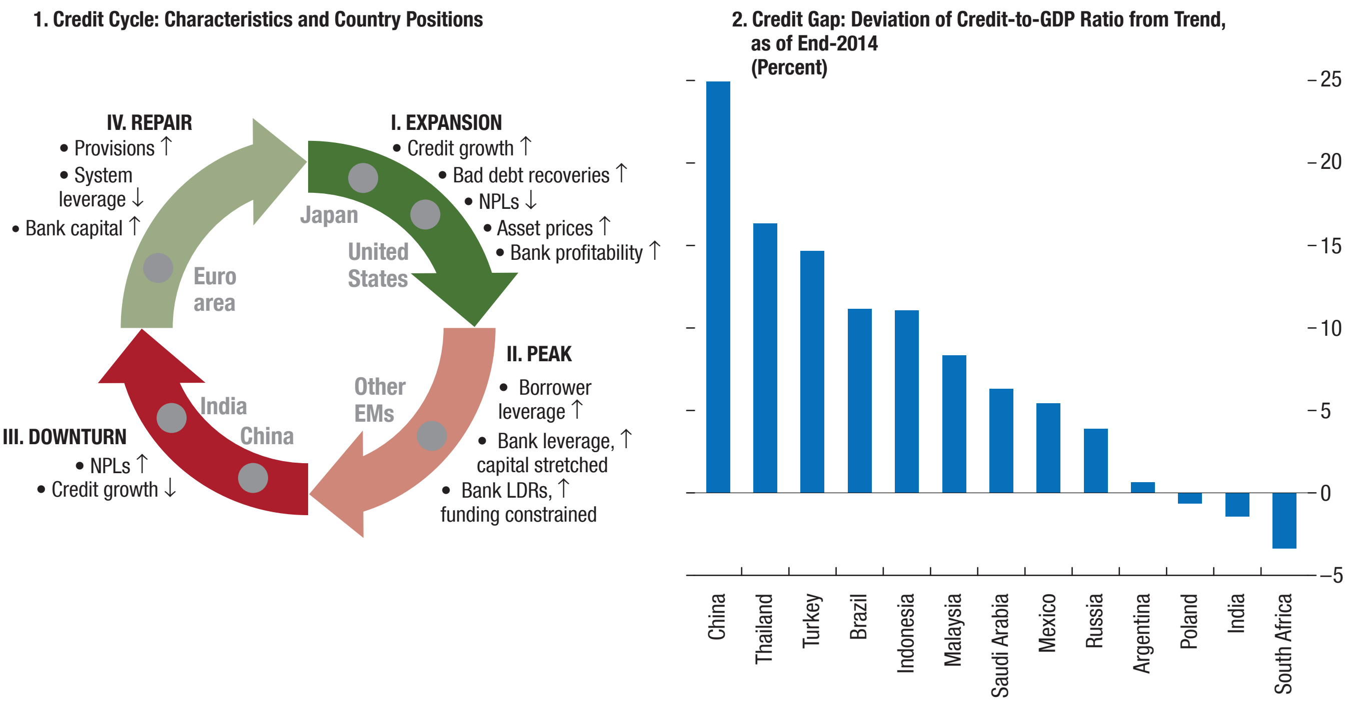
Figure 1.7. The Credit Cycle



Sources: Bank for International Settlements; Bankscope; IMF, World Economic Outlook database; national authorities; and IMF staff calculations.
Note: Credit cycles describe the consequences of credit growth on economic growth, asset quality, and leverage. In expansion, borrower profits and asset quality are robust, but high credit growth also increases banks' and borrowers' leverage. Leverage in banks and borrowers then peaks, followed by a contraction or slowdown in credit growth, downturn in asset quality, and rising nonperforming loans (NPLs). The process culminates in balance sheet repair and recapitalization, which sets the stage for a new credit cycle. The credit gap is calculated using a one-sided Hodrick-Prescott filter with a smoothing parameter of 400,000. EM = emerging market; LDR = loan-to-deposit ratio.