OVERVIEW OF CREDIT ACTIVITIES OF BANKS IN THE DEVELOPED ECONOMIES

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Abstract:

Credit cycles have long been a feature of advanced economies, and their analysis is relevant for monetary policy purposes. Among the various lending measures, the aim of this paper will be focused on credit activities of banks, giving a thorough analysis of the evolution of bank credit to the private sector, one of the most important indicators of banking development, moreover the effects of the COVID-19 health crises on its trend. This indicator will be further explained and graphically demonstrated for all G7 countries, thus analyzing the characteristics and evolution of lending in advanced economies. The study of the credit activity of the advanced economies of the G7 countries demonstrated the efficiency of banking systems to recover from financial crises and to maintain a very good credit rating, characterized by an upward trend in the evolution of lending. The financial system of the developed economies has maintained the overall stability, while COVID-19 continues to have a significant impact on economic and financial activity worldwide. Banks in these countries have tightened access to corporate credit amid the resurgence of the coronavirus pandemic.

Keywords: *Banking Sector, COVID-19 Crisis, Credit Activity, Developed Economies.*

JEL Classification: *G21*

1. Introduction

The essential role of bank credit as input in the production of goods and services places banks in a unique and influential position, so that any inefficiency of credit allocation or other market distortions in the banking sector are almost certain to be felt throughout the economy. The weakness of bank credits in many economies following the global financial crisis has led to intense debate about their economic implications.

Advanced Economy is a term used by the International Monetary Fund (IMF) to describe the most developed countries in the world. Advanced economies are also sometimes called developed, industrialized and mature economies. The seven largest economies in terms of GDP based on market exchange rates are the United States, Japan, Germany, France, Italy, the United Kingdom and Canada, also known as the Group of Seven (G7).

The financial systems of developed countries are based on banks or capital markets. In addition to traditional banks that rely on lending as their main function, in these countries a very important role is also played by investment banks that deal with securities transactions. Countries with more developed financial systems tend to grow faster, especially those with large private banks that channel credit to private enterprises and liquid stock exchanges.

Credit cycles have long been a feature of advanced economies, and their analysis is relevant for monetary policy purposes. Among the various lending measures, the aim of this paper will be focused on credit activities of banks, giving a thorough analysis of the evolution of bank credit to the private sector, one of the most important indicators of banking development, moreover the effects of the COVID-19 health crises on its trend. This indicator will be further explained and graphically demonstrated for all G7 countries, thus analyzing the characteristics and evolution of lending in advanced economies.

In the first part of the paper will be analyzed the literature related to credit activities, focusing on studies conducted for advanced economies. In particular, the analysis will be carried out based on research into the characteristics and evolution of lending in G7 countries. In the second part will be studied the graphical and descriptive analysis of the evolution of the

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indicator “bank credit to the private sector as percent of GDP” for the seven advanced economies, during the years 2001-2020.

The global economic shock resulting from the COVID-19 pandemic has seen sharp changes in production and consumption patterns in the real economy, with repeated effects on credit markets. Given the severe economic impact of COVID-19, the loan can provide much-needed capital solutions to companies under pressure, helping to preserve jobs and resume economic activity.

This paper aims to contribute to the state of knowledge of the subject in the academic literature and to capture the attribution of the evolution of credit activity, as a process of undeniable importance, which promotes the economic development of the country.

2. Literature Review

A banking system has many different structural dimensions, which are difficult to capture in one measure. "By designating the coherent set of various categories of banks with domestic or foreign capital, state or private, as well as combinations thereof, operating in a country, the banking system meets the needs of each stage of economic and social development." (Spulbăr and Nițoi (2011, p.22)).

The essential role of bank credit as input in the production of goods and services places banks in a unique and influential position, so that any inefficiency of credit allocation or other market distortions in the banking sector are almost certain to be felt throughout the economy (Shaffer, 2004).

After the financial crisis of 2008, the bank credit growth fell sharply in real terms and in the following years remained moderate in most major economies and group of countries. A massive infusion of government funds and credit easing policies into advanced economies, designed to combat a recession and support bank balance sheets, has not been translated into increased lending to the private sector (Cartas and McConagha, 2010).

Over the last 30 years, credit has grown steadily in most advanced and emerging economies. At the same time, the globalization of the banking sector, the increase of cross-border asset ownership and the rapid development of securitization and financial engineering have increased the interdependence of the banking and credit markets across the country's borders. The theoretical literature on credit market frictions has highlighted the importance of credit in shaping the links between the financial market and the real economy (Gertler and Kiyotaki, 2010). On the empirical side, many have studied the relationship between economics and financial development and found that better-functioning financial intermediaries accelerate economic growth (Levine, 2005). Countries with more developed financial systems tend to grow faster, especially those with large private banks that channel credit to private enterprises and liquid stock exchanges. In particular, a negative shock to the US real credit is transmitted to the credit in the euro area, the United Kingdom, Japan and some emerging market economies with a high degree of financial openness, with a particularly profound impact on the UK, possibly due to the strong ties in banking sectors between the UK and the US (TengTeng Xu, 2012).

Credit cycles have long been a feature of advanced economies, and their analysis is relevant for monetary policy purposes. Indeed, for monetary analysis, the relevance of the evolution of credits to the private sector over the cycle stems from the fact that they are the main counterpart of money aggregation, so their assessment is necessary for understanding and interpreting monetary developments (ECB, 2011). Moreover, in the euro area, unlike the United States, bank loans are the most important source of external financing, not only for households but also for non-financial corporations. Therefore, they play a very important role in shaping the evolution of the economic activity and in transmitting the monetary policy position to the economy.

The banking system that exists in the United States is a dual banking system, in which state and national banks are leased and supervised at various levels. This translates into differences in the way credit is regulated, legal loan limits and variations in state-to-state regulations. The dual structure has stood the test of time, and most economists agree that it is necessary for a solid and vibrant banking system like the US (Kenton, 2020). The Federal Reserve (central bank) is the one that regulates money lending by establishing reserve requirements that indicate the amount of money that banks are allowed to borrow. Depending on the evolution of the US economy, the Federal Reserve will regulate different values to suit the needs of the economy at that time, using either an expansionary monetary policy or a contractionary one (Mittal, 2018). The lower the requirement, the more money the banks get to make money, because they can borrow more money.

Germany's banking system comprises three pillars: private commercial banks, public sector banks and cooperative banks, which are distinguished by their legal form and ownership structure. The pressure to strengthen further in the coming years comes from low interest rates and banking regulations in recent years, such as Basel III, which have substantially increased banks' capital requirements. German banks fear that, in particular, real estate and corporate finance could be particularly affected and could seriously restrict banks' lending capacity. However, coupled with low interest rates and extraordinarily favorable overall financing conditions, loans to companies and the self-employed increased by EUR 974 billion in 2019, up from the previous year (+ 4.3%), according to ECB analyzes (2020).

The banking sector is one of France's six main economic assets, according to the OECD. Banks finance the development of businesses, as well as individuals, very dynamically in France. Credit is one of the main growth factors. Lending activity remains both dynamic and solid. The level of non-performing loans is very low (2.5% at the end of December 2019), as the cost of risk (as a proportion of average total assets) decreased from 0.41% in 2009 to 0.11% in 2019.

Italian banks have faced an unfavorable macroeconomic environment from a stronger overall position than they did at the beginning of the 2008 financial crisis. Much has changed since then: credit risk is reduced, capitalization increases, restructuring and consolidation takes place and profitability recovers. In 2019, the quality of Italian banks' assets continued to improve steadily, both in terms of flows and the stock of non-performing loans. The impact of the pandemic crisis on credit quality will be mitigated by the effects of government measures. The restructuring and consolidation of the Italian banking sector is in a continuous development, partly induced by the change of the regulatory environment and the digital revolution.

The United Kingdom, like the United States, has a highly developed stock market that heavily finances the economy. There are more than 360 monetary financial institutions in the UK. The blockade due to the pandemic has caused a significant slowdown in bank lending to households. Consumer credit demand is projected to decline by 15.9% in 2020, the largest annual decline since registrations began in 1993. Mortgage lending is projected to increase, but only marginally, by only 2.6% in 2020 (Luttig, 2020).

Banking in Australia is dominated by four major banks: the Commonwealth Bank of Australia, Westpac Banking Corporation, Australia and New Zealand Banking Group and National Australia Bank. A feature of Australia's banking system is the use of interbank lending to help banks operate as efficiently as possible. The role of the Reserve Bank includes ensuring liquidity in the banking system, including acting as a lender of last resort in times of liquidity crisis. The Australian bank debt market started slowly until 2016, with declining loan volumes; however, it did better than overseas markets, which experienced lower activity due to the fact that sub-investment borrowers were negatively affected by the sharp fall in commodity prices (mainly oil). Refinancing has returned due to improved lending conditions, as have financing for acquisitions due to a relative increase in mergers and acquisitions (Ellison, 2018).

The Japanese banking system is comparable to that of other industrialized countries, is stable and well regulated, and offers many options for business and personal accounts. There are a variety of institutions, from large international banks to smaller regional ones. Japanese banks offer loans and mortgages at very low interest rates, however they can be difficult to insure. In addition to requiring applicants to have a certain income level, most banks will grant loans and mortgages only to Japanese citizens, permanent residents, or foreign nationals with a Japanese spouse. Demand for loans in Japan is growing again. After a decline in 2010 and 2011, the slow recovery has become visible again. In Japan, private sector credit is largely channeled through the banking system. Debt financing represents almost 60% of corporate financing, most loans being channeled through the banking system (Lam and Shin, 2012). All banks are active in housing loans and consumer loans. Loan intermediation in Japan has been affected by the average low nominal interest rate.

Banks account for about two-thirds of the business credit market in Canada. Banks are prudent lenders and are constantly working to make creditworthy companies in Canada available for lending. Banks account for 70% of total loans to businesses through commercial loans, short-term promissory notes, known as bankers' acceptances, non-residential mortgages and other credit products. Maintaining these sound and fundamental principles of prudent lending is important to Canada's banking system and also in the interests of all Canadians. Canadian banks remained strong, contributing substantially to economic growth.

The central bank's responses to COVID-19 have been extraordinary in terms of speed, size and scope. Much lighter monetary policy, the massive provision of liquidity and specific credit support for the real economy have played a role in stabilizing financial and credit conditions. The US Federal Reserve announced as many emergency programs in eight days (March 14-23, 2020) as in all of 2008. In addition, the Fed implemented more programs in 4 months than in the entire global financial crisis. On the net, there is evidence that the central bank's actions have been positive for access to credit and the real economy in very difficult times (Mosser (2020)). In response to the economic collapse, central banks, including the Fed, have launched a massive set of programs to address both the real and financial suffering caused by the pandemic (Fleming et.al. (2020)).

G7 economies are witnessing an early recovery. But whether this recovery will be rapid depends on the trajectory of COVID-19 in these countries. Central banks in advanced economies have responded quickly and strongly to these financial and economic disruptions. This has been accompanied by measures to support economic activity, including lower policy rates, the introduction of new or expanded asset purchase programs and schemes to reduce long-term interest rates and support the flow of credit to businesses, and households (Vallence and Wallis (2020)).

3. The Evolution of Bank Credit to the Private Sector in the G7 Countries

In this part of the paper, the indicator “bank credit to the private sector as percent of GDP” will be further explained and graphically demonstrated for all G7 countries, thus analyzing the characteristics and evolution of lending in advanced economies.

The Figure nr. 1. below shows the evolution of bank credit to the private sector as percent of GDP for the period 2001-2020 in the USA.

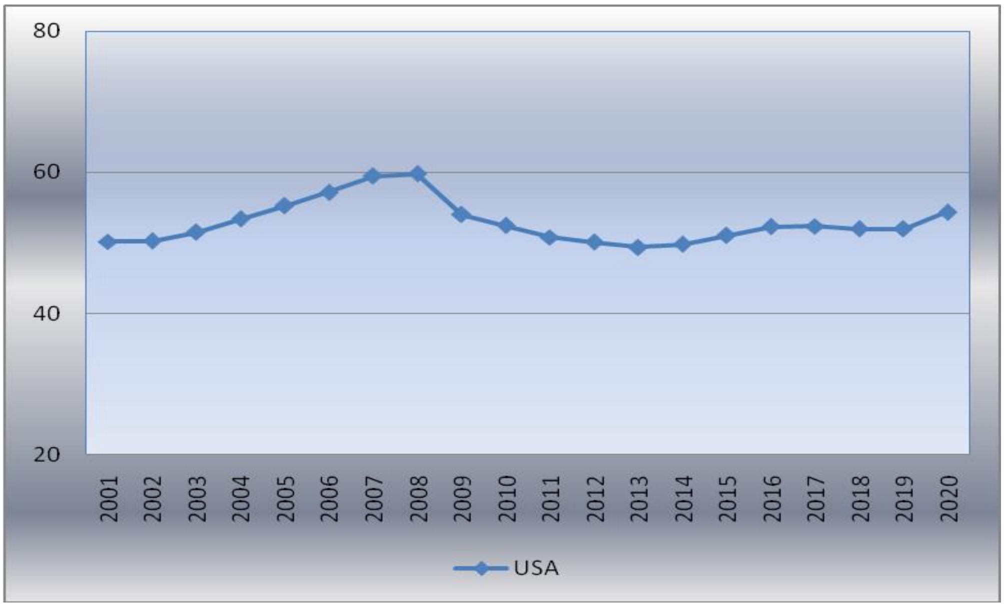

Fig. nr. 1. The evolution of bank credit to the private sector as percent of GDP (2001-2020) – USA**, Source:** own processing according to the data taken from https://www.theglobaleconomy.com/

Bank credit is an important source of financing for the business sector, but the USA is a notable exception to other countries in the world, with a highly advanced capital market, where companies can also exploit well-developed stock and bond markets to finance projects. The average value for the USA during this period was 52.86%, with a minimum of 49.36% in 2013 and a maximum of 59.78% in 2008. The most recent value in 2020 is 54.35%. In recent years, credit quality has increased for US banks. The percentage of non-performing loans is lower, credit quality problems are mainly limited to commercial and industrial loans of large banks, and credit weakness is concentrated in a small number of lending industries.

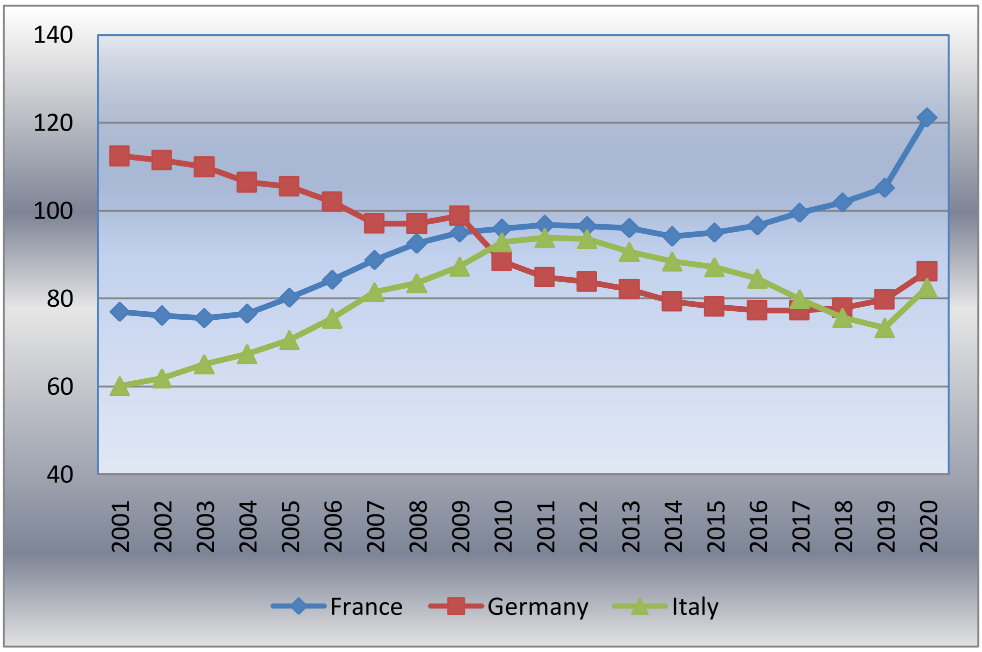

Fig. nr. 2. The evolution of bank credit to the private sector as percent of GDP (2001-2020) – France, Germany, Italy**, Source:** own processing according to the data taken from https://www.theglobaleconomy.com/

The Figure nr. 2. above shows the evolution of bank credit to the private sector as percent of GDP in France, Germany and Italy, during the years 2001-2020. The average value for France during this period was 92.24%, with a minimum of 75.55% in 2003 and a maximum of 121.19% in 2020. The most recent value in 2020 is 121.19%. The average value for Germany during this period was 91.79%, with a minimum of 77.3% in 2016 and a maximum of 112.42% in 2001. The most recent value in 2020 is 86.15%. The average value for Italy during this period was 79.79%, with a minimum of 60.12% in 2001 and a maximum of 93.92% in 2011. The most recent value in 2020 is 82.5%. From Figure nr. 2. it can be seen that Germany is the country that had high percentages of credit to the private sector in the pre-crisis period and after the crisis these values decreased more than in France and Italy.

In the Figure nr. 3. it is represented the evolution of bank credit to the private sector as percent of GDP in the United Kingdom, during the years 2001-2020.

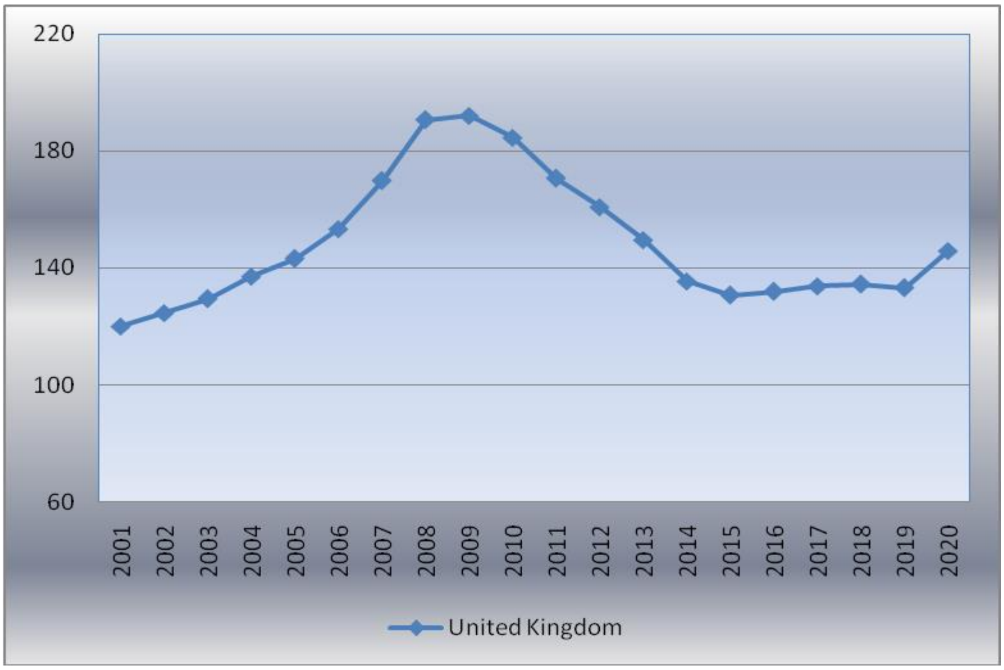

Fig. nr. 3. The evolution of bank credit to the private sector as percent of GDP (2001-2020) – United Kingdom**, Source:** own processing according to the data taken from https://www.theglobaleconomy.com/

The average value for the UK during this period was 148.57%, with a minimum of 120.15% in 2001 and a maximum of 192.12% in 2009. The most recent value in 2020 is 145.88%. Compared to other countries, the values recorded for the United Kingdom are significantly higher.

In the Figure nr. 4. below it is represented the evolution of bank credit to the private sector as percent of GDP in Japan, during the years 2001-2019. The average value for Japan in this period was 101.07%, with a minimum of 93.38% in 2004 and a maximum of 109.64% in 2019. The most recent value in 2019 is 109.64%.

Concluding, the study of the credit activity of the advanced economies of the G7 countries demonstrated the efficiency of banking systems to recover from financial crises and to maintain a very good credit rating, characterized by an upward trend in the evolution of lending. The indicator used, namely bank credit to the private sector, is a very important one related to banking development. But even these countries have had periods in which they have faced problems and decline in lending.

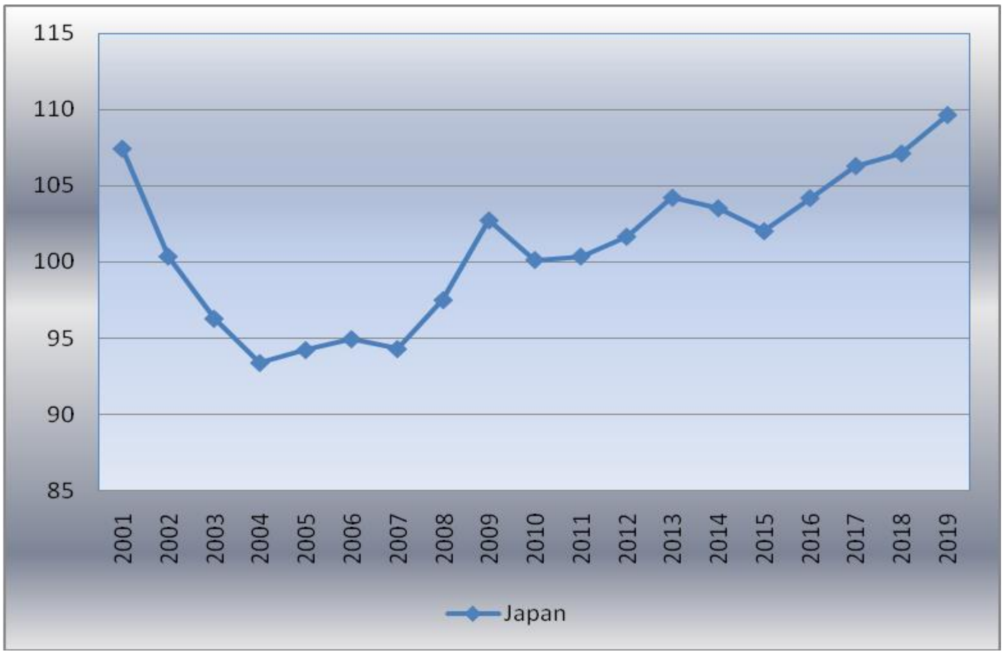

Fig. nr. 4. The evolution of bank credit to the private sector as percent of GDP (2001-2019) – Japan**, Source:** own processing according to the data taken from https://www.theglobaleconomy.com/

4. Conclusions

Bank lending to the private sector in the G7 countries stagnated after the banking crisis and declined in many key global economies in the following years. This continuing drought in bank lending in developed economies is not just a matter of appetite, it is a matter of regulation. Eager to prevent a recurrence of the banking crisis, regulators are now asking banks to hold more capital against their activities, which makes loans more expensive.

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In recent years, credit quality has increased for US banks. Germany was the country that had high percentages of credit to the private sector in the pre-crisis period and after the crisis these values decreased more than in France and Italy. Compared to other countries, the values recorded for the United Kingdom were significantly higher.

The financial system of the developed economies has maintained the overall stability, while COVID-19 continues to have a significant impact on economic and financial activity worldwide. Banks in these countries have tightened access to corporate credit amid the resurgence of the coronavirus pandemic. A tighter supply of credit could stifle growth and force some companies into insolvency, pushing up unemployment and creating a self-consolidating downward spiral.

G7 economies are witnessing an early recovery. But whether this recovery will be rapid depends on the trajectory of COVID-19 in these countries. Central banks in advanced economies have responded quickly and strongly to these financial and economic disruptions. Unlike monetary policy and liquidity instruments, many of the targeted credit programs in different countries are new to the COVID crisis. In countries with active corporate credit markets, central banks have introduced or expanded corporate bond and commercial paper purchase programs to support lending to larger firms.

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