

The financial sector and the macroeconomy:
Firms and Debt



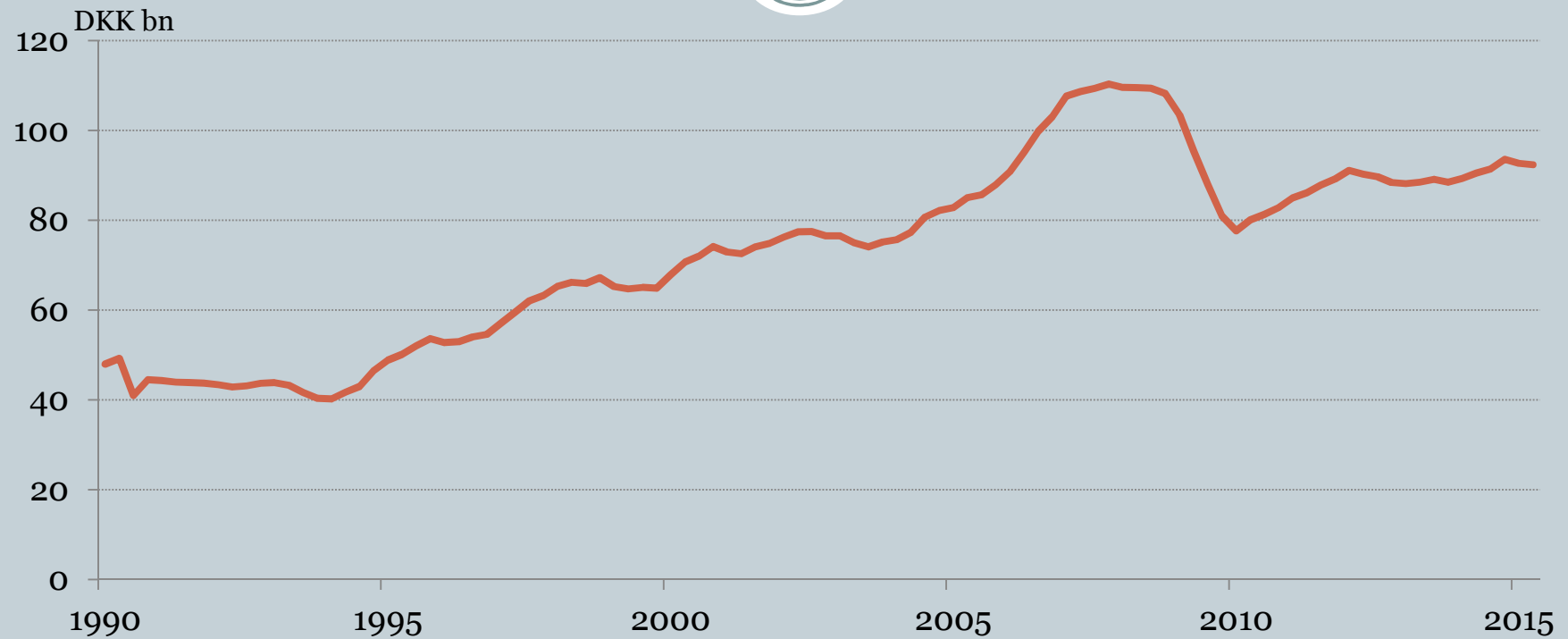
**WORKSHOP AT
DANMARKS NATIONALBANK**

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PROFESSOR, CBS**

Private investments in Denmark

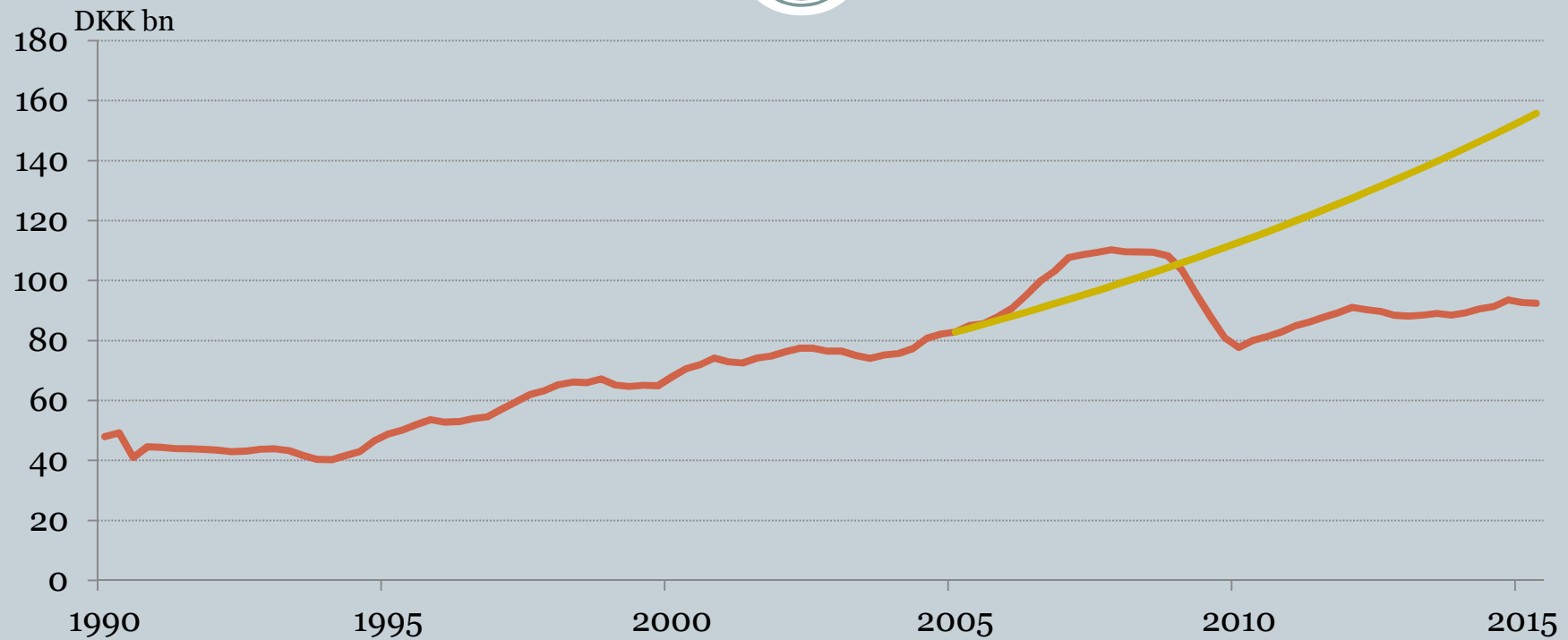
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Hypothetical investments in Denmark

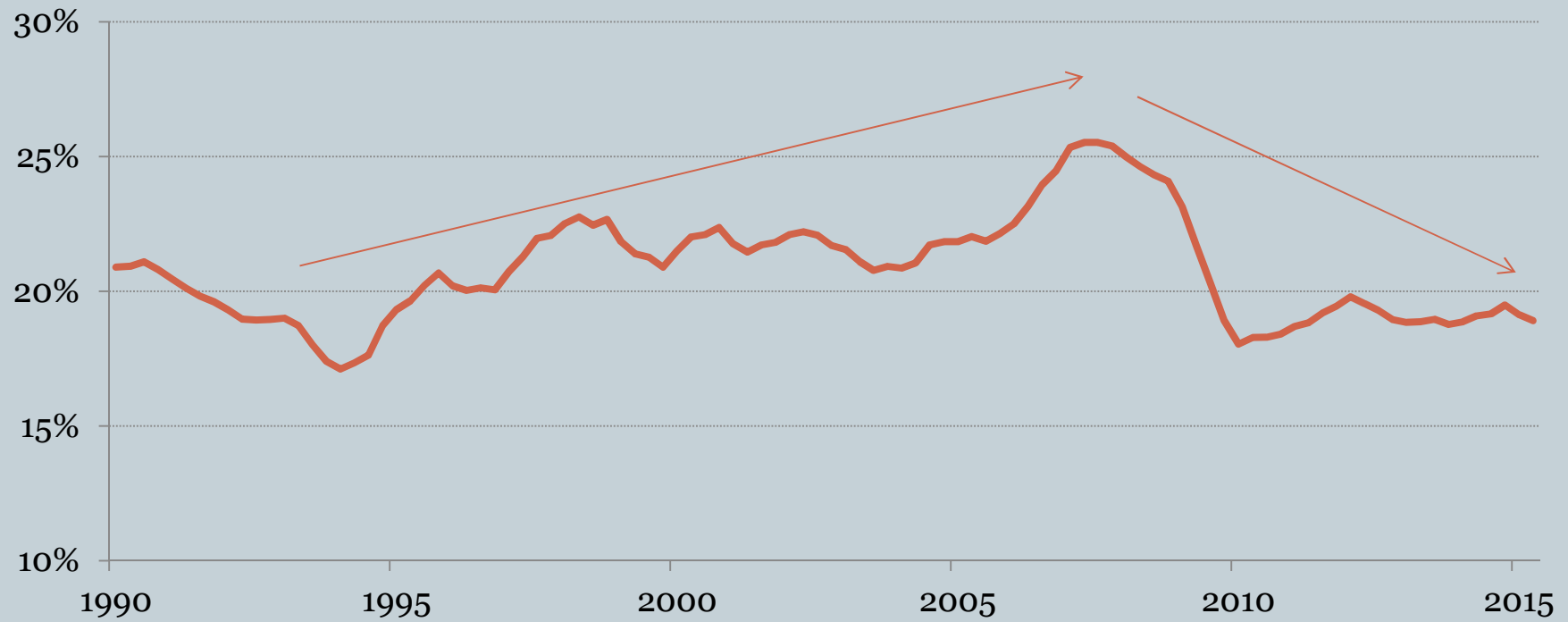
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Investment/GDP

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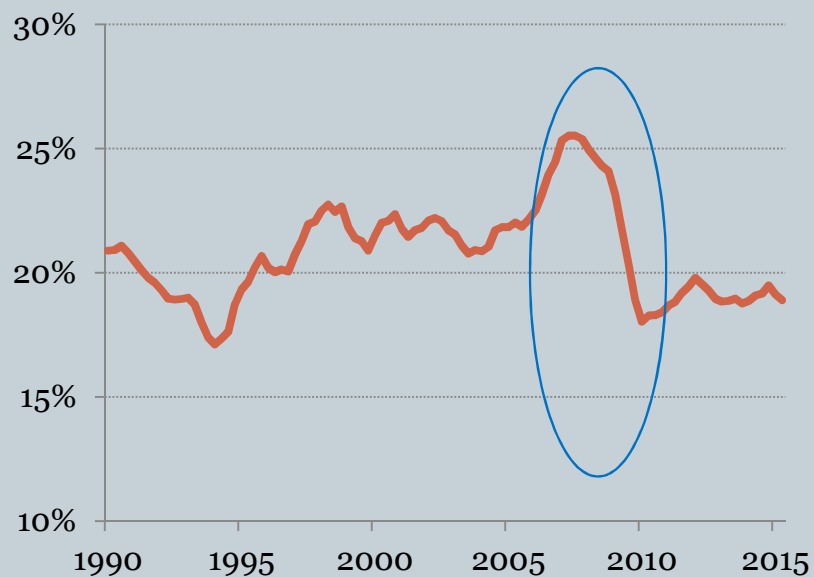


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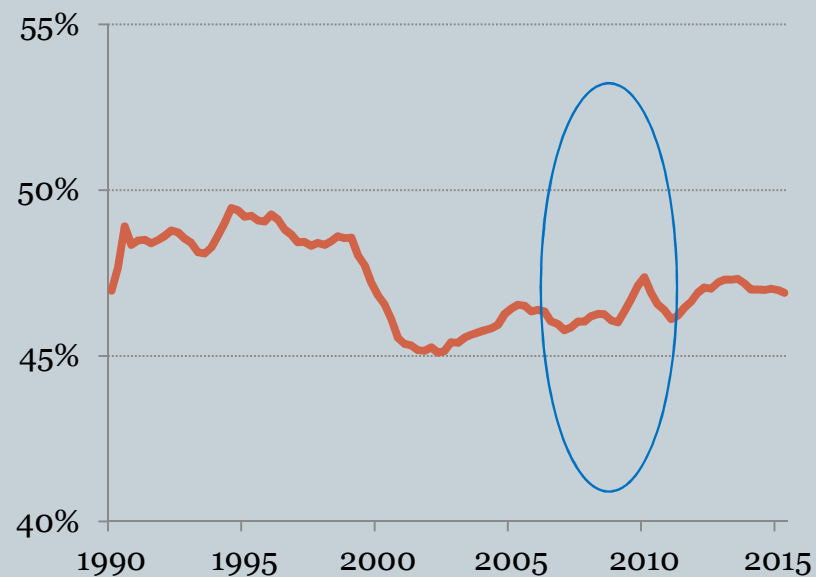
Investment vs. consumption

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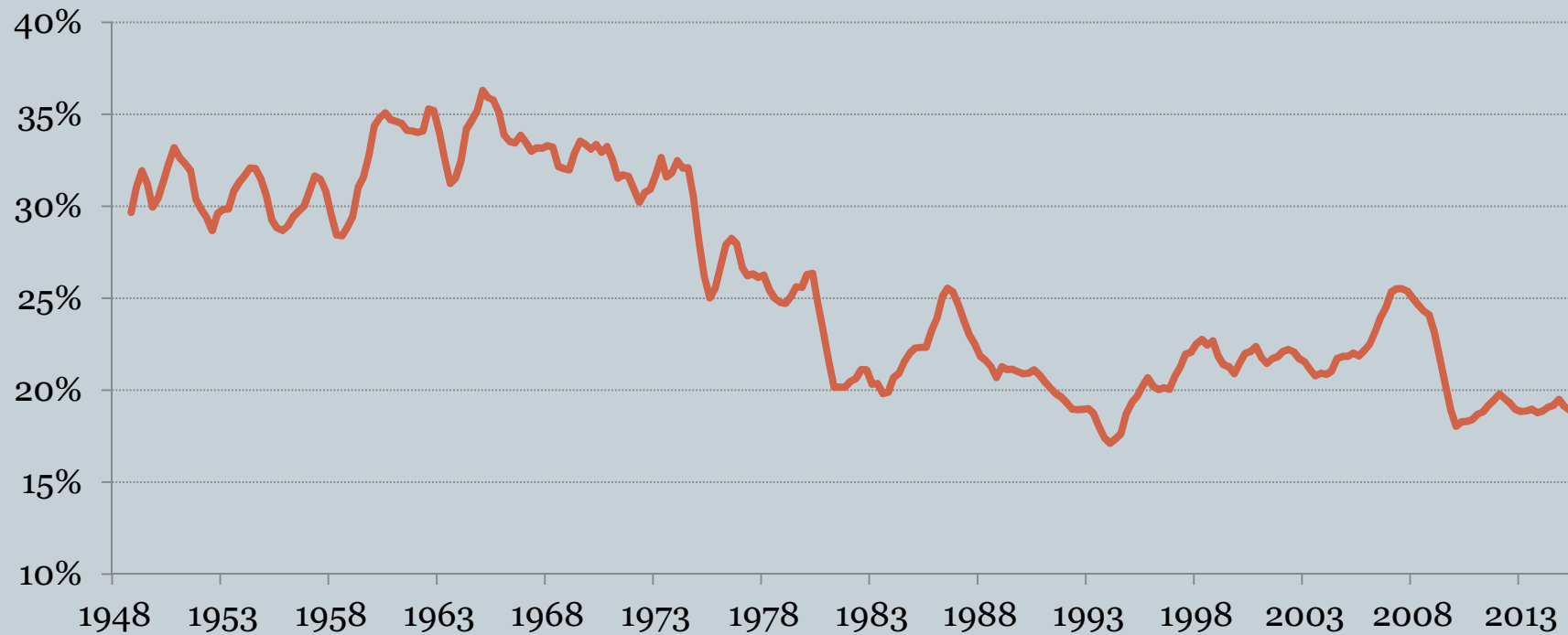
Investment/GDP



Consumption/GDP



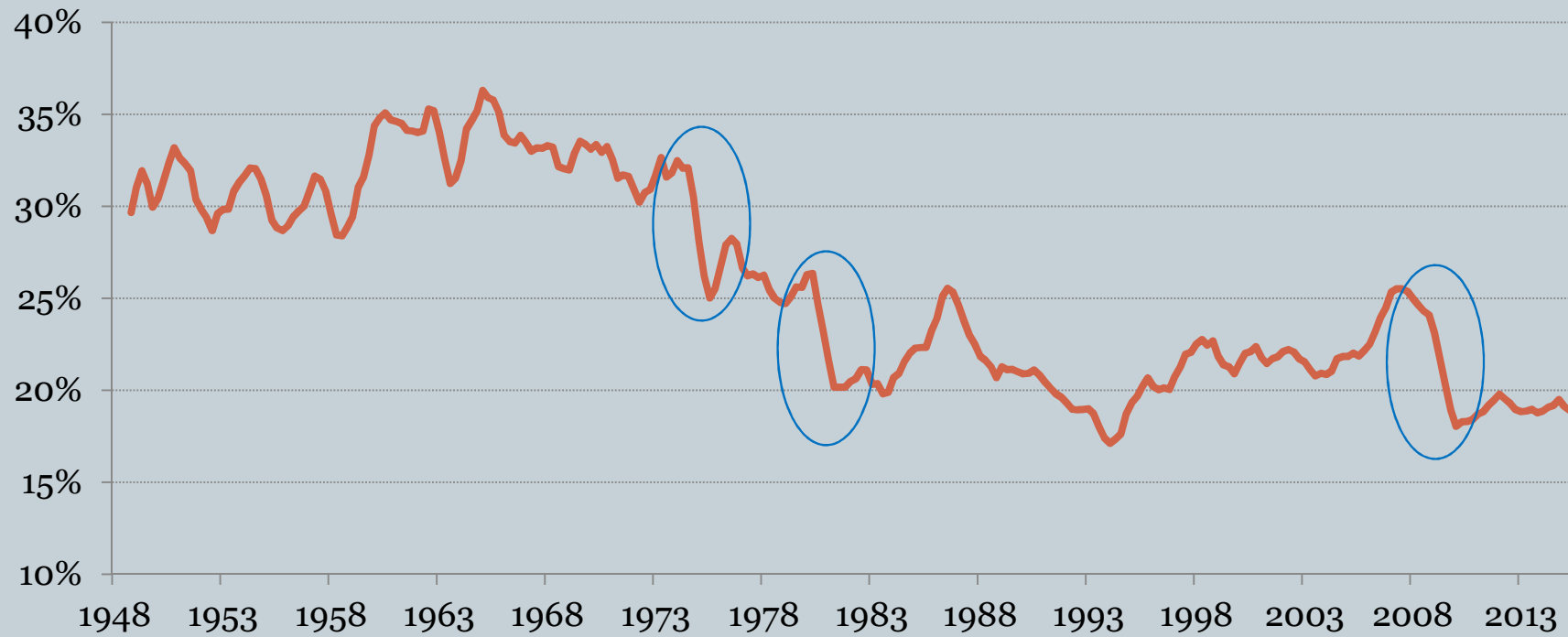
Long-run view on investment/GDP



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Long-run view on investment/GDP

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Explanations for drop in investments

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Why are investments low?

- Because cost and availability of finance remain restrictive?
- Because expected return to investments is not sufficient to justify the risk?

IMF WEO April 2015:

- *“The overriding factor holding investments back has been the overall weakness of economic activity.”*

BIS Quarterly Review March 2015

- *“Expectations of future economic conditions appear to be more important in driving investment decisions (than cheap and readily available credit).”*

Nationalbanken Monetary Review 2nd Quarter 2015:

- *“The lower level of investment since the beginning of the financial crisis has been driven mainly by falling demand.”*

Conclusion: “causality” runs from economy => investments.

Don't increase investments to get the economy going. Increase economy to get investments going!

Papers by Søren and Andreas

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Perhaps debt and access to debt (credit) also effect investments.

- **Søren:** Access to debt influences investments for new firms. But giving new firms access to non-bank financing not necessarily a good thing (as banks' screening process is then removed).
- **Andreas:** Already existing high debt reduce firms' incentives to invest. Not credit constrain, but "voluntary" cut in investments.
 - Similar to results for Danish households.

Policy implication: Give new firms better access to bank financing, but don't give them too much financing....

Solutions to drop in investments

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Difficult: Recognize that to get investments going, get economy going....

No easy solutions:

- Make sure financial sector is robust and sound, so financing access is secured.
- Eliminate frictions (if there are some).
- Keep monetary policy supportive.
- Stronger case for public investments in times like these.

Don't make too many special arrangements "forcing" extra investments (that twists incentives in unhealthy ways and later turn sour).

- Don't subsidize financing of investments too much.
- Don't subsidize investments directly too much.
- Don't force pension funds to make investments.