Private debt, public debt and capital misallocation

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Main results

Does private and public debt affect capital misallocation?

- Two theoretical explanations:
  - Financial frictions $\Longrightarrow$ incorporated in DSGE macro models (Bernanke & Gertler)
  - Bubbles $\Longrightarrow$ They tend to appear and expand in countries where productivity is low compared to the rest of the world. By absorbing local savings, eliminating inefficient investments and thus acting as substitute for international capital flows, improving the international allocation of investment and reducing rate-of-return differentials across countries.
- Empirical results
  - An increase in private debt exacerbates capital misallocation and more so in sectors with higher financial dependence
  - Public debt does not affect capital allocation
  - Financial liberalization reduces capital misallocation (link with the effect of bubbles on capital allocation across countries)
  - A rise in private debt increases capital misallocation particularly in sectors that are more technologically intensive
  - Both corporate debt and household debt have significant amplifying effects on capital misallocation, but the effect of corporate debt is much larger than that of household debt

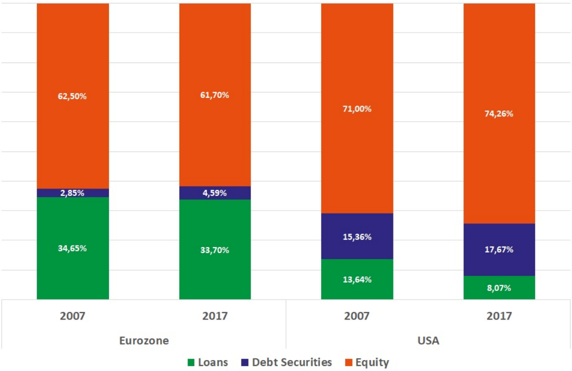
First questions and comments

- A rise in private debt increases capital misallocation particularly in sectors that are more technologically intensive
  $\Longrightarrow$ Is this because these sectors are more debt intensive? Or because the capital share is higher?
- Both corporate debt and household debt have significant amplifying effects on capital misallocation, but the effect of corporate debt is much larger than that of household debt $\Longrightarrow$ how do you explain that?
- Declining interest rates tend to increase the dispersion of returns to capital
  $\Longrightarrow$ is it possible to test the effect of ECB policy since 2011 on capital misallocation? Especially QE?
- Public debt does not affect capital allocation
  $\Longrightarrow$ Public debt is not necessarily a good indicator to test capital misallocation: it has also been found as a not so robust indicator for debt crises e.g.

Eurozone vs. USA

Data : Eurozone countries, should the results be the same in the US?

Figure: Non-financial corporations sources of funds

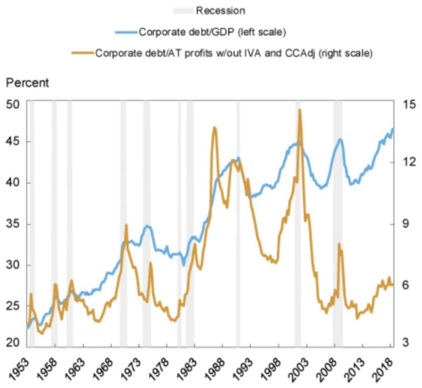


Source: ECB

Impact on financial stability

In the US, nonfinancial corporate debt is at a fifty year high ratio to GDP. Is this a threat to financial stability? You could test different leverage measures to refine your analysis

Figure: Nonfinancial corporate debt and national accounts

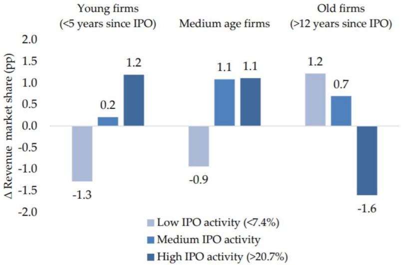


Source: Anna Kovner, Brandon Zborowski - Federal Reserve Bank of New York

- Corporate profits have also been increasing as a share of GNP. As a result the debt to profits ratio has been falling and is now well below the fifty-year highs
- The ratio of debt to EBITDA has significantly increased reflecting high debt growth at the riskiest public corporations
- Other leverage measures: nonfinancial corporate debt to book assets, market capitalization, interest coverage ratio

Is capital misallocation necessarily a bad thing? Looking at corporate defaults

Figure: Firms revenue market share changes in high- and low entry industries



Source: Bo Becker, Victoria Ivashina - Stockholm School of Economics, Harvard University

- In the past thirty years, defaults on corporate bonds have been substantially higher than the historical average.
- Becker and Ivashina find that this increase in credit risk is attributed to the disruptor firms, i.e. the new and fast-growing firms which displace incumbents.
- As established firms, who are the main issuers of bonds, get displaced by the disruptors and lose market share, corporate default rates rise.

Thank you for your attention