



**BANK OF ENGLAND**

# News release

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## **Curbing the Credit Cycle - Speech By Andrew Haldane**

Speaking at the Columbia University Center on Capitalism and Society Annual Conference in New York, Andrew Haldane - Executive Director for Financial Stability - examines the causes and consequences of credit cycles and draws implications for the design of public policy.

Andrew Haldane draws on a range of new evidence to state that credit cycles are clearly identifiable and regular phenomena across countries and through time, differing in frequency and scale to business cycles. He notes that in many cases financial crises are preceded by a credit boom, which provides "relatively concrete evidence of the credit cycle having real and damaging effects on output". He explains that credit cycles can arise as a result of co-ordination or collective action failures among lenders, with firms taking decisions that are individually rational but collectively sub-optimal. It is important to understand these frictions and how they can be solved in order to help shape new macroprudential frameworks, including the creation of new macroprudential committees, like the Financial Policy Committee.

Using a model that generates credit cycles, the paper finds evidence of a compression of returns for banks during credit booms and dispersion during busts, and an increase in the degree of co-ordination of global banks' activities after the financial liberalisation of the 1980s. Andrew Haldane suggests that taken together, this evidence "is consistent with the notion that global banks' activities have become increasingly alike, possibly as a result of increased competition and cross-border lending. The increase in the cross-country correlation of the credit cycle suggests policy needs an international dimension if it is to curb effectively the credit cycle."

He makes a series of other observations that he says should be considered when shaping future policy. First, the externalities associated with credit cycles "provide a justification for state intervention to help co-ordinate lending expectations and actions by banks". Second, because the frequency and scale of business and credit cycles are different, monetary policy "may be an inefficient tool for calming the credit cycle". Third, that "microprudential policy aimed at tackling financial imbalances in individual institutions may also be ineffective", because "bank-specific actions will not, by themselves, internalise the spillovers that arise across banks over the credit cycle". Therefore across-the-system actions are needed, which is one dimension of macroprudential policy. He says the design of such policies needs to take into account the

importance of expectations, and acknowledge that spillovers can also extend across borders and beyond the scope of current regulation into the shadow banking system. He additionally suggests that macroprudential policies should be simple ".to prevent confusion about the objectives and transmission channels".

### **Key Resources**

Curbing the Credit Cycle – Full speech

<http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech463.pdf>