Referee Report for “Rapid Credit Growth and Current Account Deficit as the Leading Determinants of Financial Crises”
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1 Summary

This paper explores empirically the importance of credit boom and current account imbalance in predicting the onset of financial crisis. To this end, the author exploits a Logit model with the panel data that cover the years of 1970-2008 and a total of 50 countries. The paper compares the results between developed and developing countries and find that, for developed countries, bank credits extended to the private sector alone is predictive of an increasing risk of financial crisis. On the other hand, for developing countries, both the lagged current account imbalance and the domestic bank credit extended to private sectors are indicative of rising risks of a financial crisis.

2 General Comments

This paper deviates only marginally from Jorda, Schularick and Taylor (2010). Both papers share similar questions, and the empirical strategy of the current paper follows the other (Section 6). Moreover, in both papers, the authors find that credit expansion alone is a robust indicator of the financial crisis for developed countries. The mere new findings, argued in this paper, is that for developing countries, the previous-period current account imbalance is indicative of the rising risks of financial crises. Therefore, in my view, the contribution of the current paper to the literature is very limited.

In addition, I find the model specification on the predictive power of current account imbalance on financial crises problematic. The independent variable adopted in panel regression is the lagged current account balance as a percentage of GDP (CA/GDP). Accordingly, the significant negative coefficient for this variable should be interpreted as follows: the larger is the current account deficit before the crisis, the more likely is the financial crisis. Yet, what the literature emphasizes is the role of the deterioration of current account balance on the onset of financial crisis. To capture such a prediction, the more appropriate variable is the changes in CA/GDP, say, using a 5-year moving average. This is because such a variable better captures the changes in CA/GDP relative to its trend level several years before the onset of the crisis.

3 Specific Comments

1. Accordingly to Jorda et.al (2010), the lagged account imbalance is predictive of a national financial crisis, not a global crisis. Therefore, I wonder
whether, for developing countries, the significant predictive power of current account imbalances on financial crisis found in this paper is due to the fact that most crises happening in these countries are simply national crises. If so, then the findings in this paper are somehow in line with those in Jorda et. al (2010).

2. The dependent variable is the binary variable about the onset of banking crises. Since bank crises in reality are only a sub-category of financial crises, the author should be careful when generalizing the findings in the paper to all financial crises.

3. On page 18, the statement “Credit booms are found to be statistically significant in raising the probability of financial crisis only for developed countries” has caveat. As Table 4a and 4b shows, among developed countries, what is robust in statistical significance in predicting the banking crises is not the variable “credit boom”, but the lagged value of bank credit extended to private sector. What are the difference between these two variables? Why the later captures the credit booms?

4. What is the horizontal axis for Figure 1 and 2? Also, Figure 2 looks too small.

5. There is a typo on page 6, line 3 and 4. It should be “...83.6 percent for developed countries, ...46.8 percent or developing countries”

References