

Moral hazard of indebted households
as a potential threat to macroeconomic stability-
observations from the
Spanish real estate bubble

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Moral hazard in the contemporary market economy

„*Moral hazard* refers to any situation in which one person makes the decision about how much risk to take, while someone else bears the cost if things go badly.”

Paul Krugman

- multiple meaning
- origins of the term
- *moral hazard* credit cycle (Roger B. Myerson)
- financial capitalism of the big government (Hyman P. Minsky)
- economics of interest groups (Mancur Olson)
- households as banks' major client
- behavioral roots of *moral hazard*
- reflexive nature of economic phenomena

Moral hazard in the economy focused on the real estate system

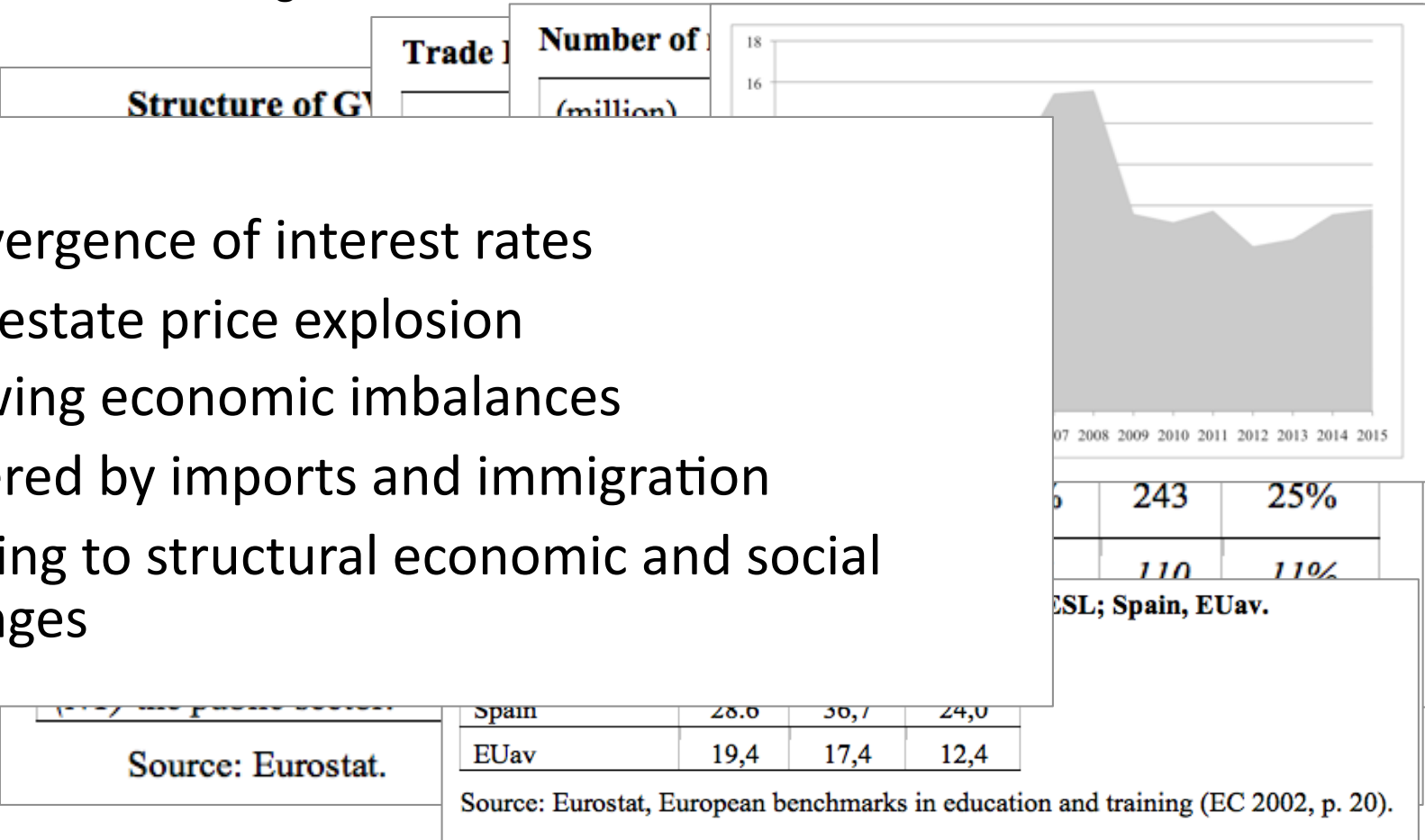
- **Banks**, supported by politicians, acting in the belief of being too big and influential to fail (*moral hazard*) use aggressive financial innovations that translate into rising real estate prices.
- **Politicians** convinced of their electoral security, act in pursuit of the desired housing policy that leads to growing debt of the society (*moral hazard*).
- **Households**, being able to purchase residential property for an acceptable portion of their current income, take liabilities paid for decades without regard to their future financial standing (*moral hazard*) and give support to politicians who offer this policy.

The Spanish economic boom and bust of the first decade of EMU

„If the Titanic sinks, the first class passengers will be sacrificed too.”

José Manuel García- Margallo

- convergence of interest rates
- real estate price explosion
- growing economic imbalances
- covered by imports and immigration
- leading to structural economic and social changes



Source: Eurostat.

Growing dependence of the economy on the banking sector

“Where is the cash flow?” Hyman P. Minsky

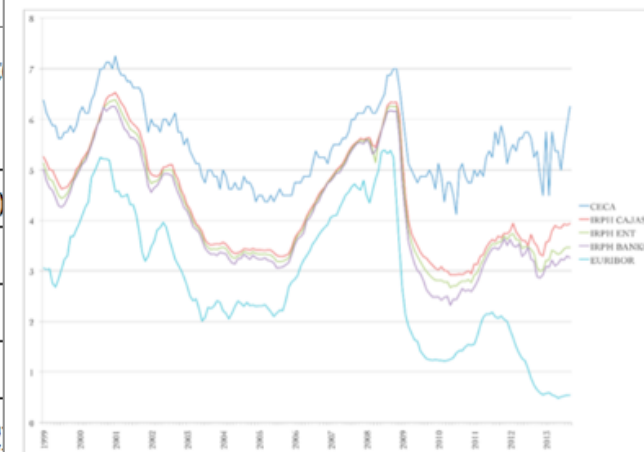
- increasing *bank bias* of the economy
- with politically influenced *cajas*
- ballooning share of real estate related lending
- with little competition in the banking sector

Capitalization of the Madrid Stock Exchange in years 1995-2015; Spain.

| (% GDP) | 1995 | 2000 |
|---------------------------|------|------|
| <i>MC</i> | 101 | 85 |
| <i>BA</i> | 177 | 181 |
| <i>BA/MC³⁷</i> | 1,8 | 2,1 |

Source: data.worldbank.org, OEC

Mortgage reference interest rates in years 1999-2013, Spain.



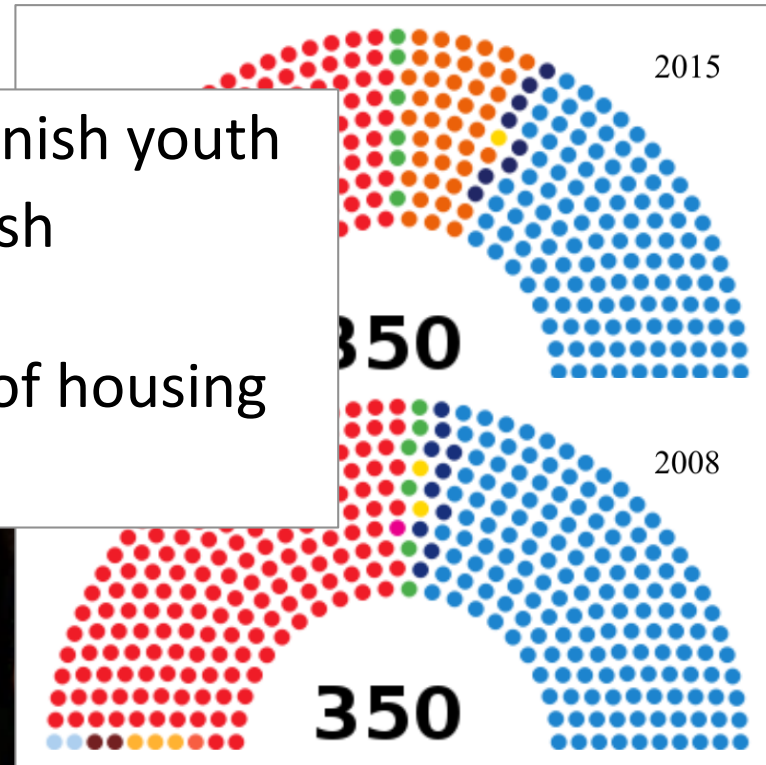
Source: BDE.

The bubble related social change reflected in remodeling of the Spanish political scene

“It's a magic night in Spain. And probably these days are the starting days for the change.”

Pablo Iglesias

- high unemployment among Spanish youth
- intensive indebtedness of Spanish households
- deterioration in the availability of housing
- evictions



100% 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016

Source: OECD.

Conclusions

Conditions leading to accumulation of *moral hazard* in the economic system

- dominant position of developed, retail, privately owned banks; resistant to foreign competition, dominated by highly political *cajas*,
- decentralization of the state's control for the regional administration, especially in the field of land management,
- the state's support of the real estate and the construction sectors,
- growing consumption of households as a result of increased employment and wages, improving optimism, boosted by falling interest rates to the historically lowest levels.

Conclusions

- Reflexive nature of *moral hazard* can impact future economic reality
- Its significance will grow, especially with regard to the observed shift of the state power-society relations, reinforced by the influence of social media, the phenomenon of fake news and self-organizing social groups
- Public opinion research necessary

Thank you for the attention!

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