



Dipartimento di Economia & Centro di Ricerche e Documentazione "Piero Sraffa"

Organizzano il seminario

ECONOMIC LIMITS TO A CREDIT DRIVEN ECONOMY. LESSONS FROM A SUPERMULTIPLIER MODEL

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Abstract:

- (1) A credit boom leading to an economic growth, financial collapse and recession (as we have seen from 1995 to 2008) can be explained by a supermultiplier model. It computes the impact of an expanding industry (construction in our case) on induced consumption and expansionary investment. The first is captured by the multiplier, the second by the accelerator. If properly conceived, the accelerator is a stable and stabilizing mechanism. It shapes the structure of demand and production so that all the variables tend to grow at the autonomous trend. Traditionally, the multiplier of consumption has been considered a stable mechanism, as stable as the propensity to consume on which it relies. Our conclusion is that, once we account for finance, the multiplier evolves through time and becomes potentially destabilizing. The disposable income of workers, from which consumption derives, depends not only on fixed parameters (like the tax rate) but on the debt service rate that increases endogenously when credit expands faster than the nominal GDP. Once the economy is highly indebted, an increase in the interest rate or a fall in income may cause a massive default leading to a financial crash and a global economic downturn.
- (2) The basic condition for dynamic equilibrium is that the growth of credit is lower or equal to the rate of growth of nominal GDP. The potential market of the goods included in the vector of autonomous demand sets a clear limit to output expansion. Subsistence consumption adds a further check. On the contrary, there is not such a limit for credit expansion. In a booming economy, if banks expand credit in parallel, they will not appreciate the risks they are creating for the entire economy. Such risks will appear later in the form of asset bubbles and over-indebtedness. Over-indebtedness introduces a deflationary pressure on aggregate demand, leads to a recession and makes the recovery more difficult.
- (3) Our main policy proposal can be labelled "credit discrimination". Financial authorities should regulate credit in different ways according to its destination. (a) Loans to buy assets should be forbidden (b) Mortgages loans should be restricted when they expand faster than the building industry. Asset inflation in the residential market is an indicator of the ongoing mismatch.

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La partecipazione è aperta a tutti gli interessati