Global outlook in asset allocation

Where will Systemic risk reside?

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(*) the opinions expressed here do not necessarily reflect those of the Banque de France or the Eurosystem

Focus on macro sources of systemic risk

Systemic risk may take different forms:

(i) contagion effects

(ii) common exposure to macro shocks

(iii) financial imbalances (credit booms, etc) that may suddenly unravel

I will concentrate on (ii) and (iii), but look at contagion in housing markets

Main messages

I- Macro risks look balanced as the recovery is well engaged

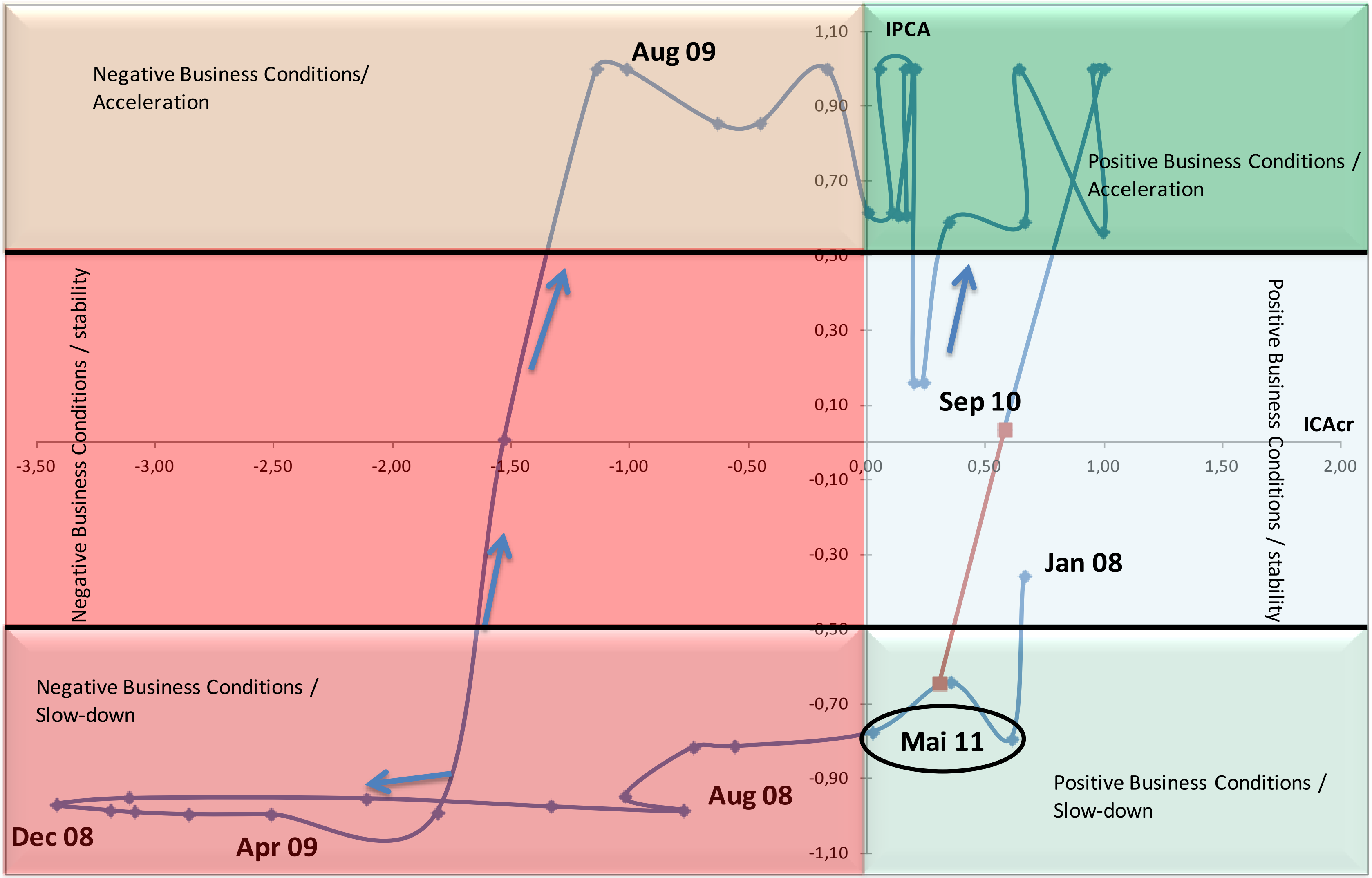
- After the post-cris bounce-back, France and Germany are converging back to similar steady state growth, although based on different sources
- Although some levelling off afterwards, confirming a scenario of subdued growth, as in the whole euro area
- But Heterogeneity in the euro area

II- Financial imbalances, in particular in the public sector, require decisive action

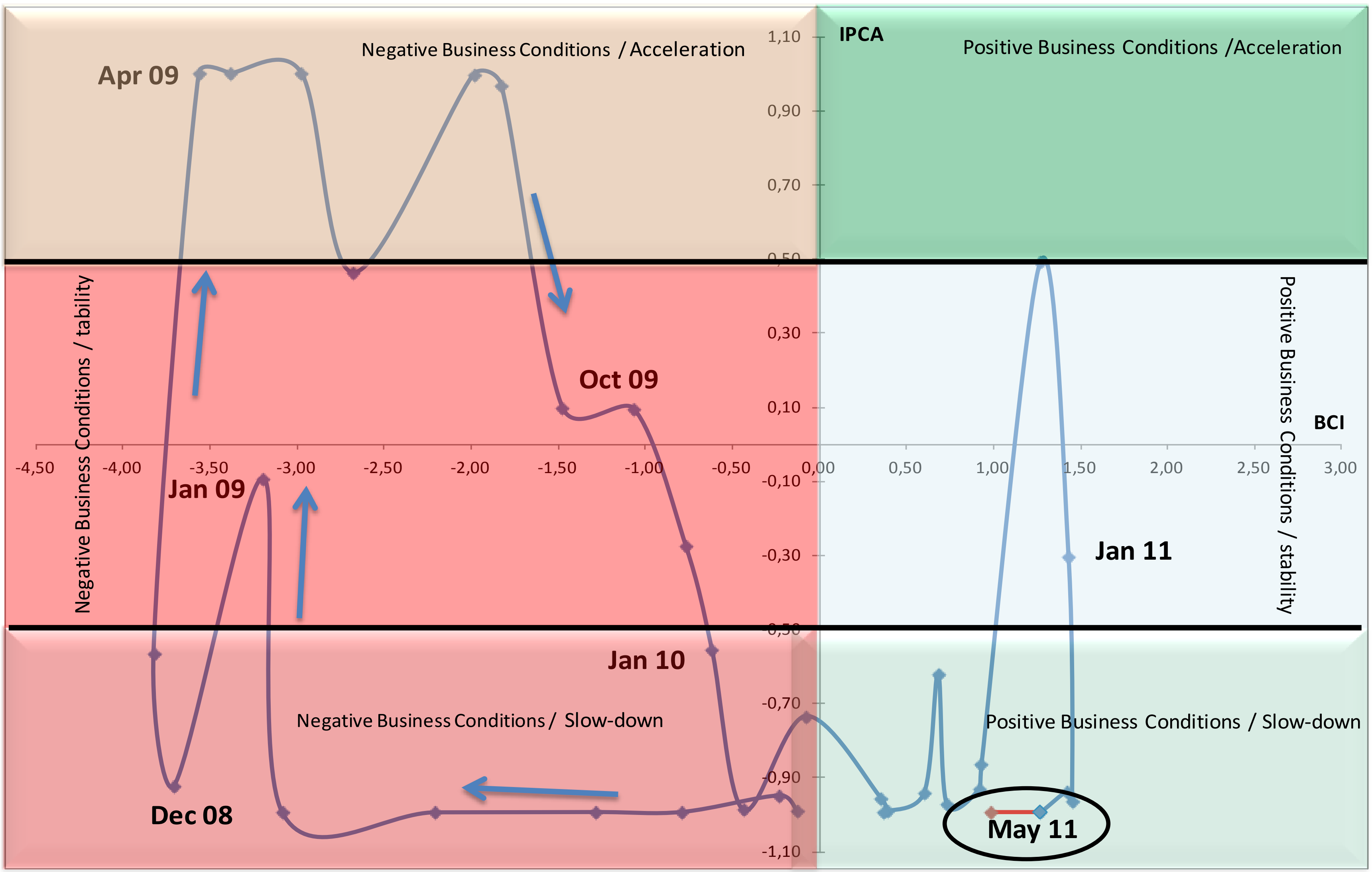
- Increasing debt levels in the private sector
- Consolidation plans keep euro area public Debt/GDP in the 80-90% range, still far above pre-crisis levels with negative effects on GDP growth
- The consolidation of public expenditures is the main lever that is likely to stabilize public debt

III- Lack of adjustment in the housing market in some countries?

I. 1. BDF « clock indicator » : France has completed the recession cycle since the summer of 2009 (x-axis : growth, y-axis : acceleration)

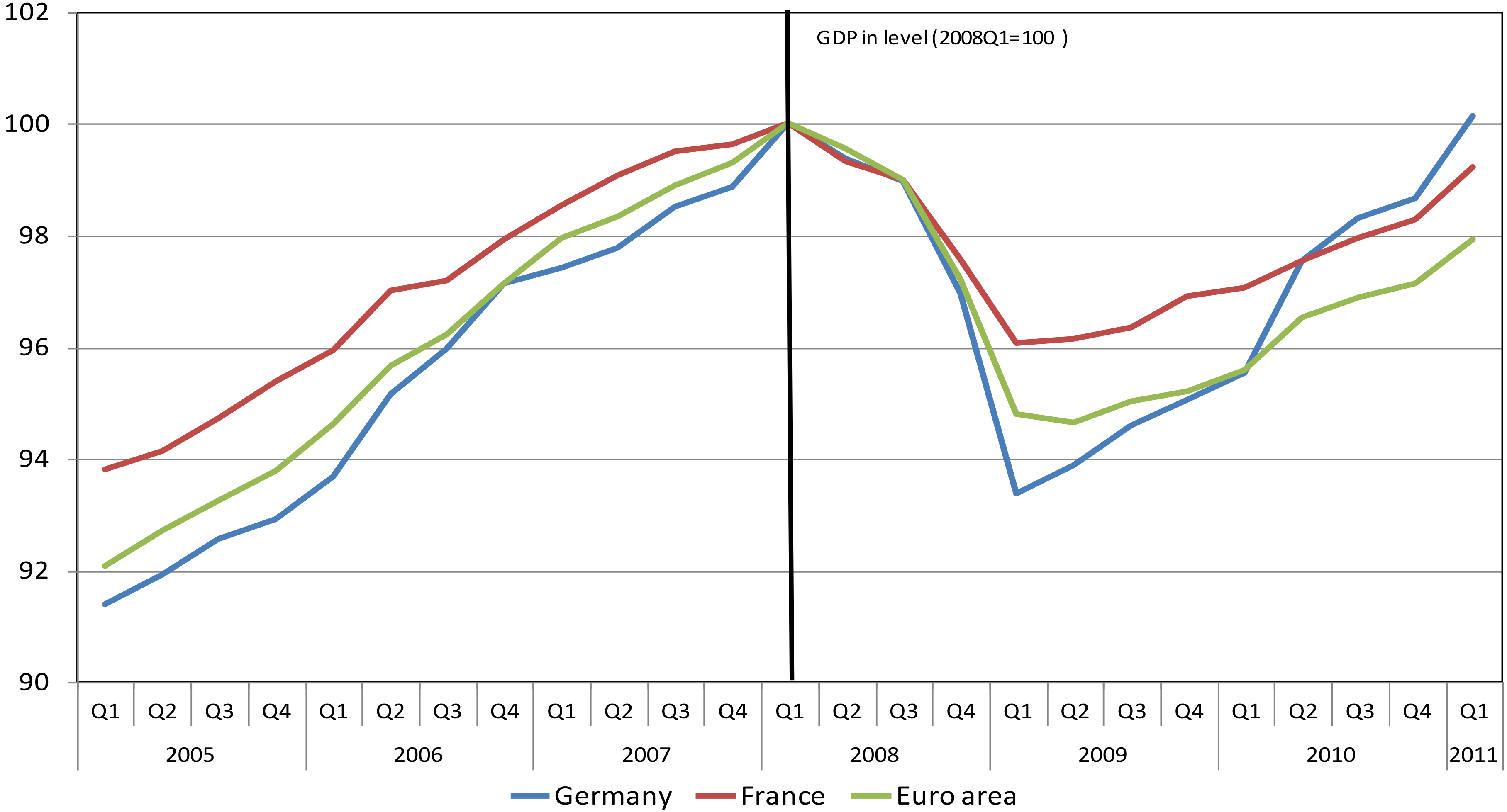


BDF « clock indicator » for euro area : growth in the business sector is above its long run average since early 2010

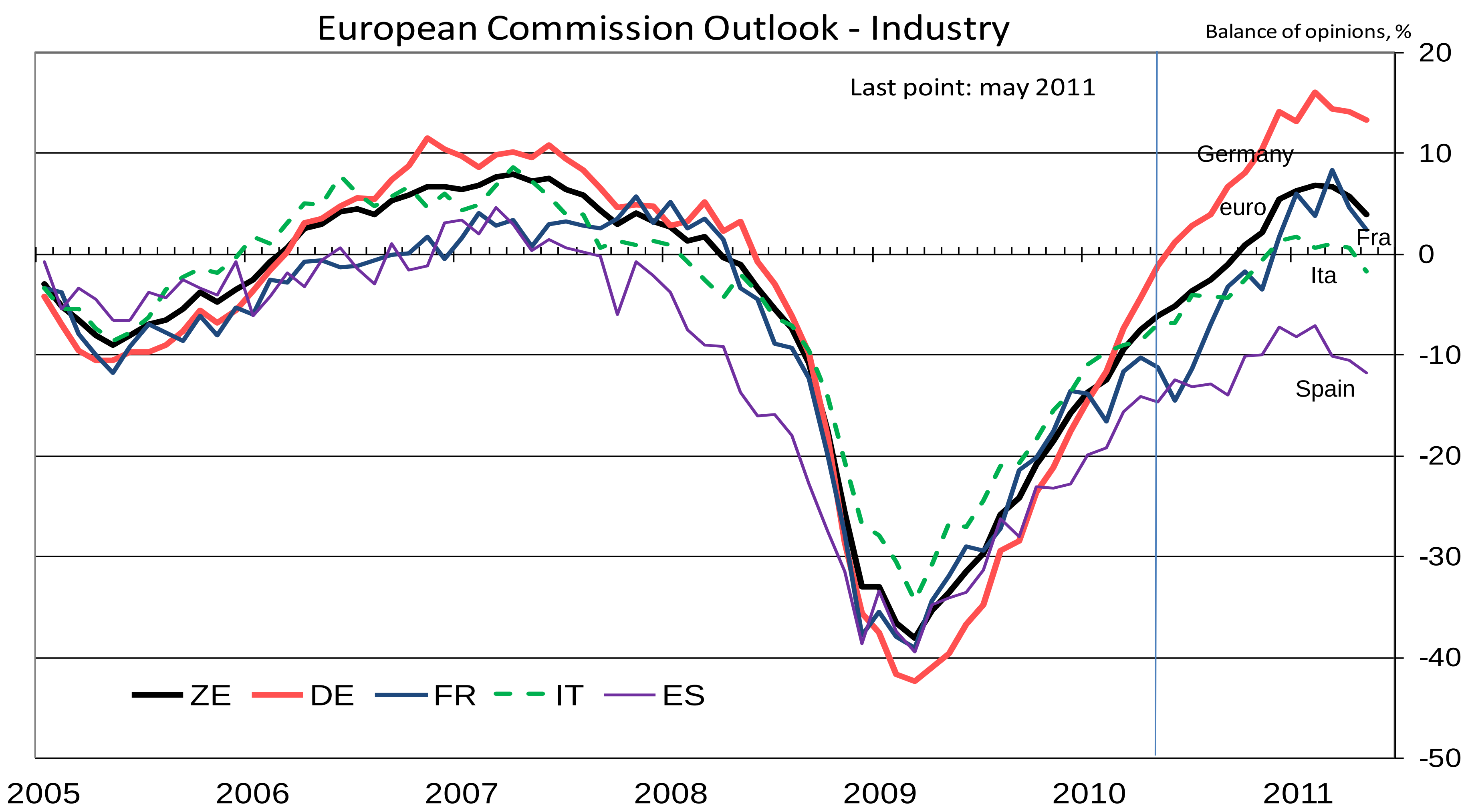


I.2. After the post-cris bounce-back, France and Germany are converging back to similar steady state growth, although based on different sources

Real GDP close to the previous peak

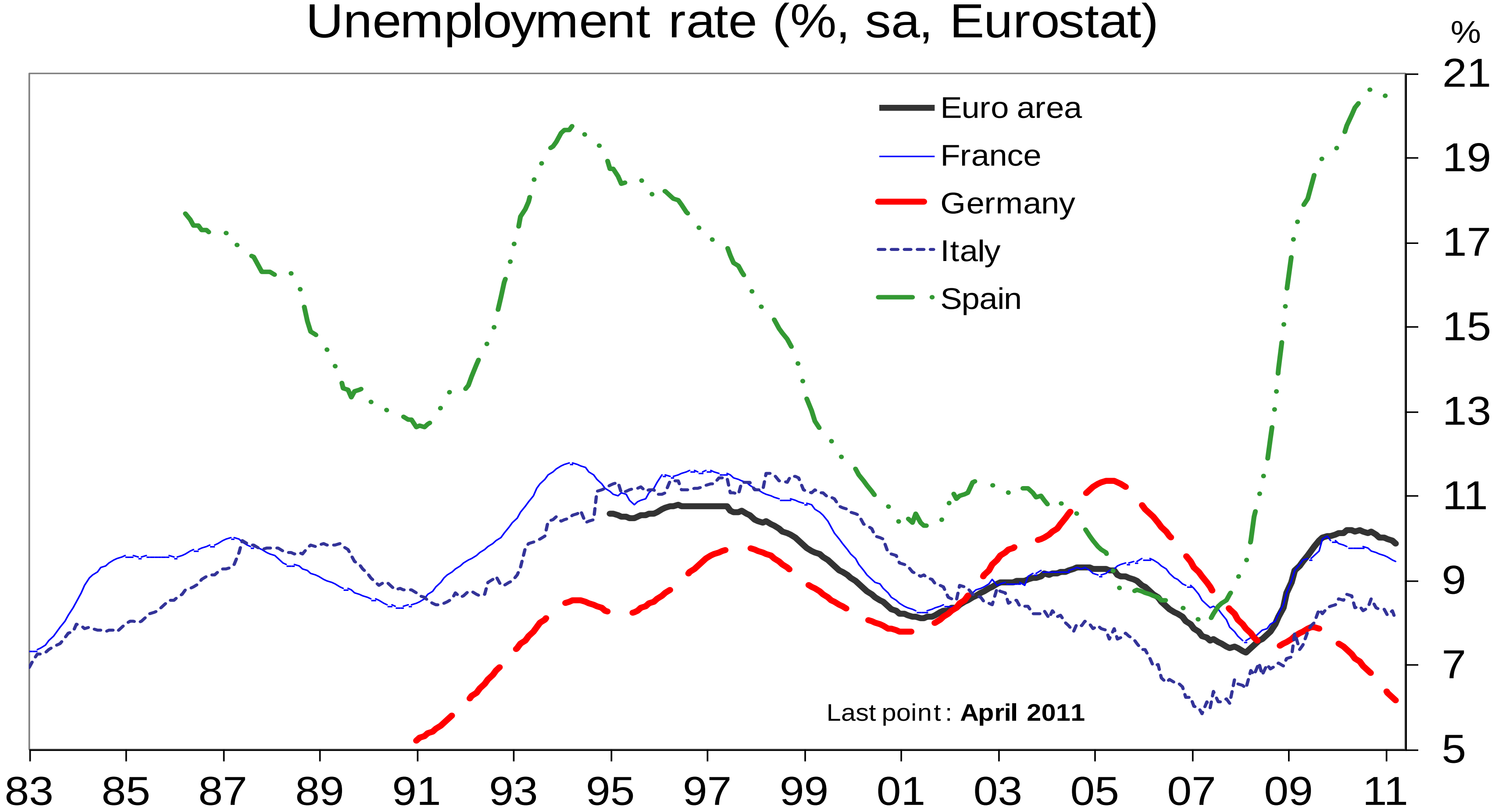


Business climate in manufacturing industry is close to pre-crisis level in euro area and France (above for Germany)



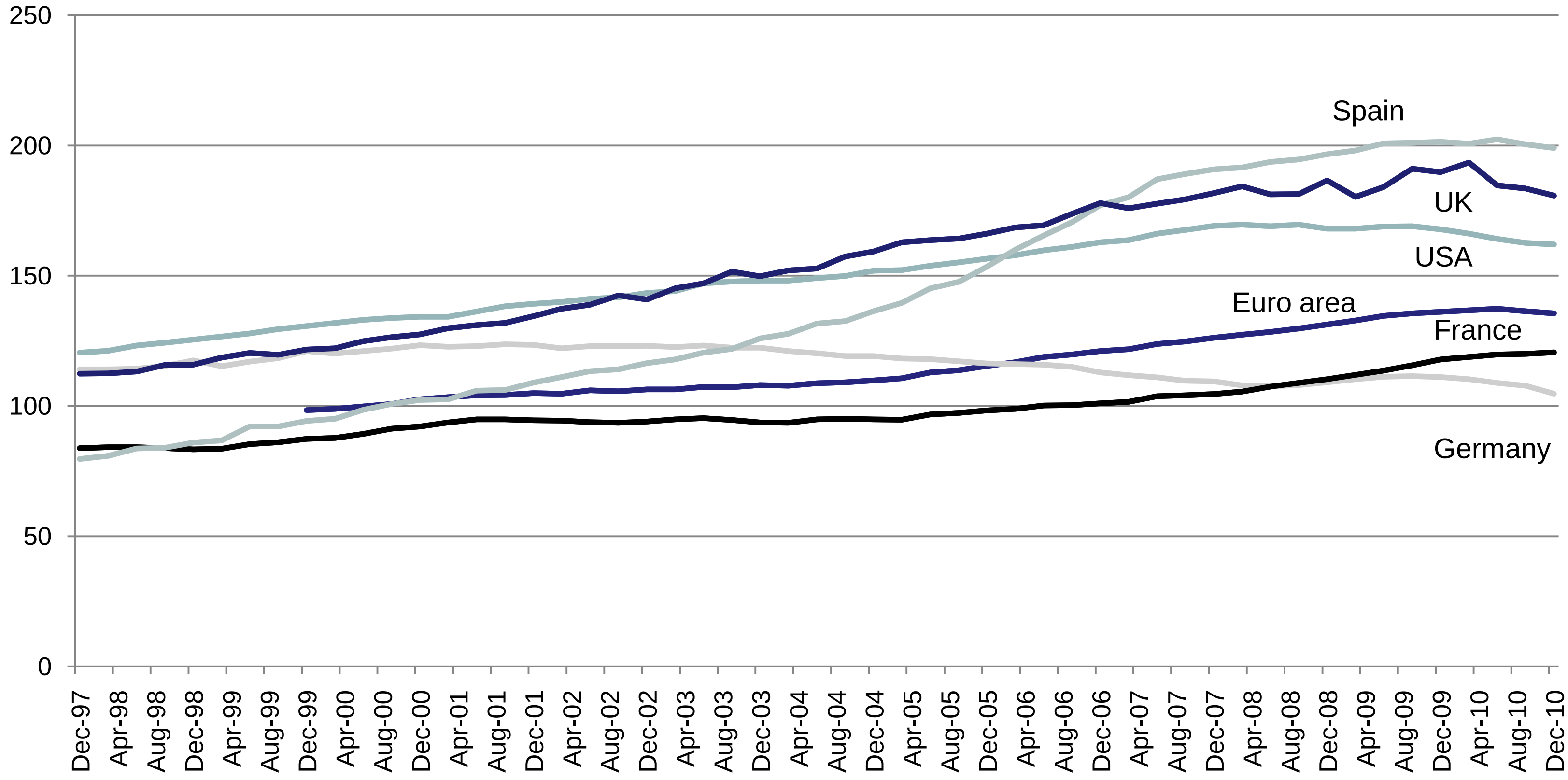
I.3.Heterogeneity of unemployment : Germany vs Spain

Unemployment rate (%, sa, Eurostat)



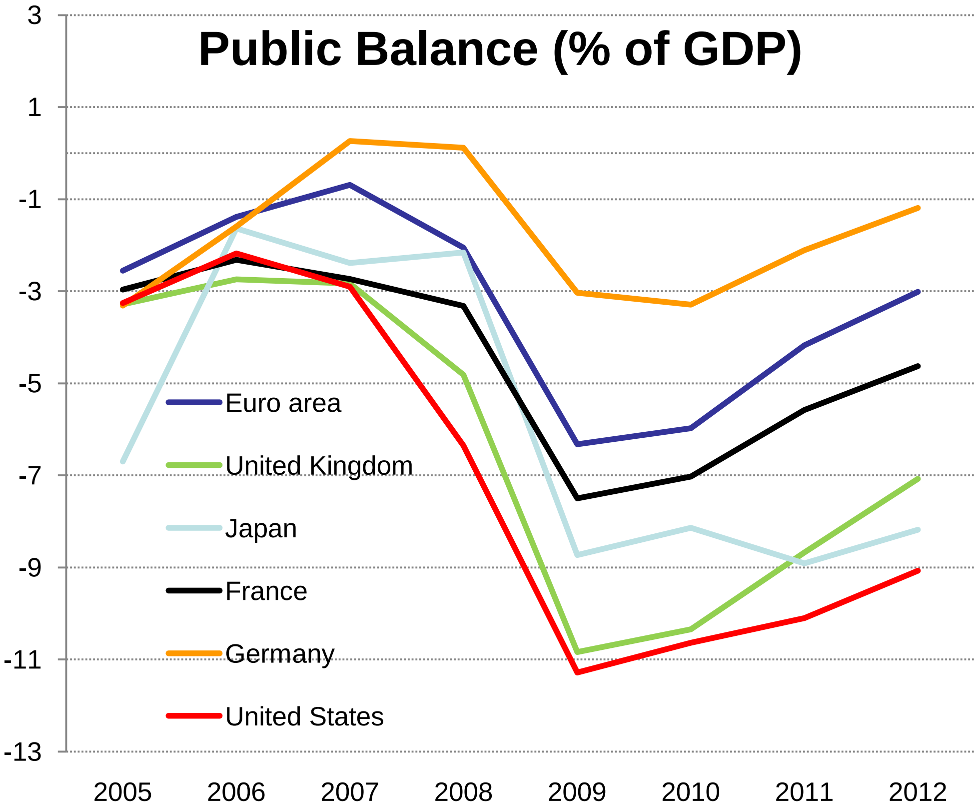
II- Financial imbalances

II-1. Overall debt level in the private sector (hh+nfc) : in average euro area is below US and UK, except ESP

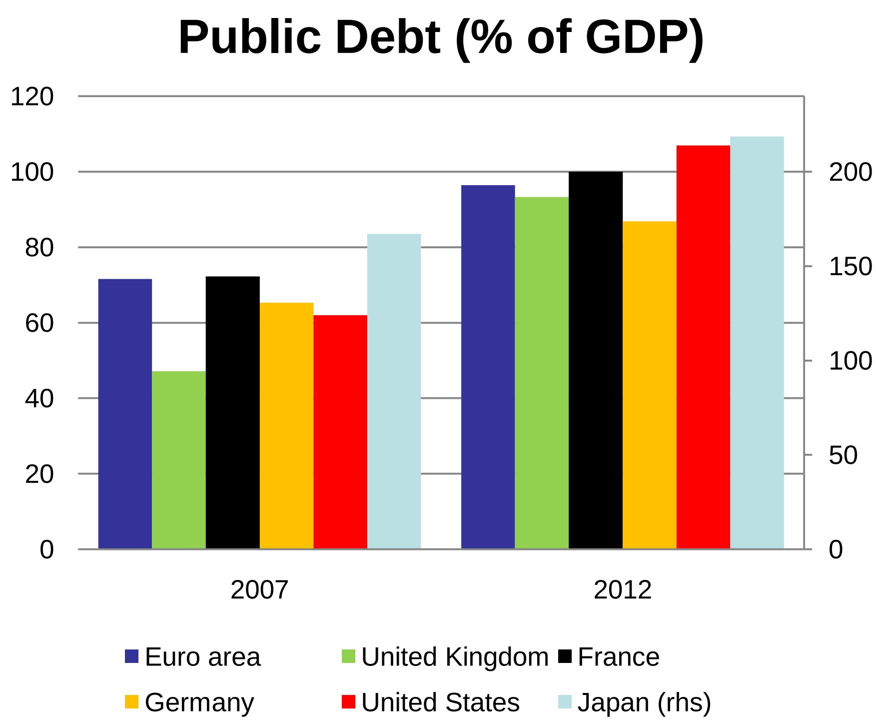


II-2 Public sector

Deteriorated fiscal positions in developed countries

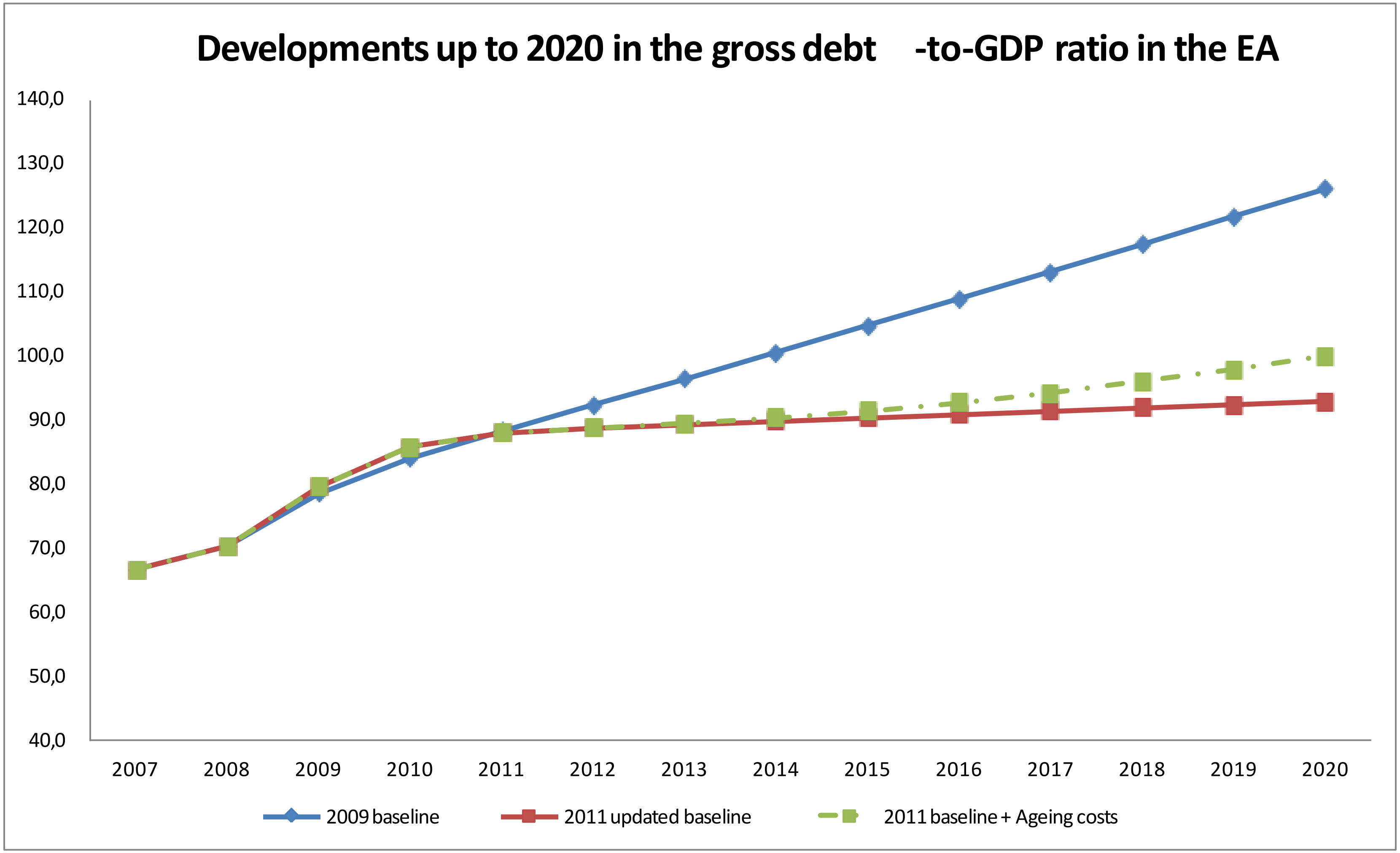


Source: OECD

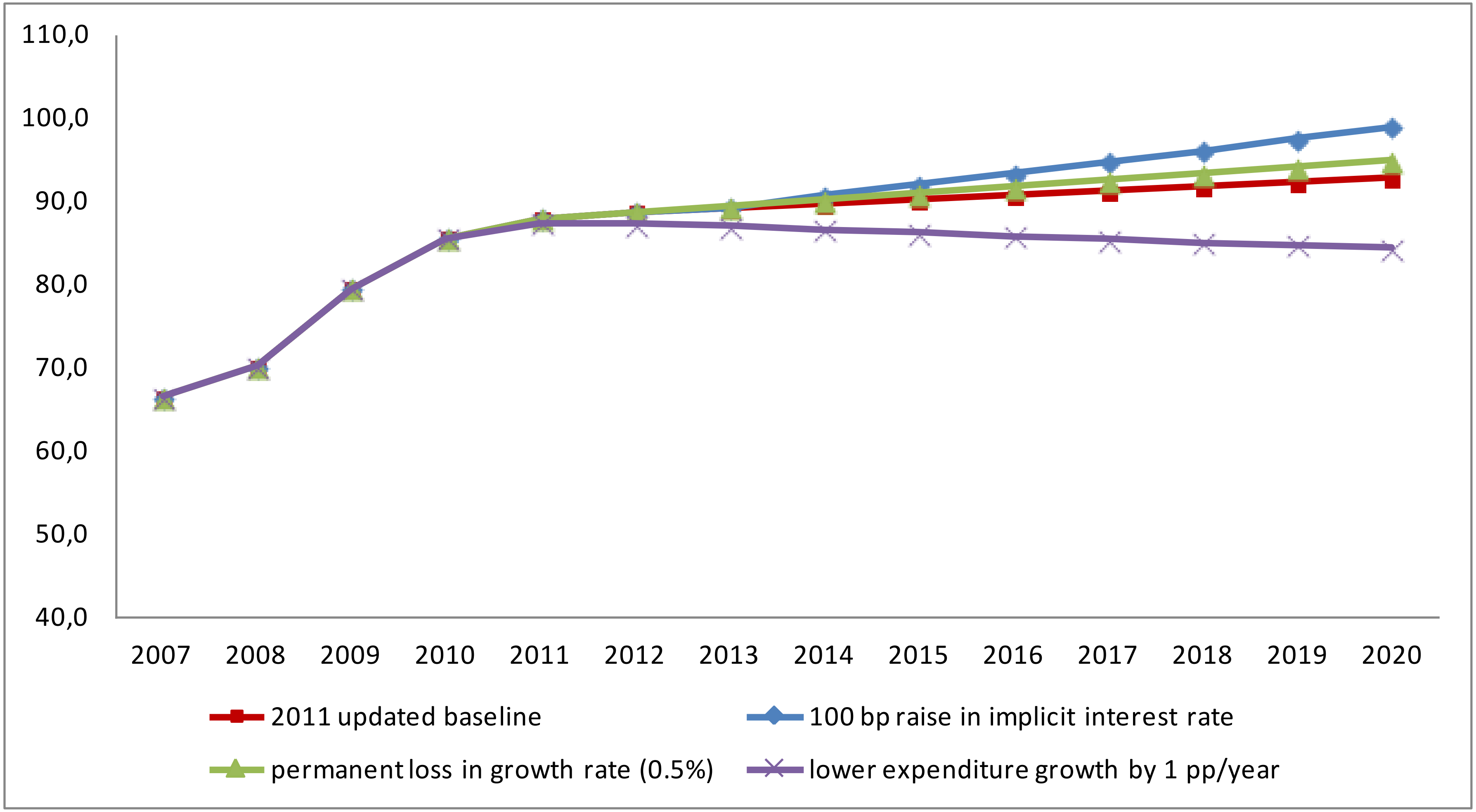


Source: OECD

In the euro area, large scale consolidation plans have been announced by governments: they would help stabilize public debt, although remaining in the 80-90% range, with negative effects on growth

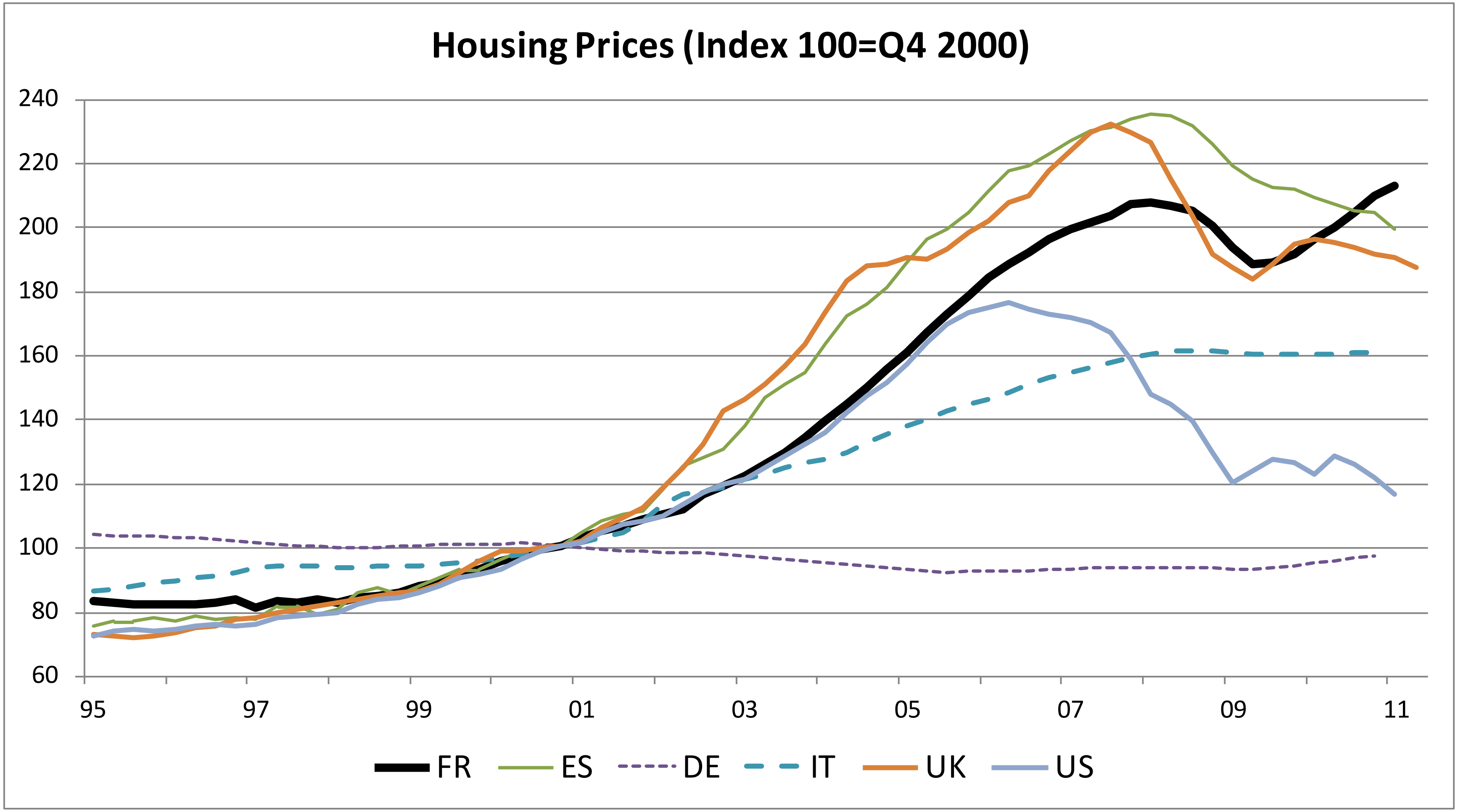


Two upside risks : higher interest rates and lower GDP growth while the lower growth of public expenditure is the only way to reduce public indebtedness



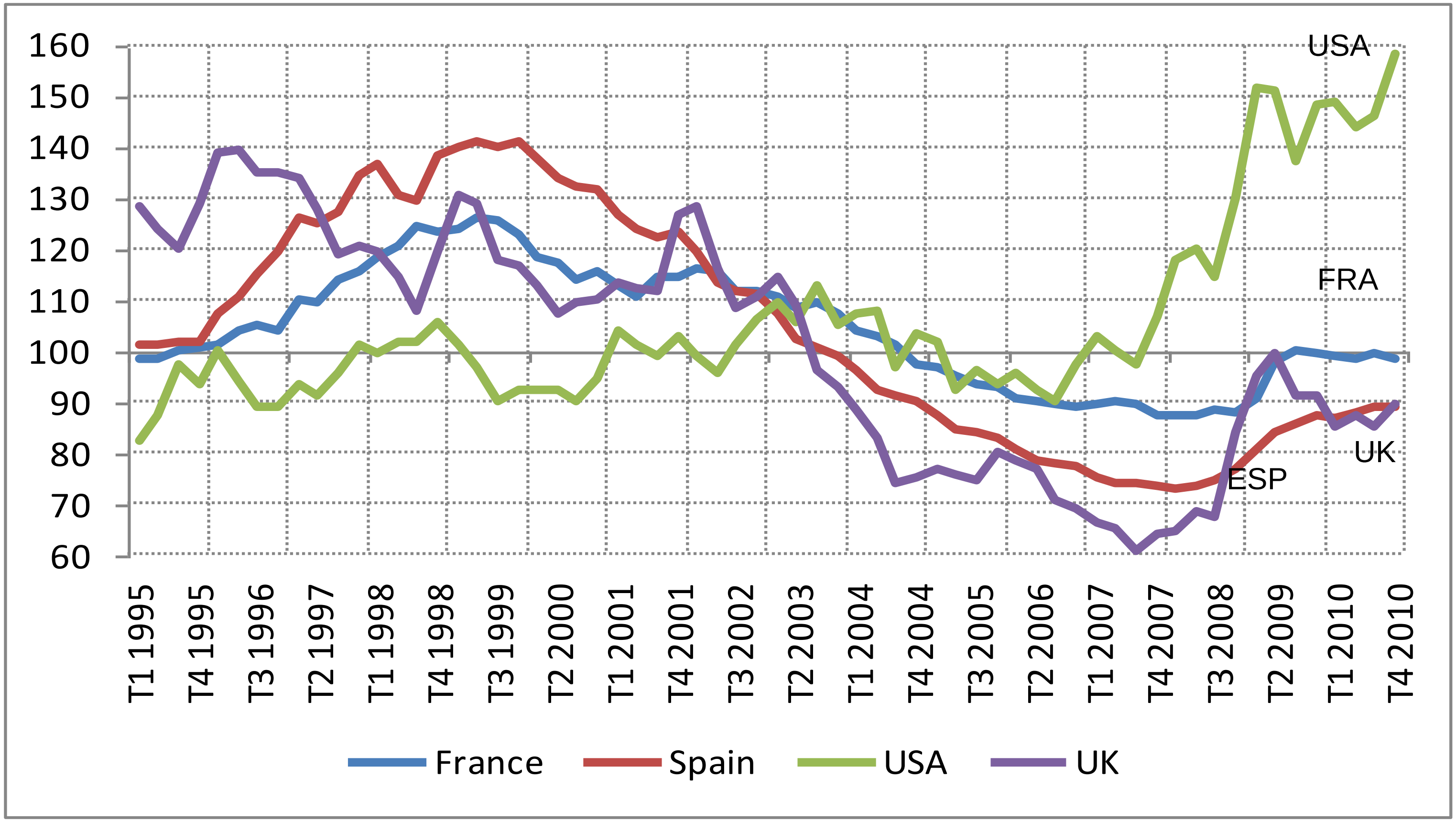
III. Risks from housing market ?

III.1 Nominal house prices at historical high at end of 2010 in France

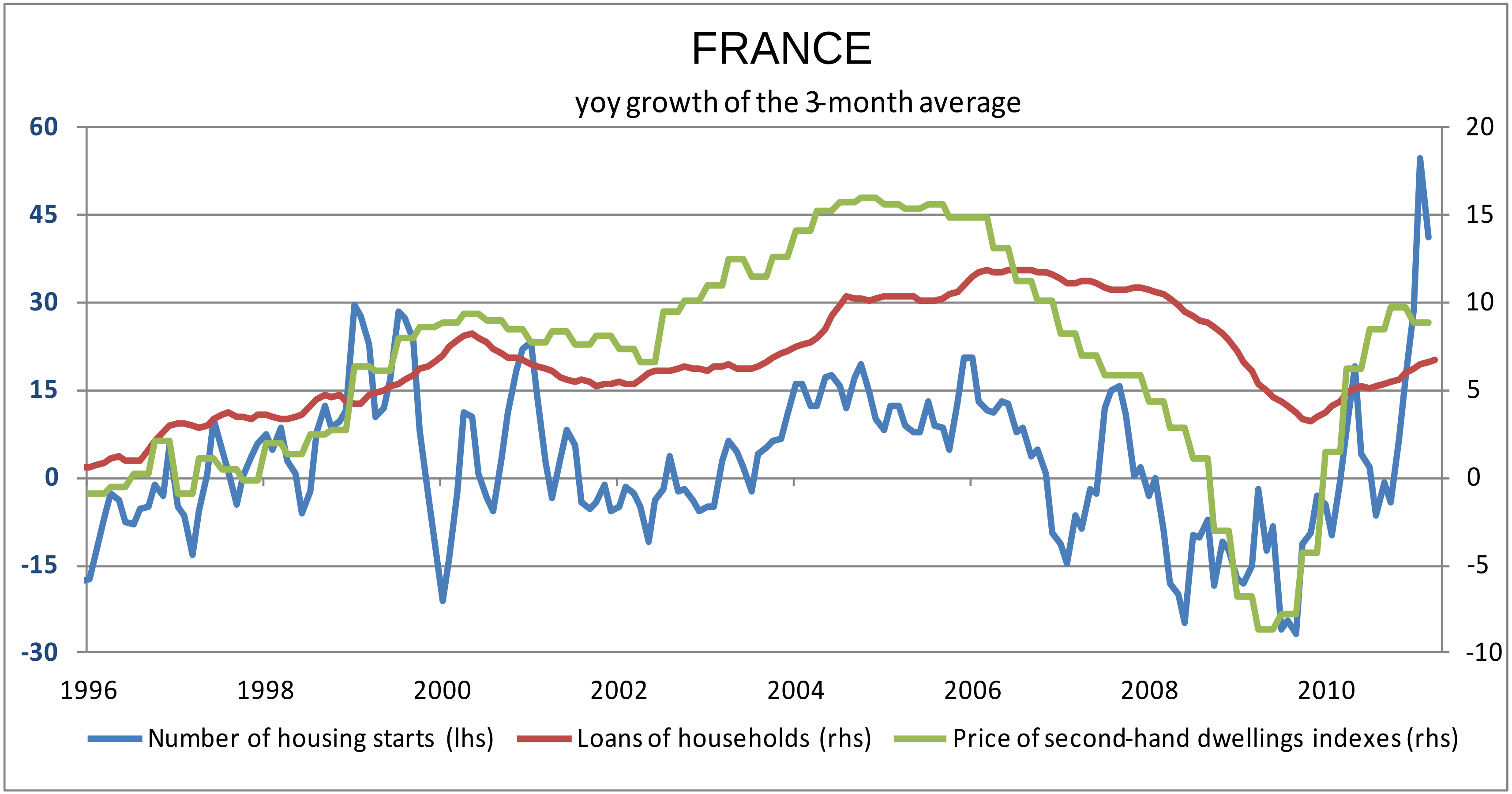


III.2 Improvement in affordability after the crisis less significant in France than in other countries

Affordability Index (Normalized Mean 1990-2010=100)



III.3. Dynamic prices and mortgage loans. Will the recent recovery in housing starts be sustained ?



III.4 Evidence of contagion in housing markets (de Bandt & Malik, 2010)): Spain

→ Look at correlation between real house prices in a given country and common factor in international (real) house prices

Crisis periods

Model determines regime shifts , with probability of crisis regime (thin line) matching that of financial crisis (thick line)

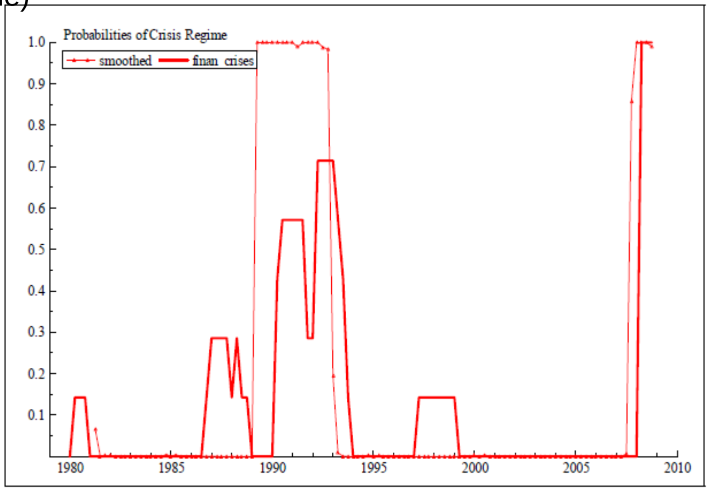


Figure 3: Spain. Correspondance of identified Crisis regimes (via smoothed probabilities) with the index of global intensity of financial crises (finan_crises

IRFs

Correlation between domestic and global shocks, measured by impulse response function (IRF) exhibits larger magnitude in crisis period= contagion

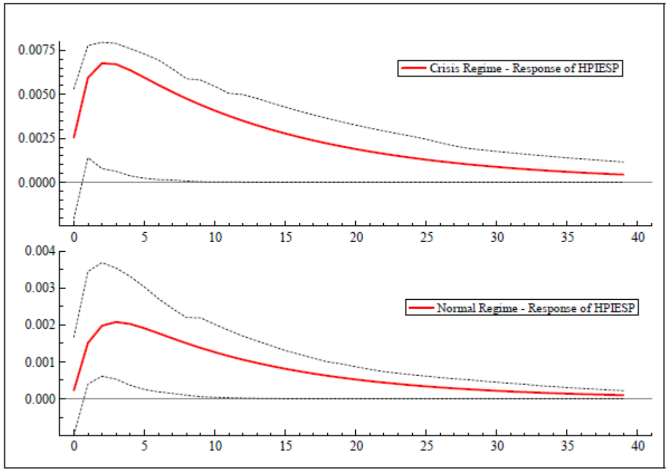


Figure 5: Spain. Regime dependent impulse responses of real house price changes to an international house price shock, in Crisis or Normal regimes. Dotted lines represents one standard deviation confidence bands based on 1000 bootstrap replications. Time on horizontal axis in quarters.

III.4 Evidence of contagion in housing markets (de Bandt & Malik, 2010)): UK

Crisis periods

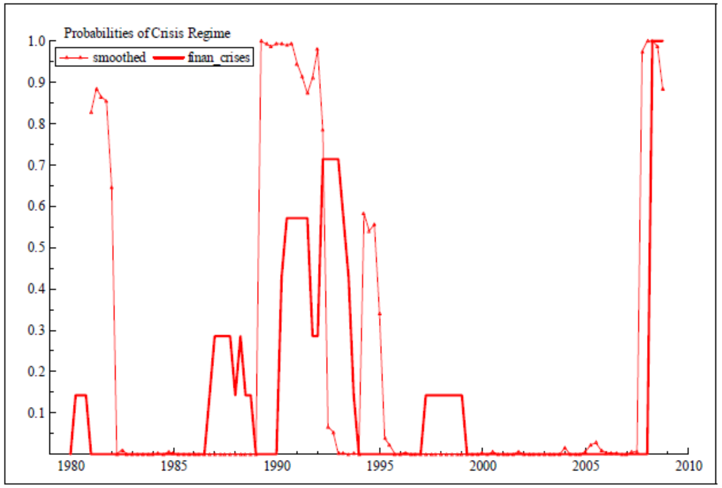


Figure 4: UK. Correspondance of identified Crisis regimes (via smoothed probabilities) with the index of global intensity of financial crises (finan_crises)

IRFs

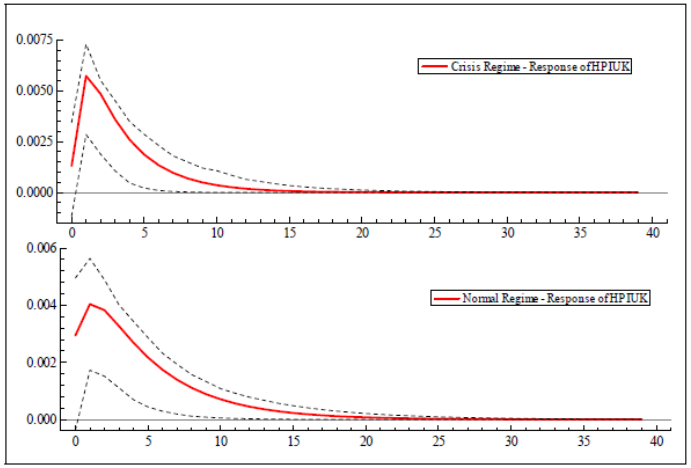


Figure 6: UK. Impulse responses of real house price changes to an international house price shock within Crisis and Normal regimes. See Figure 5 for details.