Why is money difficult?

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BCRA, Buenos Aires
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What is shadow banking?

“Money market funding of Capital market lending”

- Global ($) funding of local (FX) lending
- Market pricing, both money and capital
- Key role of market-making institutions
- Key role of central bank as backstop
## Shadow Banking as Global Finance

### Shadow Bank

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>FX Risky Asset</td>
<td>$ Repo</td>
<td>$ Repo</td>
<td>Capital</td>
</tr>
<tr>
<td>Credit Default Swap</td>
<td></td>
<td></td>
<td>Credit Default Swap</td>
</tr>
<tr>
<td>Interest Rate Swap</td>
<td></td>
<td></td>
<td>Swap</td>
</tr>
<tr>
<td>FX Swap</td>
<td></td>
<td></td>
<td>FX Swap</td>
</tr>
</tbody>
</table>

### Asset Manager

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Capital</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Credit Default Swap</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Swap</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>FX Swap</td>
</tr>
</tbody>
</table>
I. Banking is a Swap of IOUs

<table>
<thead>
<tr>
<th>Bank</th>
<th>Me</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td><strong>Liabilities</strong></td>
</tr>
<tr>
<td>+loan</td>
<td>+deposit</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Central Bank</th>
<th>Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td><strong>Liabilities</strong></td>
</tr>
<tr>
<td>+discount</td>
<td>+currency</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fed</th>
<th>ECB</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td><strong>Liabilities</strong></td>
</tr>
<tr>
<td>+euros</td>
<td>+dollars</td>
</tr>
</tbody>
</table>
Psychological Barriers

- Fetish of the “Real”: What is being “loaned”?  
- Alchemy resistance: Something from nothing?  
- Negative numbers: Currency a liability?
II. Essential hybridity

• Central Bank as Bankers’ bank
  – Private sector, peace time, private profit
  – Backstop for money market funding (flow)
  – Backstop for capital market lending (stock)

• Central Bank as Government bank
  – Public sector, war time, public purpose
  – Backstop for war debt issuance (flow)
  – Backstop for government debt market (stock)
Political Barriers

• Left: Chartalism, Knapp, MMT
  – Money as creation of the state, authority

• Right: Metallism, Menger, Austrian
  – Money as creation of the marketplace, trust

• Contradictions/Dynamics of Hybridity
  – Symbiosis: Parasitism vs. Mutualism
III. Inherent Hierarchy

1. Dollar
2. C6 Swap Line
3. Bilateral Swaps, Regional Pooling, IMF
4. National Money
5. National Credit
Ideological Barriers

• Westphalian ideology: sovereignty as equalizer
• Economic ideology: markets as equalizer
IV. Inherent Instability of Credit

• Credit anticipates uncertain future
  – Mistakes are inevitable; externalities and herding
  – Money doesn’t manage itself

• Older Versions
  – Hawtrey, trade credit
  – Keynes/Minsky, business investment and credit

• New Market Based Credit
  – Household mortgage credit, not business
  – Capital market securitization, not bank lending
  – Global money market funding, not domestic deposits
Equilibrium Thinking Barrier

• Prices “clear” markets, by equating fundamental supply and demand
• Time is just an additional dimension of commodity space
• Instability comes from outside, key issue is absorbing exogenous shock
V. Economics not much help

• Technocratic management obscures politics
  – Business cycle stabilization
  – Inflation targeting

• Academic debate obscures institutional reality
  – Fiscal policy versus Monetary Policy
    • IS/LM versus MV=PY
  – Active Management versus Laissez Faire
    • Discretion versus Rules
  – “New Synthesis” and “Great Moderation”
    • Taylor Rule
Monetary Walrasianism barrier

- Marschak 1934 (Classical?)
  \[ q_i = \sigma_i\left(\frac{P_i}{W}\right) = \delta_i(p_1, p_2 \cdots w \cdot e), \]
  \[ \sum p_i q_i = w \cdot e = MV, \]
  \[ P = \lambda(p_1 \cdots p_n, q_1 \cdots q_n). \]

- Marschak 1938 (Neoclassical?)
  \[ \frac{p}{q} = \frac{U_x \frac{dx}{da} + U_y \frac{dy}{da} + \ldots}{U_x \frac{dx}{db} + U_y \frac{dy}{db} + \ldots}. \]
VI. Financial Globalization

• “an effective, smoothly functioning international capital market is itself an instrument of world economic growth, not a nuisance which can be disposed of and the functioning of which can be transferred to new or extended inter-governmental institutions....”

• “the main requirement of international monetary reform is to preserve and improve the efficiency of the private capital market while building protection against its performing in a destabilizing fashion.”

(Kindleberger et al, 1966)
Triple Threat

• Big Government
• Big Finance
• Big Wide World
What is shadow banking?

“Money market **funding** of Capital market **lending**”

• **Global** ($) funding of **local** (FX) lending
• **Market pricing**, both money and capital
• Key role of **market-making** institutions
• Key role of **central bank as backstop**
The Money View

• Banking as a Payments System
  – Copeland (1952): A Moneyflow Economy
  – Minsky (1957): The Survival Constraint

• Banking as a Market Making System
  – Hawtrey (1919): Hierarchy of Money and Credit
  – Hicks (1989): Centrality of the Dealer Function
  – Bagehot (1873): Dealer of Last Resort
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