Financial stability and sectoral debts: overview of research problems

Prof. Dr. Eduardas Freitakas\textsuperscript{a} and Tomas Mendelsonas\textsuperscript{b}
\textsuperscript{a}Mykolas Romeris University, eduardas.freitakas@gmail.com and \textsuperscript{b}Mykolas Romeris University, mendelsonas@mruni.eu.

Abstract
The aim of this paper is to review current research problems in analysis of relationship between financial stability and aggregated debts and define research problems which are not well explored and can inspire further researches. First, concept of financial stability was briefly reviewed and macro prudential approach explained, as the further analysis is based on this approach. Further it was reviewed what questions are raised while analyzing each aggregated debt’s impact and overall influence of all debts on financial stability. Aggregated debts are the debts of institutional sectors which are households, enterprises and government. It was noticed that most research problems concentrate on analysis of how either household debt or public debt impacts financial stability. The influence of enterprise debt is much less researched. In particular how non-financial business sector’s debt is related with financial stability of the country. And finally, the overall impacts of all aggregated debts is the least researched, therefore there is obvious need for further research problems in this area.

Keywords: Financial stability, household debt, enterprise debt, public debt.

Introduction
Financial stability is a rather new academic topic in economics. Its importance significantly increased during global economic crises which began in 2008. Events of financial instability has huge negative impact on economy and social welfare. Therefore it is very important to analyze the ways how to safeguard financial stability. Historically microeconomic point of view dominated while researching financial stability, but recently scientist agree that macroeconomic approach is required. Financial system has to be analyzed as a whole, systemic risk factors has to be identified. One of the most important source of risk for financial system is debt.

Financial stability and aggregated debts
Financial stability can be approached from two perspectives which are microeconomic and macroeconomic. Research of financial stability began from microeconomic perspective. But during last decade macroeconomic approach emerged. This approach is much less researched therefore provides more research problems which can be further analyzed.

During last two decades debts increased substantially in OECD countries (Sutherland et al., 2012). Which is a warning signal as indebtedness level is a very important variable influencing financial stability. High indebtedness level increases the sensibility of financial system to economic fluctuations. While analyzing debt dynamics and its influence to economy and financial stability debt is usually defined as three separate variables: government debt, enterprise debt and household debt. Consequently researchers raise different research problems while analyzing relationship between financial stability and each mentioned debts.
Household debt was increasing rapidly before the rise of year 2008 global crisis. Liberalization of financial markets and financial innovations stimulated investments. Credits became available for individuals with low income and it became easier to borrow for the first home (Girouard et al., 2006). Number of authors raised questions on how increased indebtedness of individuals influence financial stability (Kask, 2003; Beer and Scurz, 2007; Debelle, 2004; Davies, 2009; Santoso and Sukada, 2009; Endut and Hua, 2009).

Relationship between financial stability and enterprise debt is substantially less researched topic comparing to household case described before. Therefore it was noticed that research problems which inspire analysis of enterprise debt influence on financial stability are not well researched and need further consideration.

The relationship between financial stability and government debt is researched in the similar level as in household debt case mentioned above and much more compared to enterprise debt case. A few authors concentrate on public debt management (IMF and the World Bank, 2003; Hoogduin et al, 2010). It is also analyzed how public debt management, fiscal policy and monetary policy are related while pursuing financial stability (Togo, 2007; Dodge, 2010). Research problems concerning spill-overs between different policies are raised. Number of authors analyze last European sovereign debt crisis (Lane, 2012; Ardagna and Caselli, 2012). Different research problems are raised aiming to understand reason of European sovereign debt crisis, its progress and prevention.

The least number of research problems are analyzed while considering overall impact of all aggregated debts (household, enterprise and public debts) to financial stability. Some authors argue that it is more important to concentrate on private debt (households and enterprises) comparing to public debt while searching for policies towards financial stability (Schularick and Taylor, 2012). In the beginning of the last global financial crisis some authors analyzed relationship between increase of private borrowing and banking crisis (Schularick and Taylor, 2012), others research relationship between fiscal policy and financial crisis (Almunia et al. 2010). But there were little attention towards analysis of joint public and private debt impact on financial stability (Jorda’ et al. 2013; Schularik, 2014). This finding shows the need for research problems in that area, where complex approach is employed.

Conclusions

Most research problems are raised while analyzing how financial stability is influenced by household debt or public debt. Much less researched is the impact of enterprise debt of financial stability. In particular how non-financial business sector’s debt is related with financial stability of the country. Authors concentrate more on debt of financial institutions as they are part of financial system, but problems in non-financial enterprises may also create systemic risks to financial stability.

Finally, the least researched topic is the relationship between financial stability and all aggregated debts together. There is lack of composite approach towards aggregated debts and further research problems should be considered in this area.

As it was noticed there is not enough to concentrate on one aggregate debt, as problems on other sectors may be overlooked. Also there may occur a complex effect of all aggregated debts on financial stability. As all institutional sectors are closely interconnected and debt problems in one sector may weaken another sector’s financial situation. Therefore it is important to further consider research problems concerning overall effect of aggregated debts on financial stability.
References


Endut, N. and Hua, T.G. (2009). Household debt in Malaysia. BIS Papers, No 46.


