

Securitisation and Financial Stability

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Abstract

A widespread opinion before the credit crisis of 2007/8 was that securitisation enhances financial stability by dispersing credit risk. After the credit crisis, securitisation was blamed for allowing the ‘hot potato’ of bad loans to be passed to unsuspecting investors. Both views miss the endogeneity of credit supply. Securitisation enables credit expansion through higher leverage of the financial system as a whole. Securitisation by itself may not enhance financial stability if the imperative to expand assets drives down lending standards. The ‘hot potato’ of bad loans sits in the financial system on the balance sheets of large banks rather than being sold on to final investors, since the aim of financial intermediaries is to expand lending in order to utilise slack in balance sheet capacity.

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