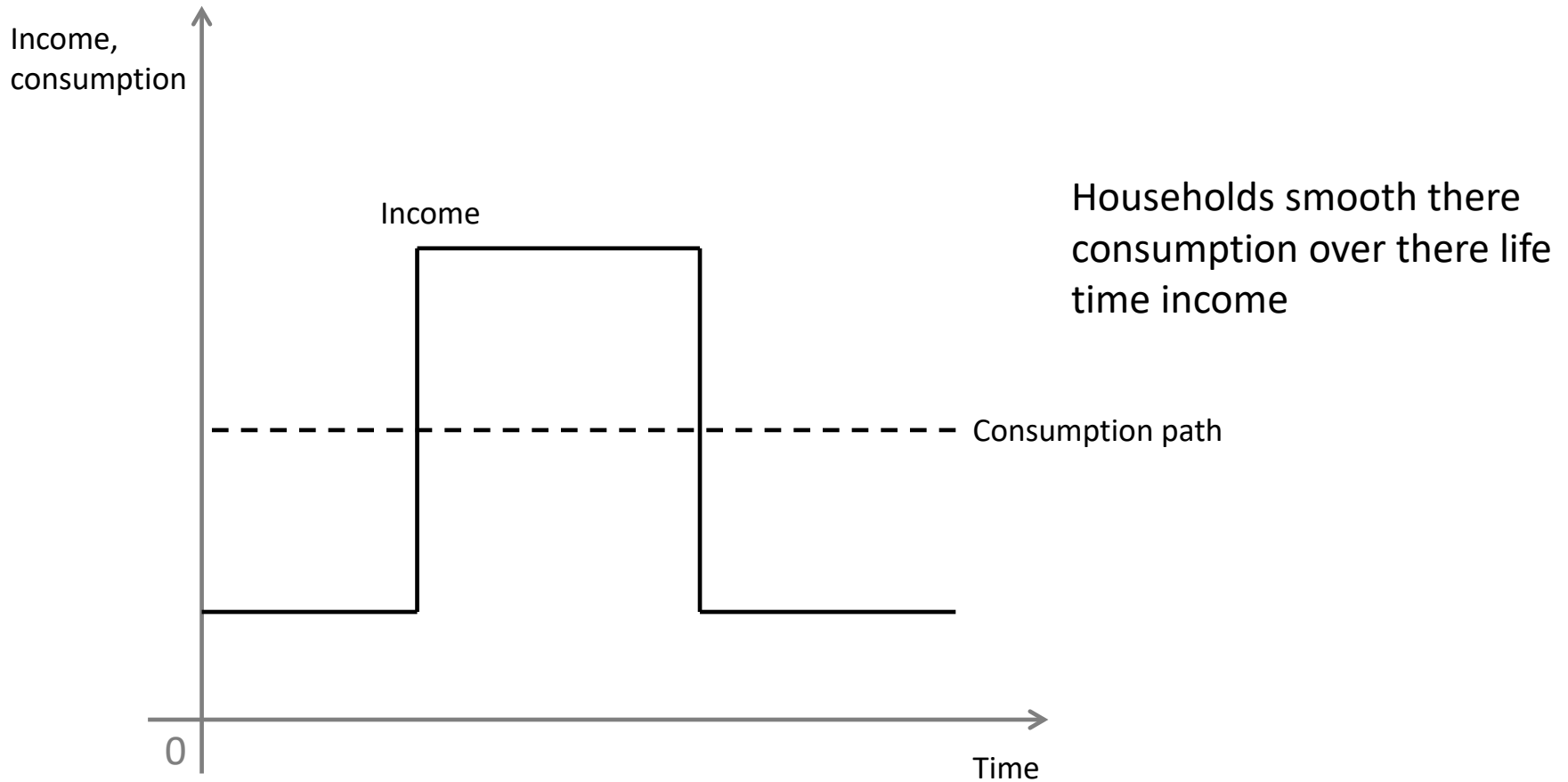
Saving and Investment in a small open economy



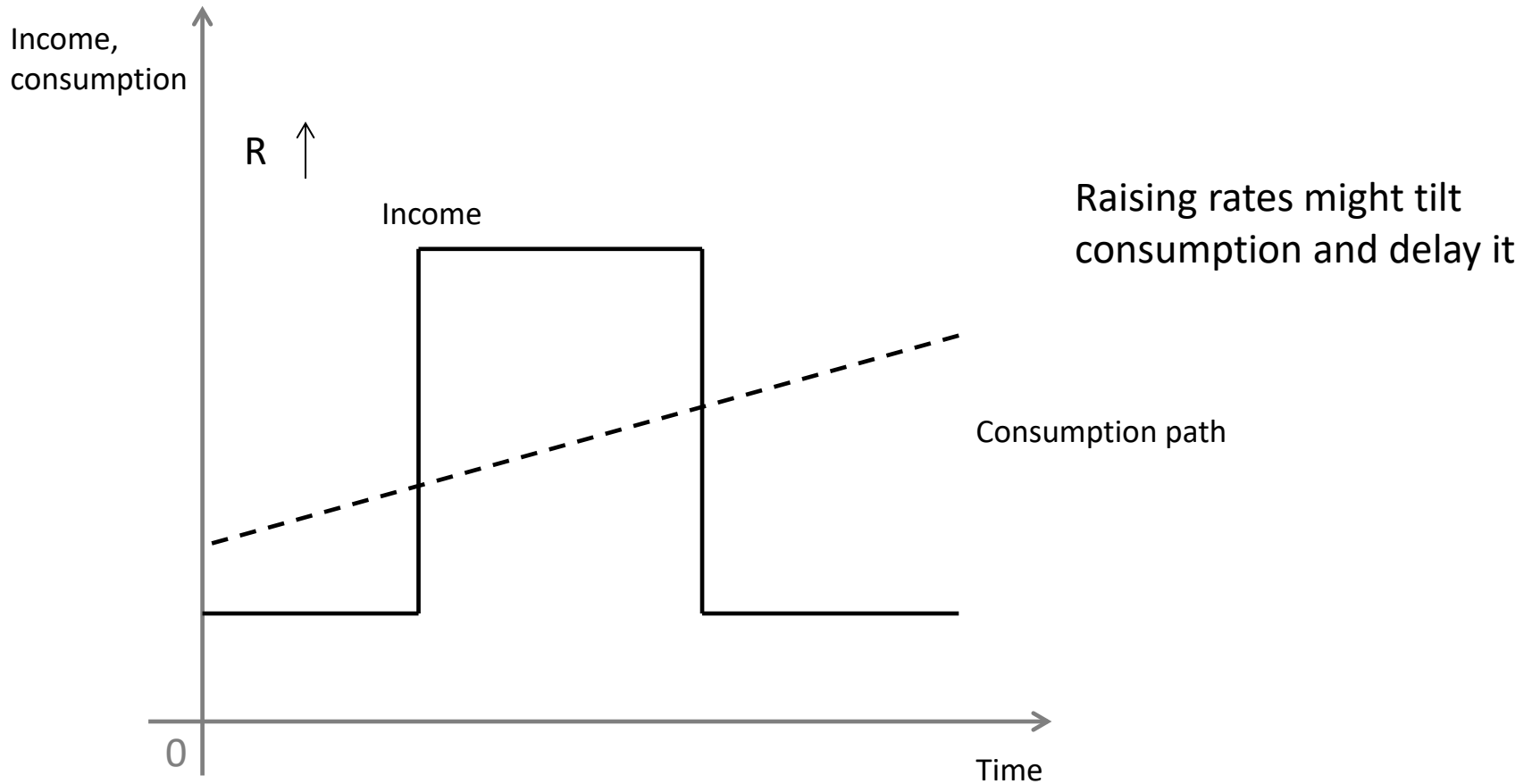
The shortage of domestic savings is met by the arrival of foreign capital



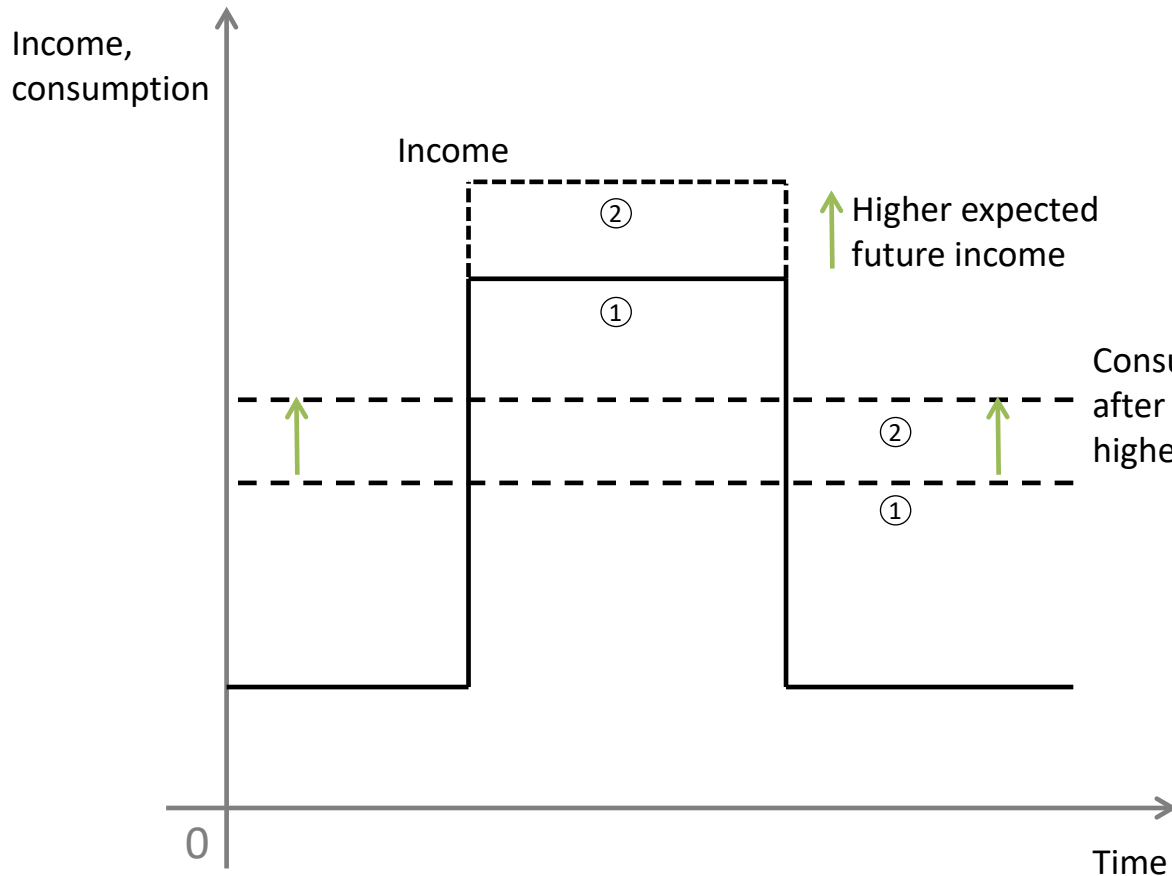
Life cycle income



Life cycle income and monetary policy



Life cycle income with a positive income shock

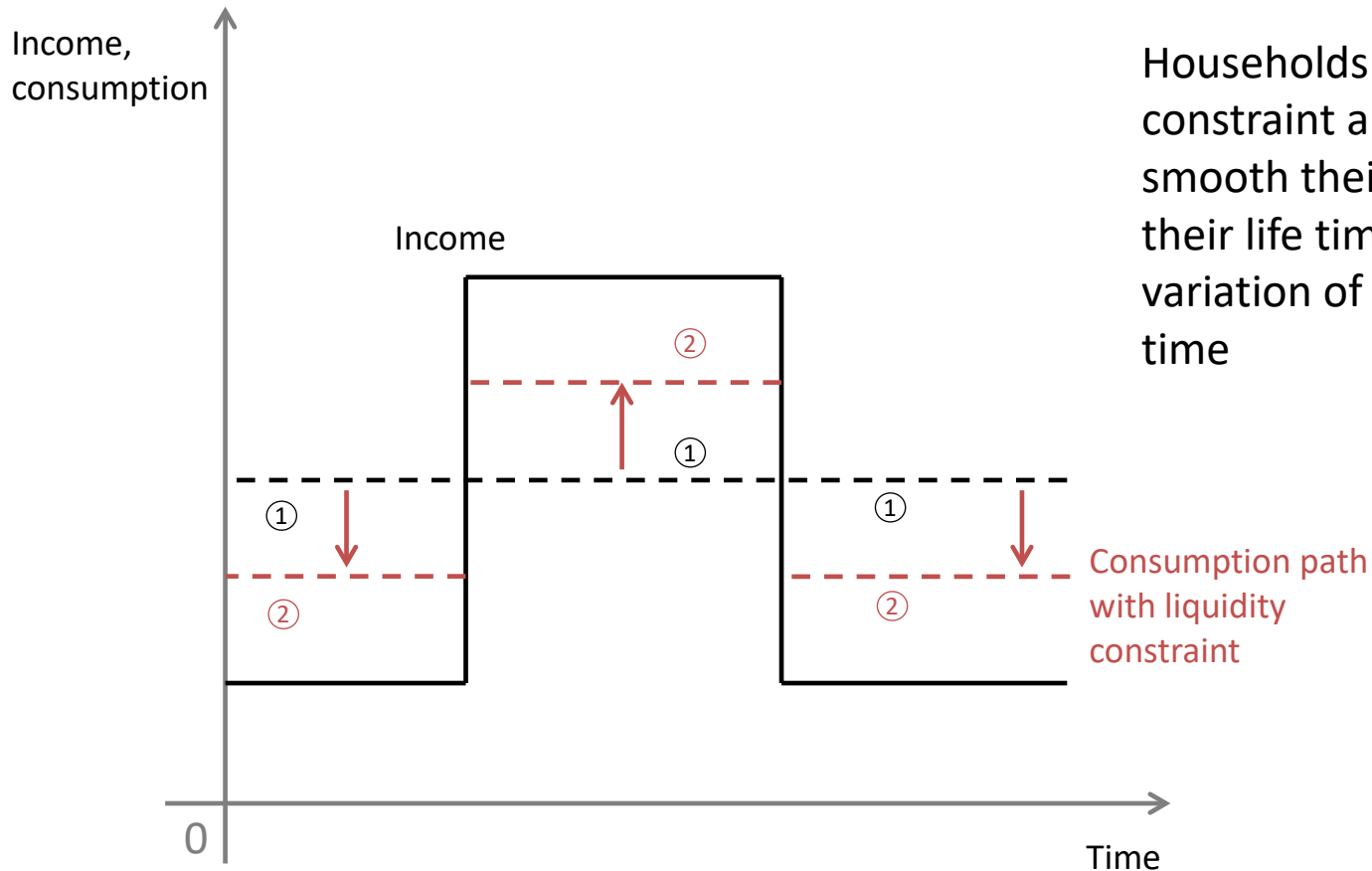


When household expectations about their future income change they optimise they consumption accordingly

Consumption path after anticipating a higher future income



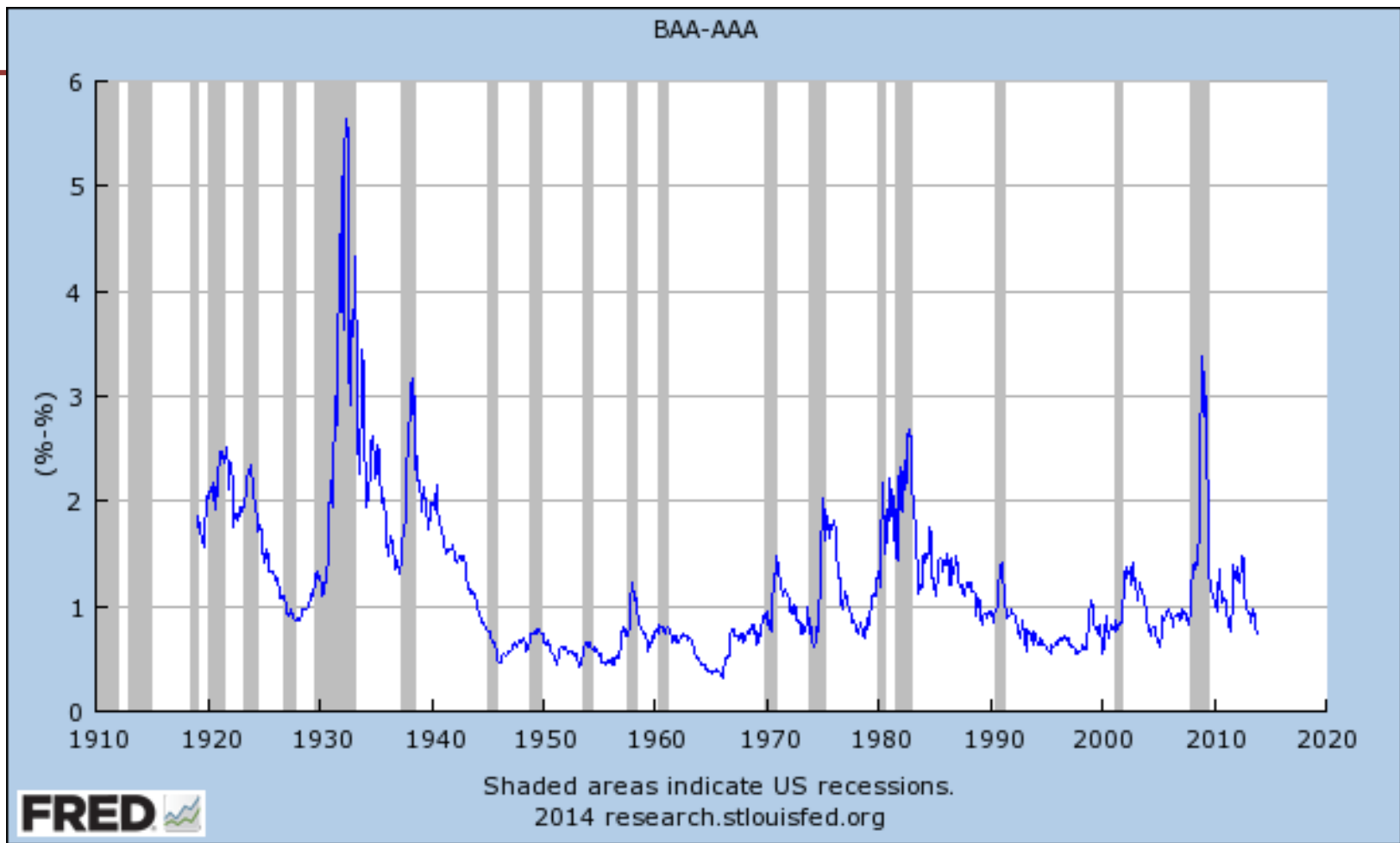
Life cycle income with liquidity constraint



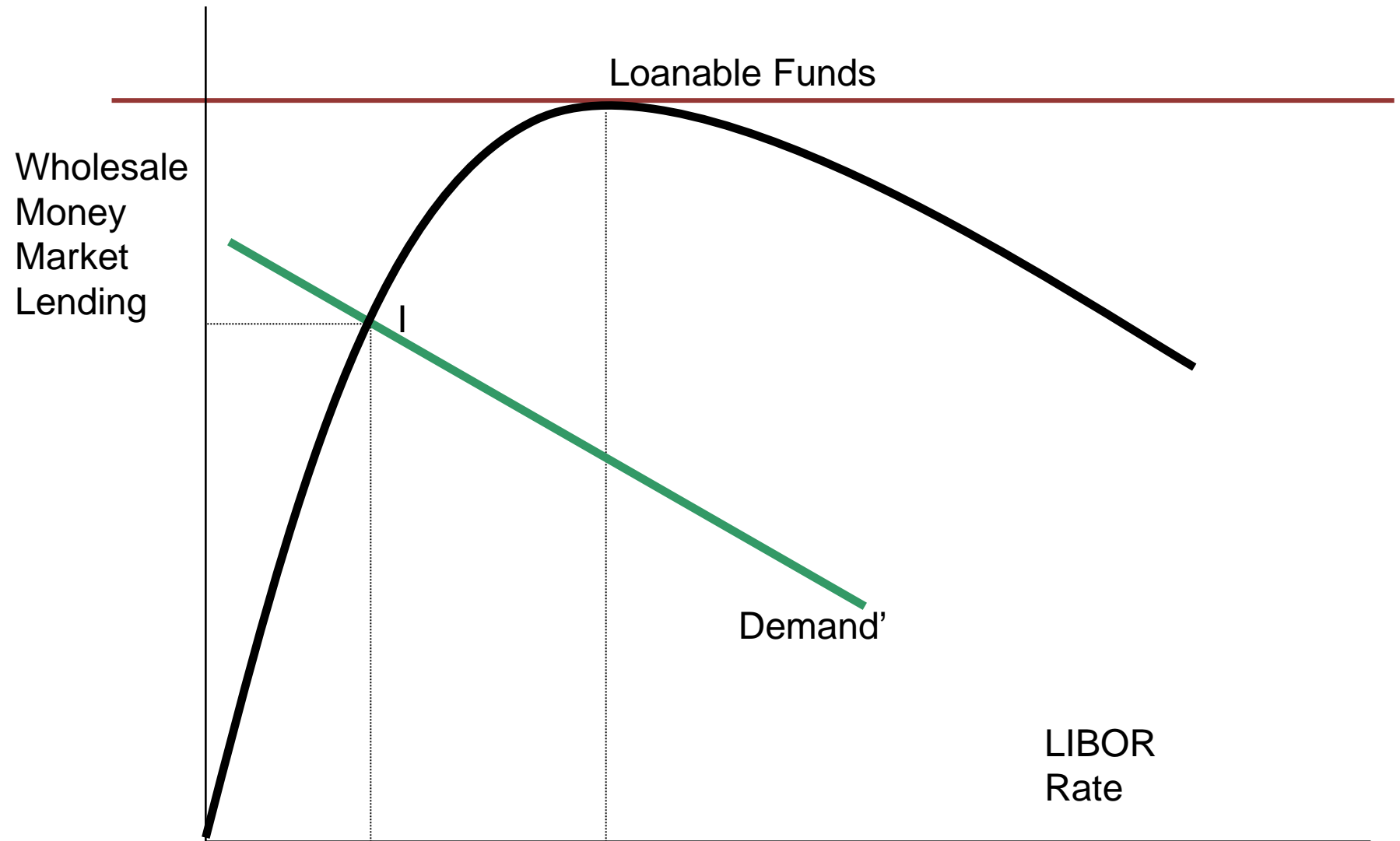
Households facing a liquidity constraint are not able to perfectly smooth their consumption over their life time, it implies a higher variation of consumption over time



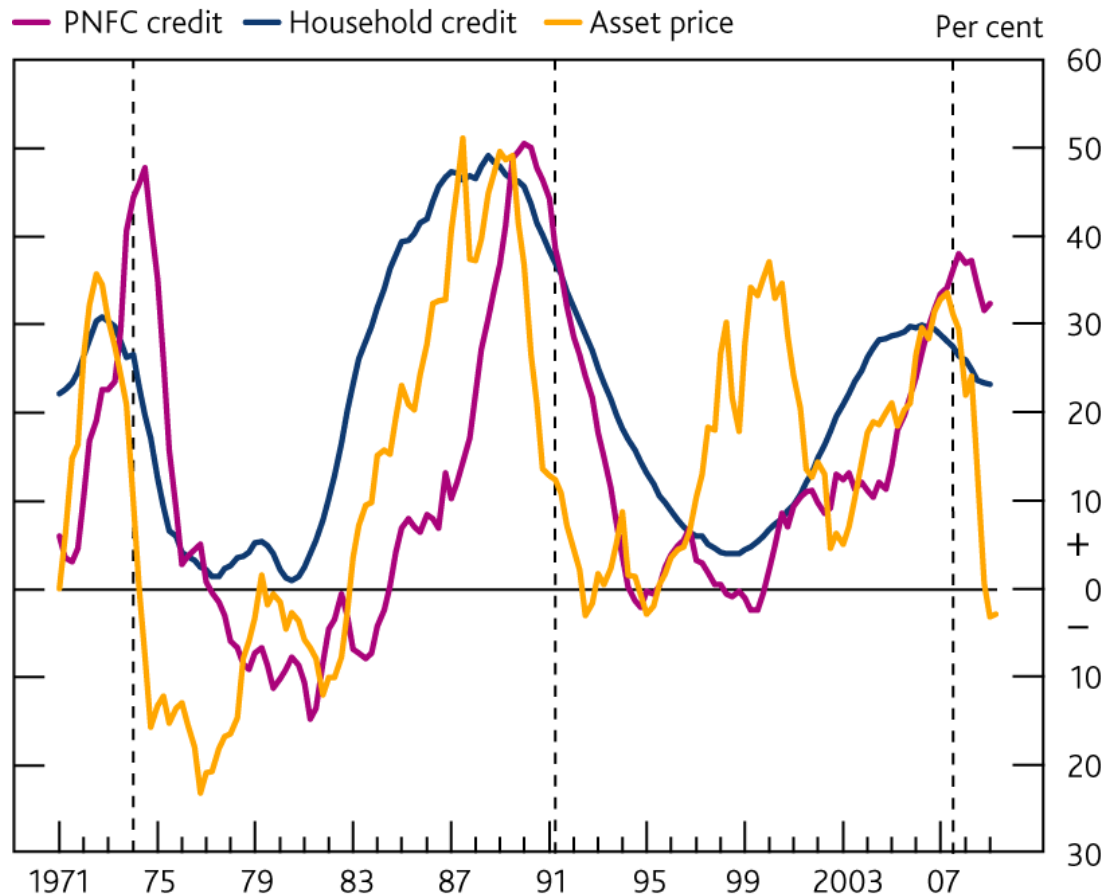
AAA-BAA Moody's Corporate Spread



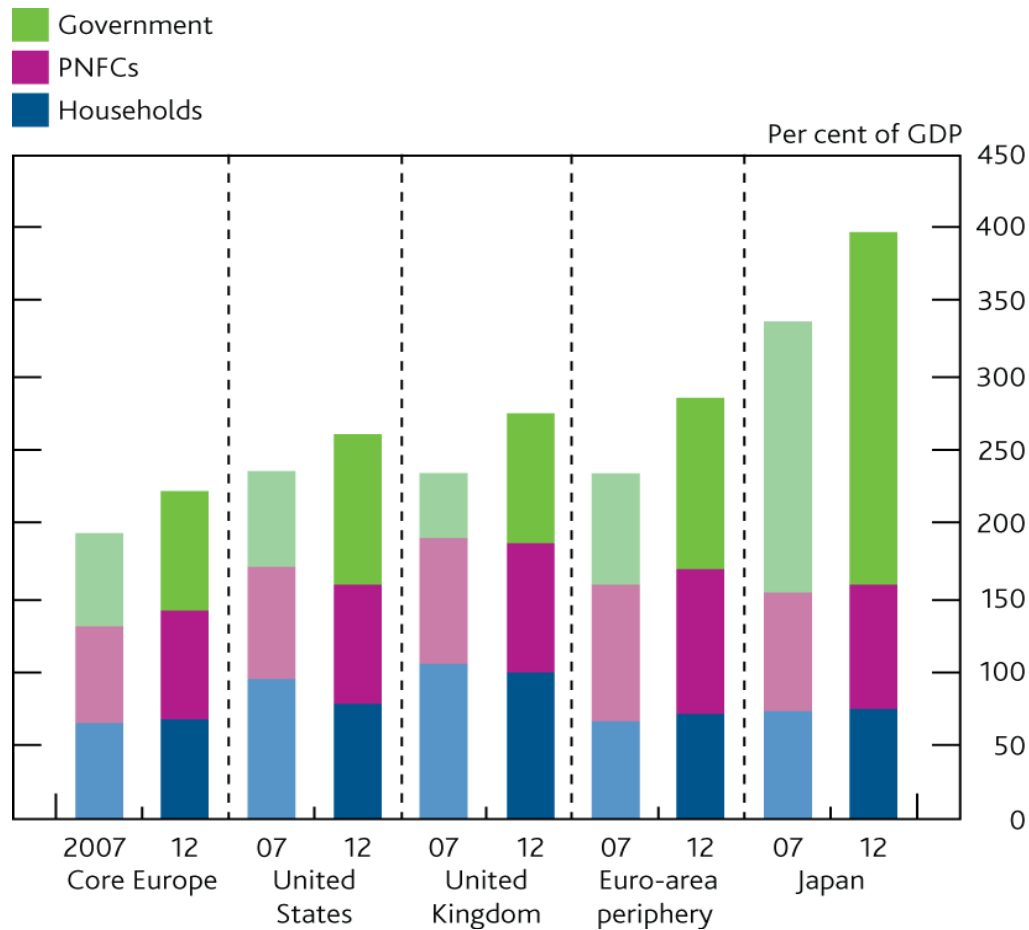
Spreads and Interest Rates



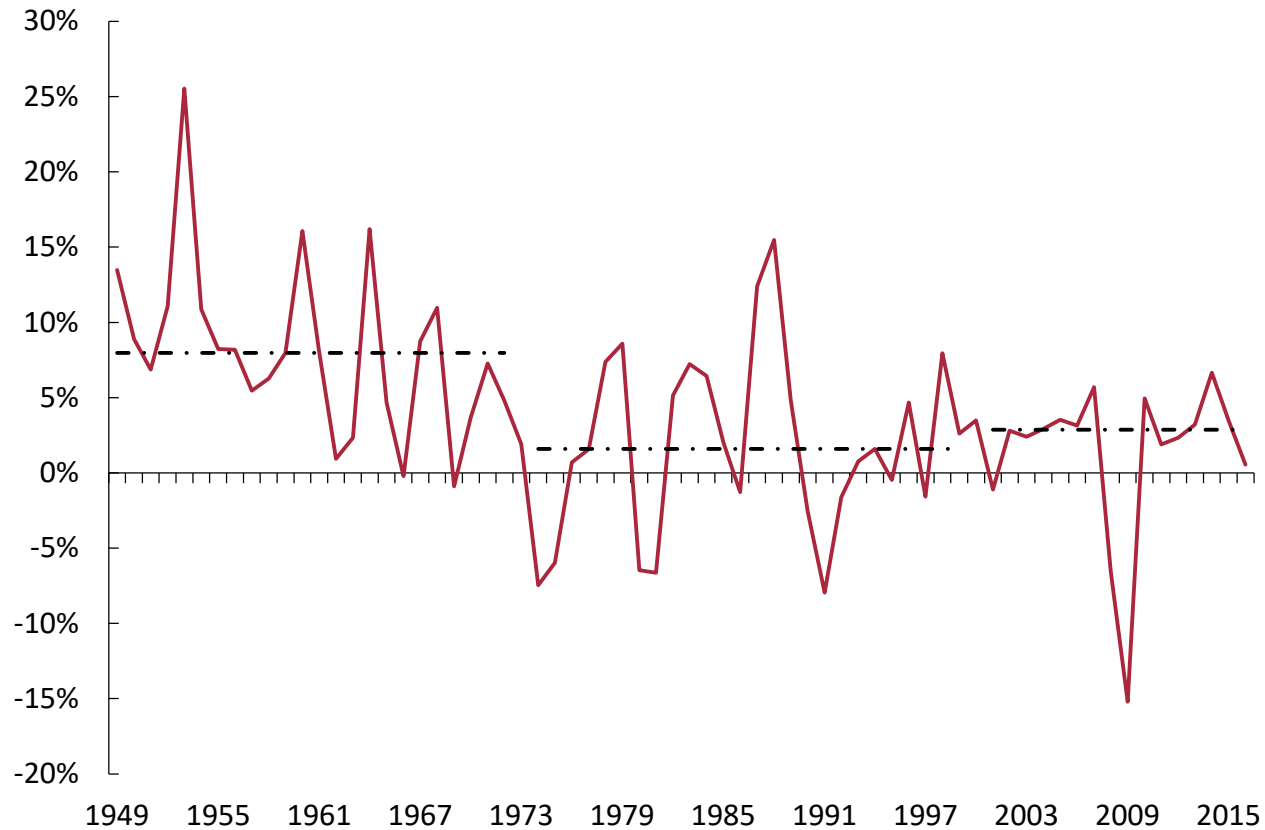
Asset prices and credit in the United Kingdom



Debt levels in advanced economies have risen



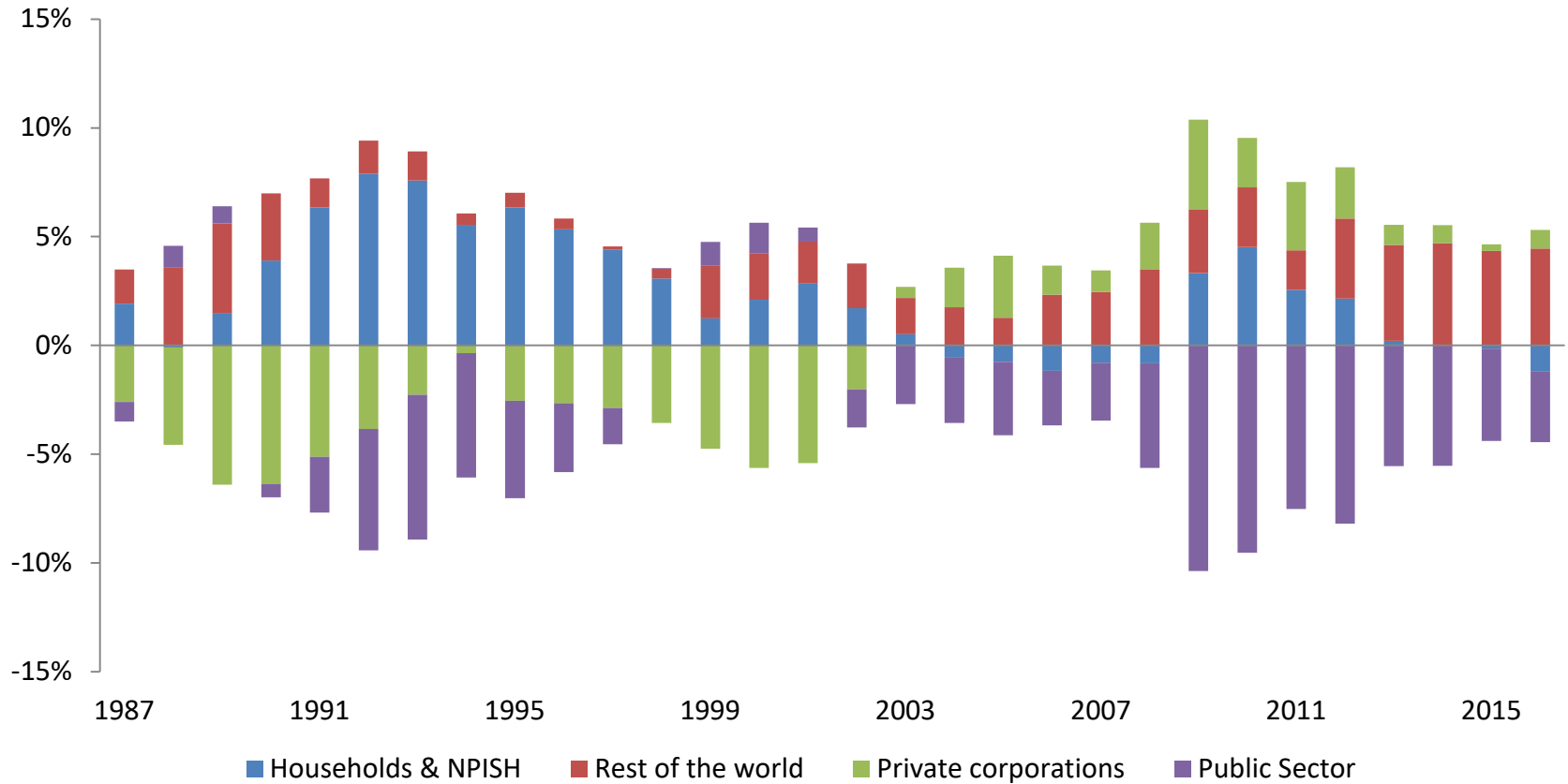
Real investment growth 1949–2016



Source: European Commission and NIESR.



Sectoral balances (as % of GDP), 1987 – 2016



Source: ONS

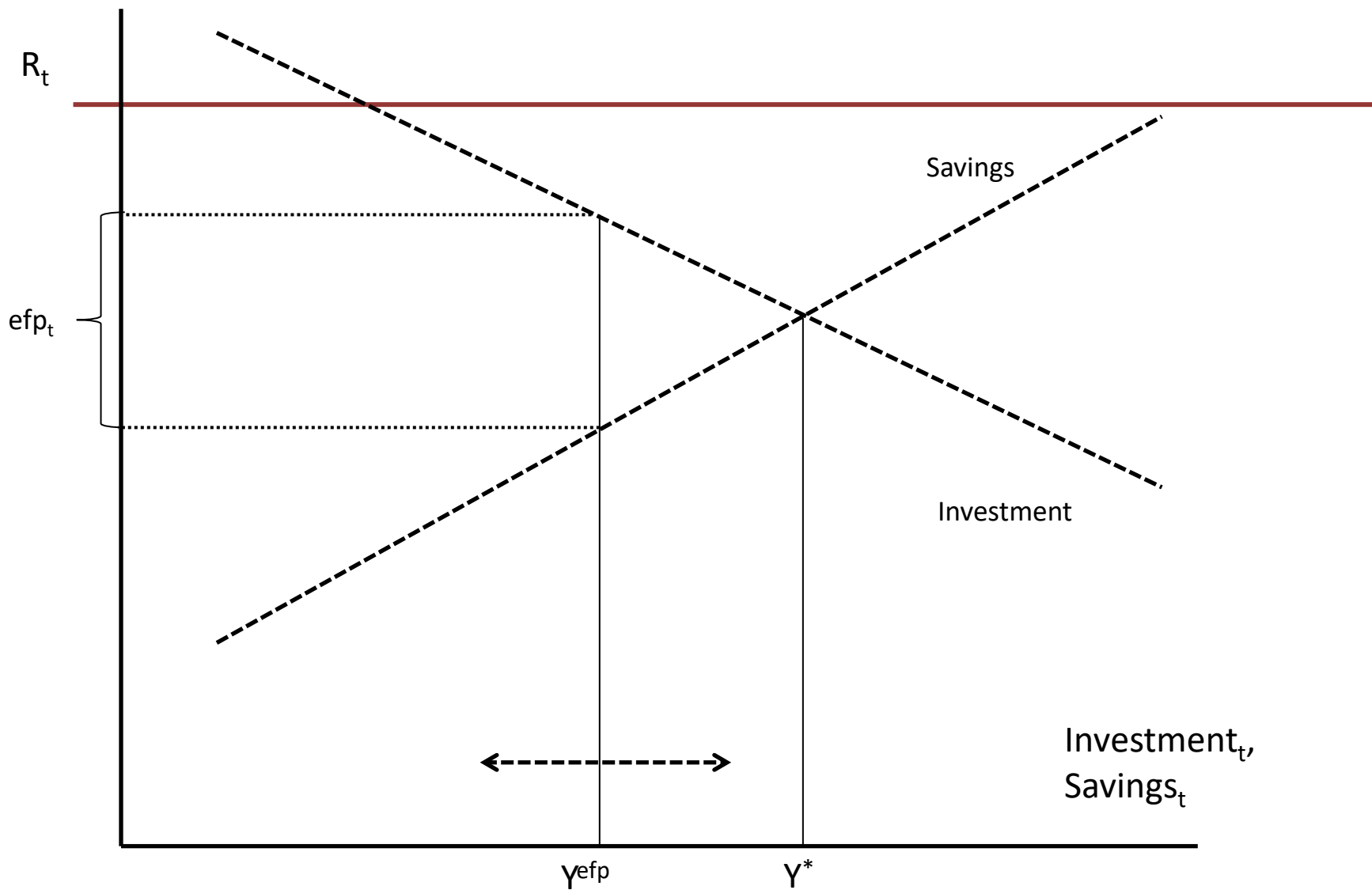


Savings and Investment

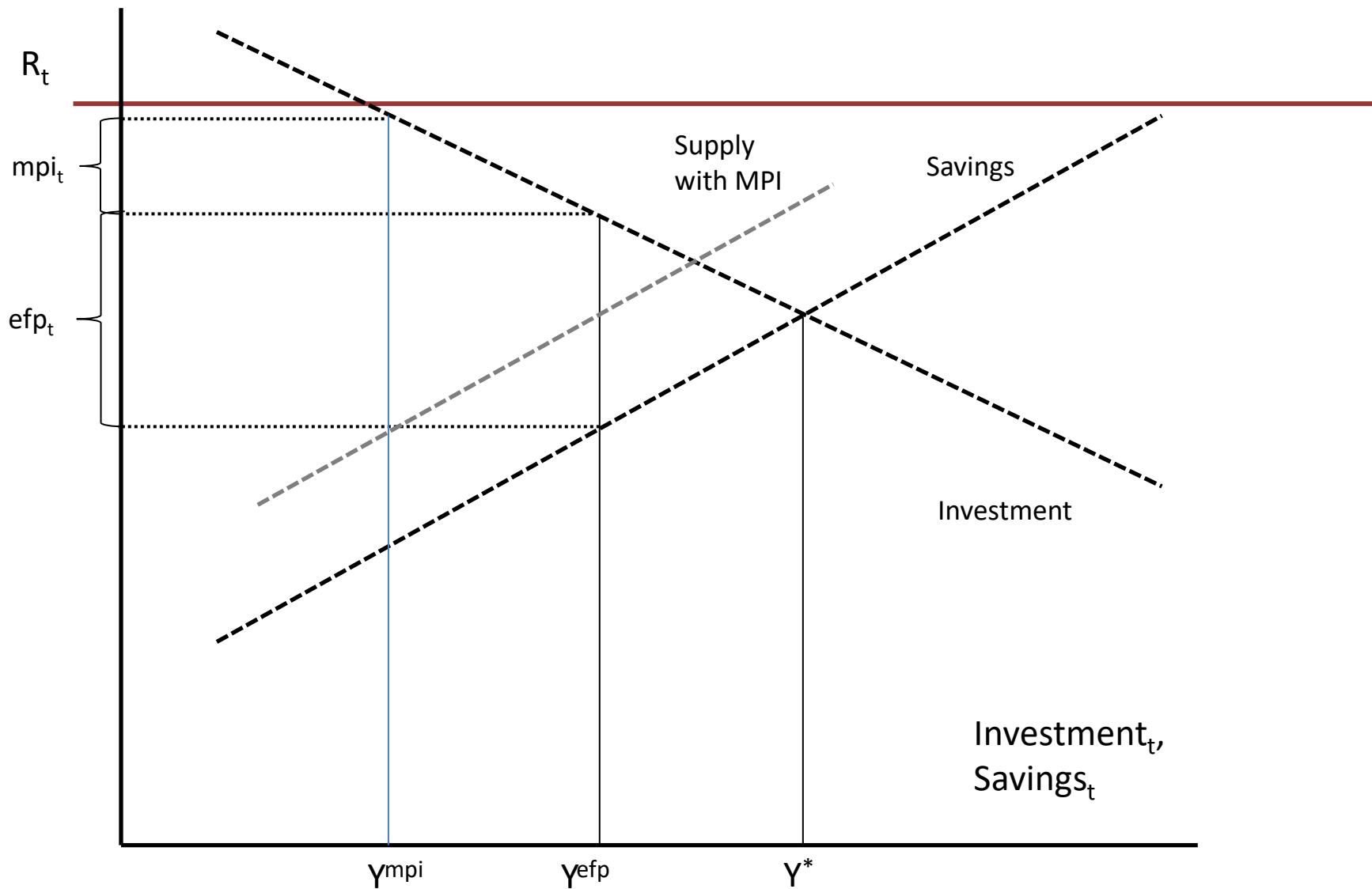
- Savers cannot allocate funds
- Borrowers have private information about their ability to repay
- Collateralise loans
- Demand a premium to give return to financial intermediaries
- Might be cyclical
- Does not eliminate bad lending because loans are linked to collateral value i.e. asset prices
- Financial intermediaries need to make provisions for loans



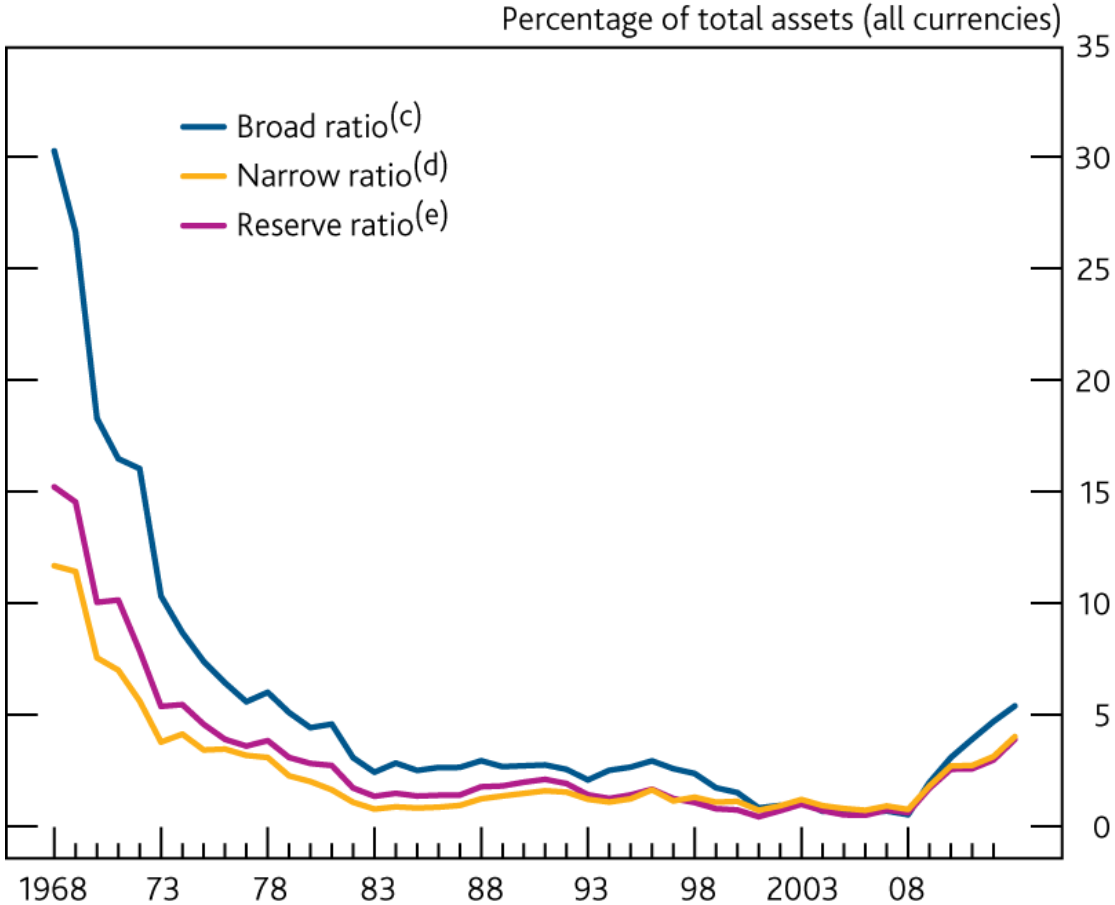
Savings and Investment with premia



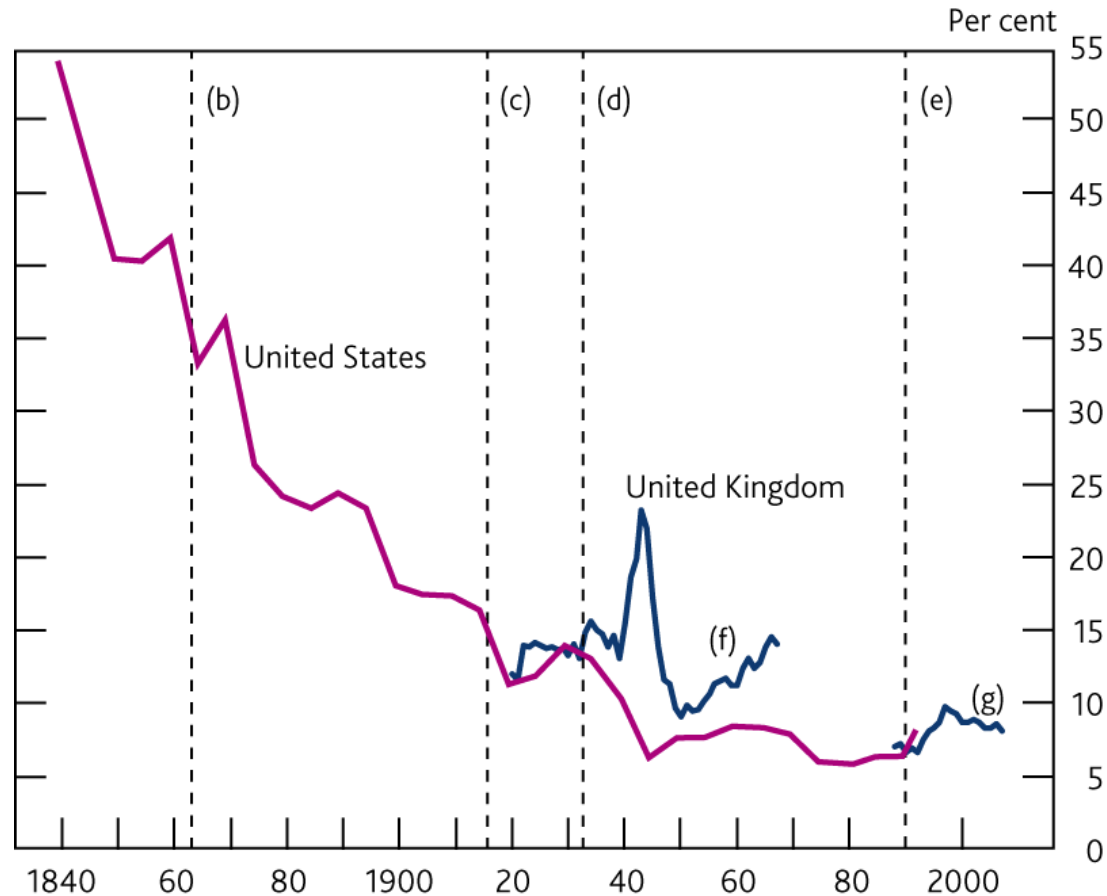
Savings and Investment with premia and MPIs



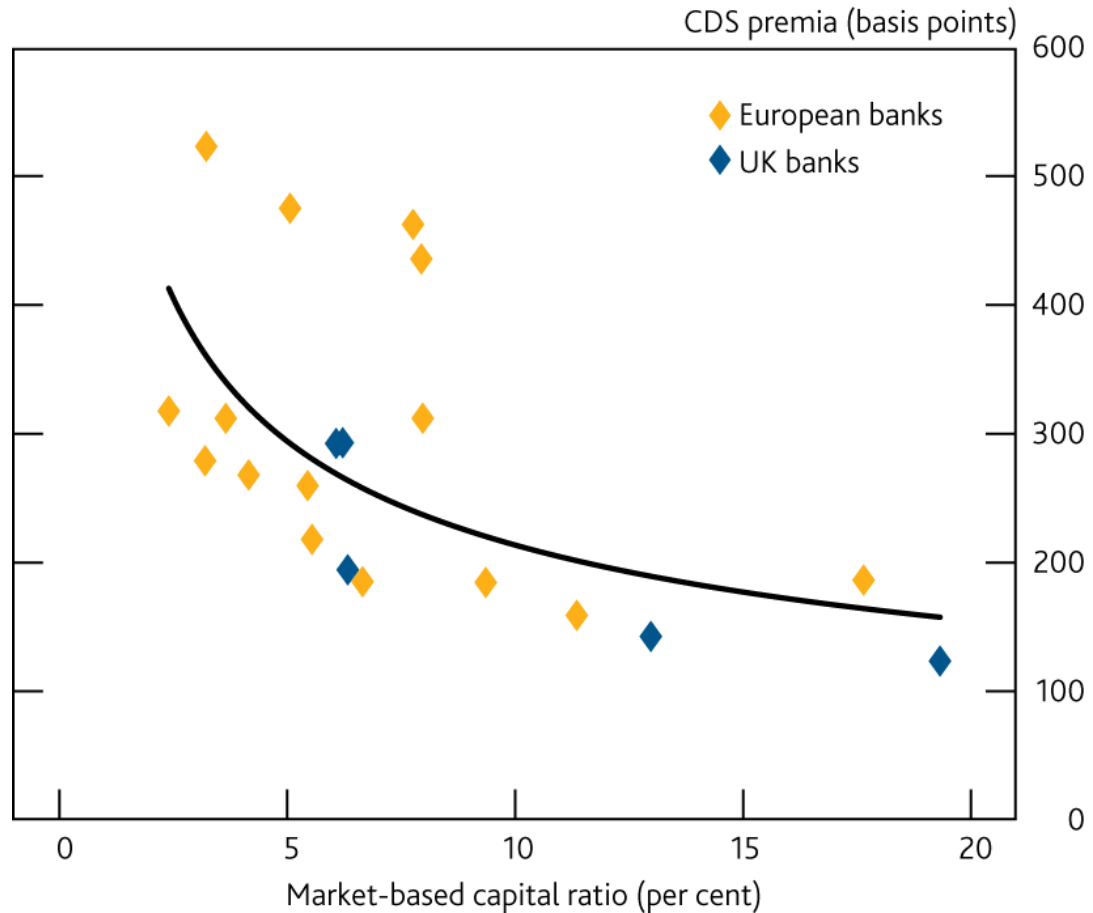
Sterling liquid assets/total asset holdings in UK



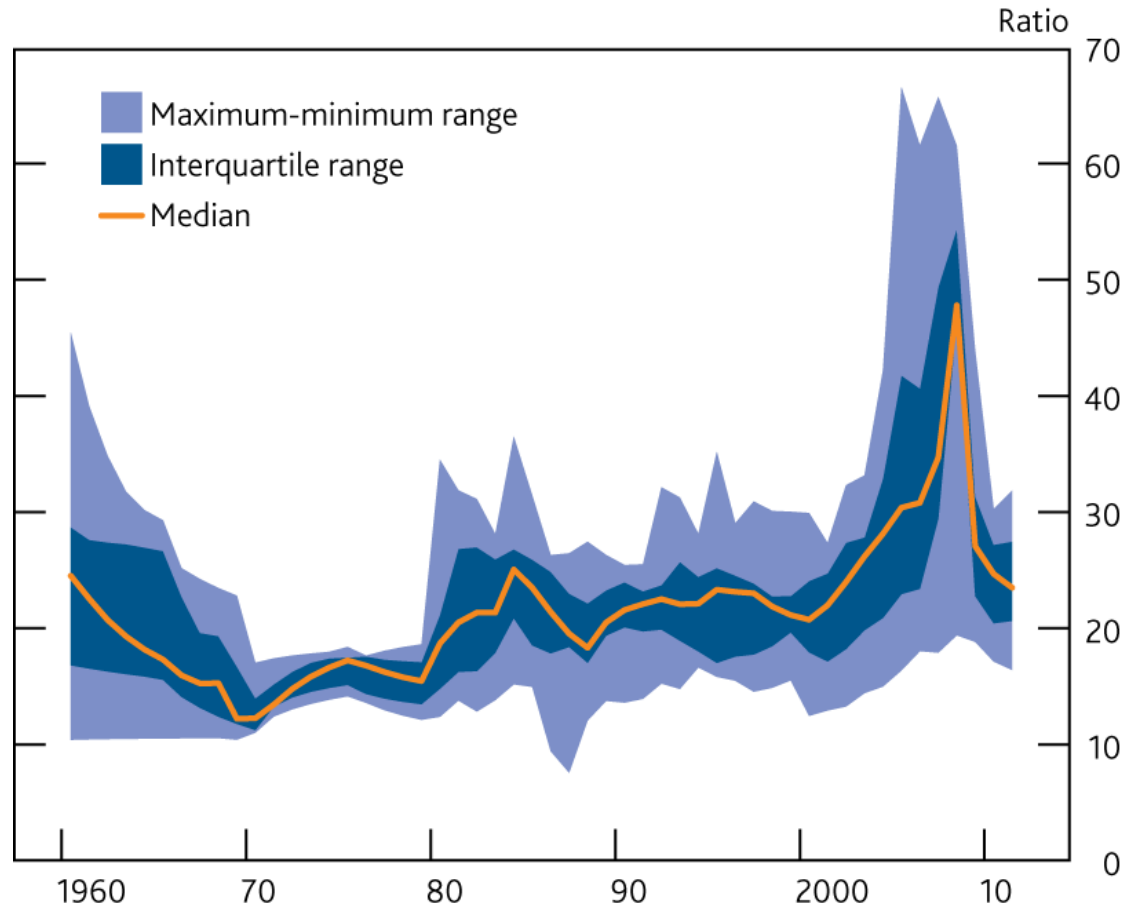
Long-run capital levels for UK and US banks



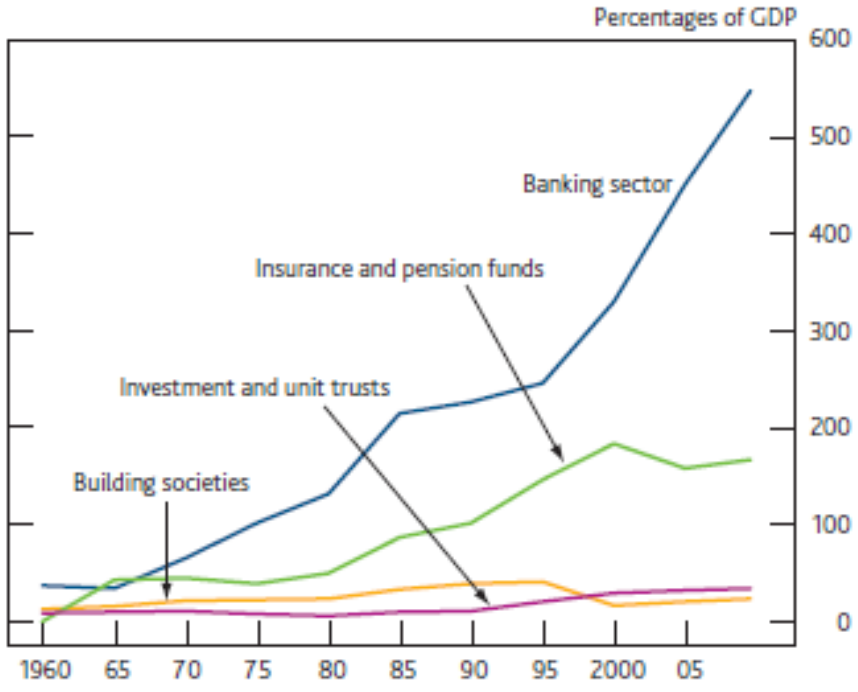
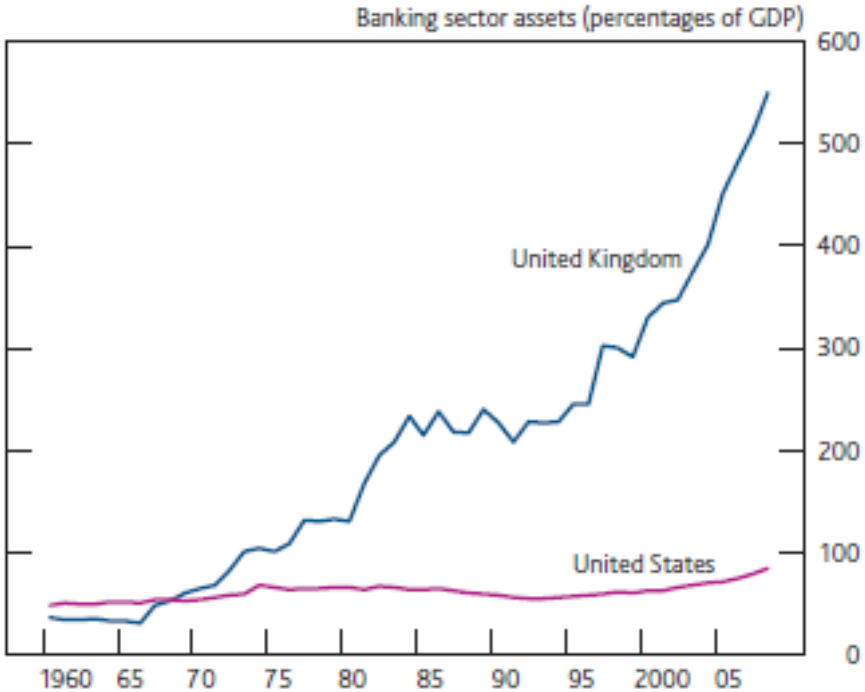
Market-based capital ratios and funding costs



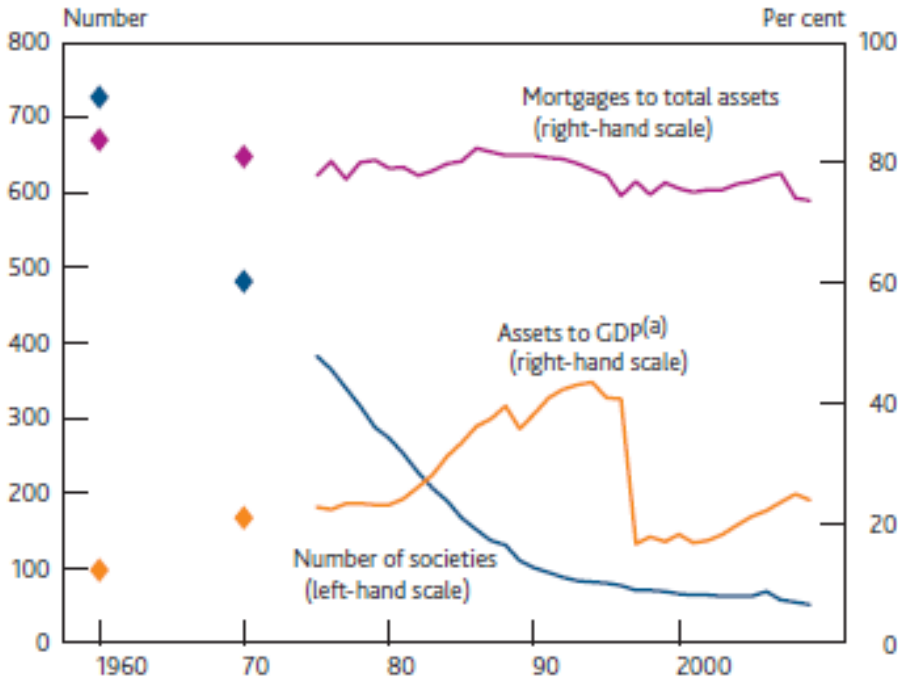
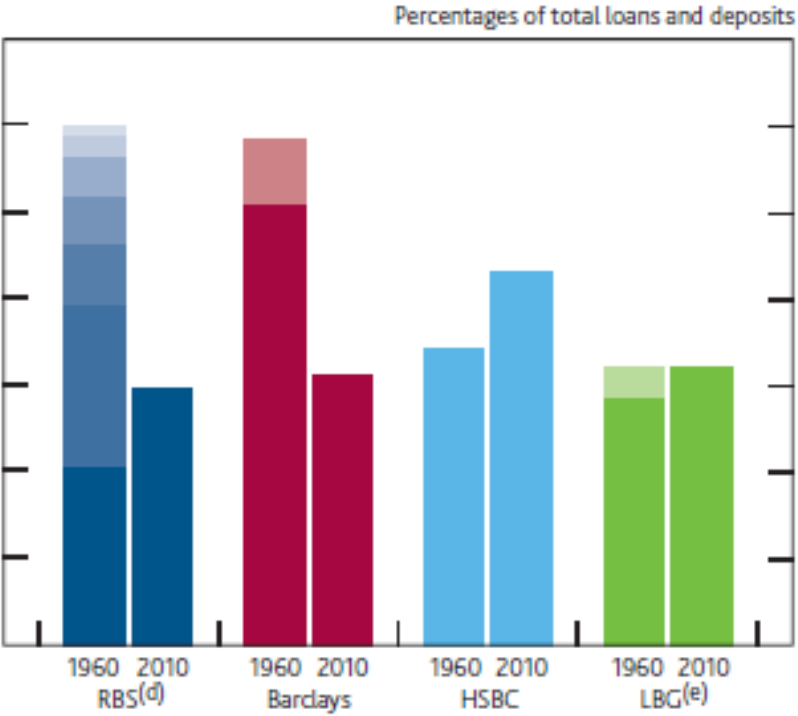
UK banks' leverage



UK Bank size and relative to other financial institutions



UK Banks (lhs) and Building Societies (rhs)



Balance sheet composition for major UK bank

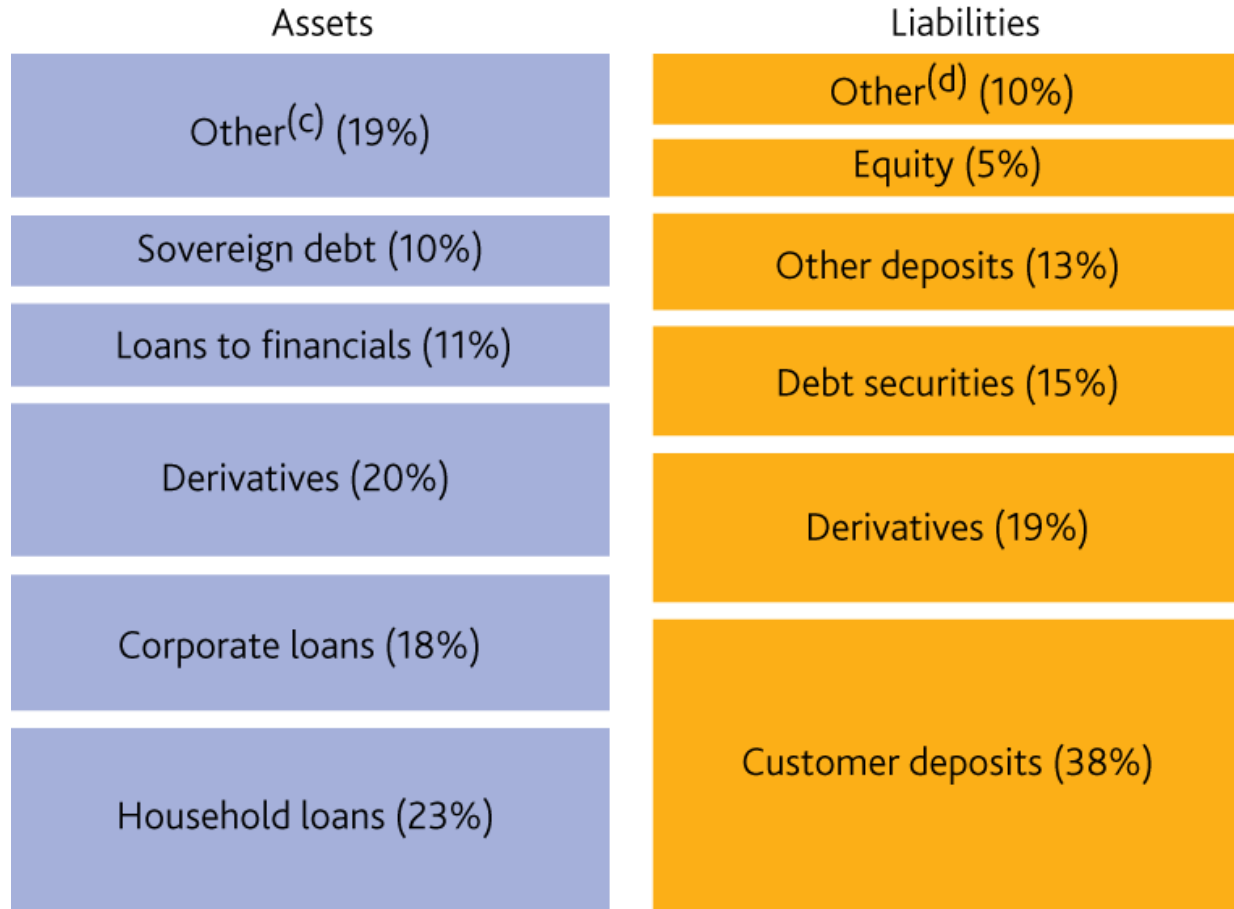


Table 1. Balance sheet of the household sector, 2015

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Assets	11,948		Liabilities	11,948	
<i>Tangible Assets</i>	<i>5,637</i>	<i>47%</i>	<i>Financial liabilities</i>	<i>1,751</i>	<i>15%</i>
Real Estate	5,307		Loans	1,622	
Durable goods	330		Insurance & pensions	64	
			Debt securities	3	
			Other	62	
<i>Financial Assets</i>	<i>6,311</i>	<i>53%</i>	<i>Net Wealth (= Assets –</i>	<i>10,197</i>	<i>85%</i>
Insurance & pensions	3,731		<i>Liabilities)</i>		
Equities	791				
Cash & deposits	1,474				
Debt securities	94				
Other	221				

Source: ONS, National balance sheet: households & non-profit institutions serving households (NPISH), £ billions



Table 2. Balance sheet of the Non-Financial Corporations 2015

Table 2. Balance sheet of the NFC, 2015

Assets	4,218		Liabilities	4,218	
<i>Non-Financial Assets</i>			<i>Financial liabilities</i>	5,149	122%
	2,196	52%	Insurance & pensions	973	
Real Estate	1,237		Equities	2,559	
Machinery/Equip.	527		Debt Securities	366	
Inventories	263		Loans	1,022	
IP/other	169		Other	228	
<i>Financial Assets</i>	2,022	48%	<i>Net Wealth (= Assets –</i>	-931	22%
Insurance & pensions	4		<i>Liabilities)</i>		
Equities	898				
Cash & deposits	587				
Debt securities/loans	388				
Other	145				

Source: ONS, National balance sheet: households & non-profit institutions serving households (NPISH), £ billions



Estimates of the stock of external finance for UK businesses

£ billions								
Source	Bank lending ^(b)				Bonds Markets (public)	Insurance companies and pensions funds	Asset-based finance (eg factoring and invoice finance)	Peer-to-peer lending
	PNFCs ^(c)	Total non- financial corporations ^(d)	SMEs ^(e)	Large ^(e)	ONS ^(f)	ONS ^(g)	Total advances ^(h)	Peer-to-Peer Finance Association ^(j)
Type								
Code	B4VR	B4H3 Z8YJ	Z8YH	Z8YI	KLB6	RLKA		
2009	531	583			268	22	14	
2010	479	536			265	23	15	
2011	450	504	189	315	300	31	16	
2012	427	472	176	296	328	34	17	
2013	406	448	166	282	336	35	18	
2014	390	435	167	268	330	38	19	0.6
2015	387	430	164	265	313	38	20	1
2016	402 (Aug.)	445 (Aug.)	161 (Aug.)	284 (Aug.)	351 (Q2)	39 (Q2)	20 (Q2)	1 (Q2)



Concluding Remarks

- Is lending to households or property crowding out lending to firms?
- Does the financial cycle propagate or amplify the real economic cycle?
- Have macro-prudential instruments limited risk-taking by the financial sector?
- The standard model of borrowing and lending does not really capture patterns in saving and investment in the UK very well.

