

IS THE GLOBAL ECONOMY – 'SAFER, SIMPLER & FAIRER' - as FSB CLAIMS?

Prime
POLICY RESEARCH IN MACROECONOMICS

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www.primeeconomics.org



FINANCIAL
STABILITY
BOARD

THE CHAIRMAN

3 July 2017

To G20 Leaders

A decade after the start of the global financial crisis, G20 reforms are building a safer, simpler and fairer financial system.



1. UNDERSTANDING THE SYSTEM

2. GLOBAL ECONOMY

3. THE OUTLOOK



Presentation title
DATE

UNDERSTANDING MONEY AND MONETARY SYSTEM



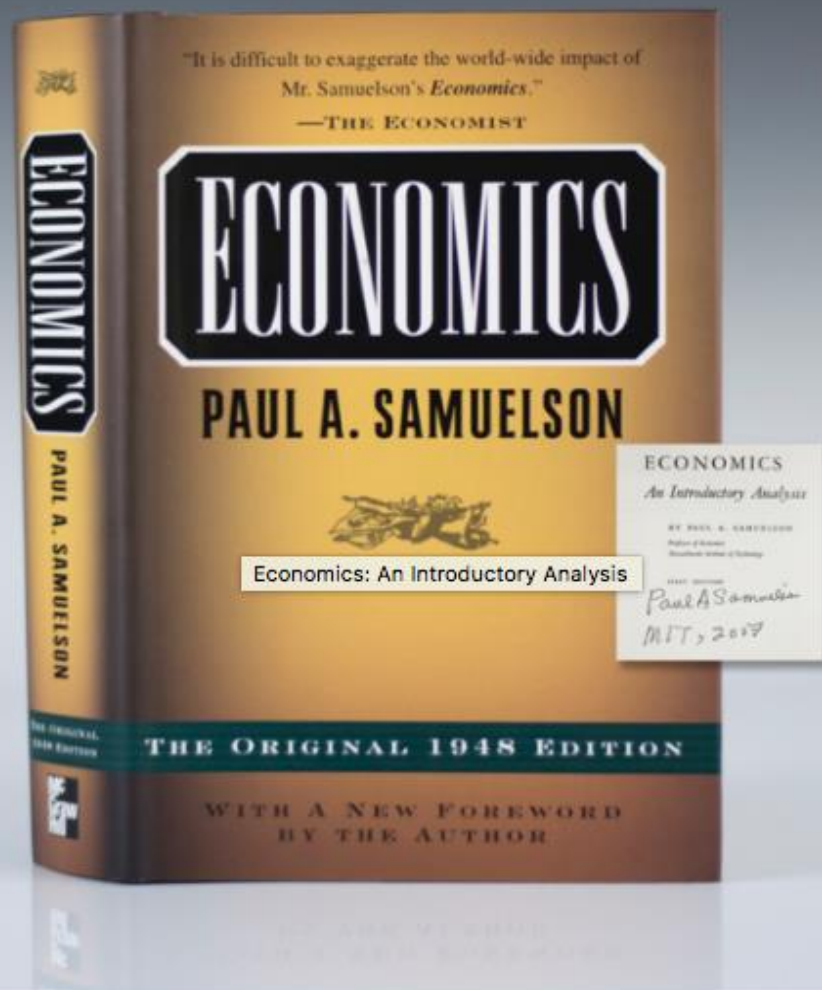
Presentation title
DATE

‘MONEY AS COMMODITY’





Orthodox, neoclassical economic models suggest that finance is a “veil” and not an independent source of risk.

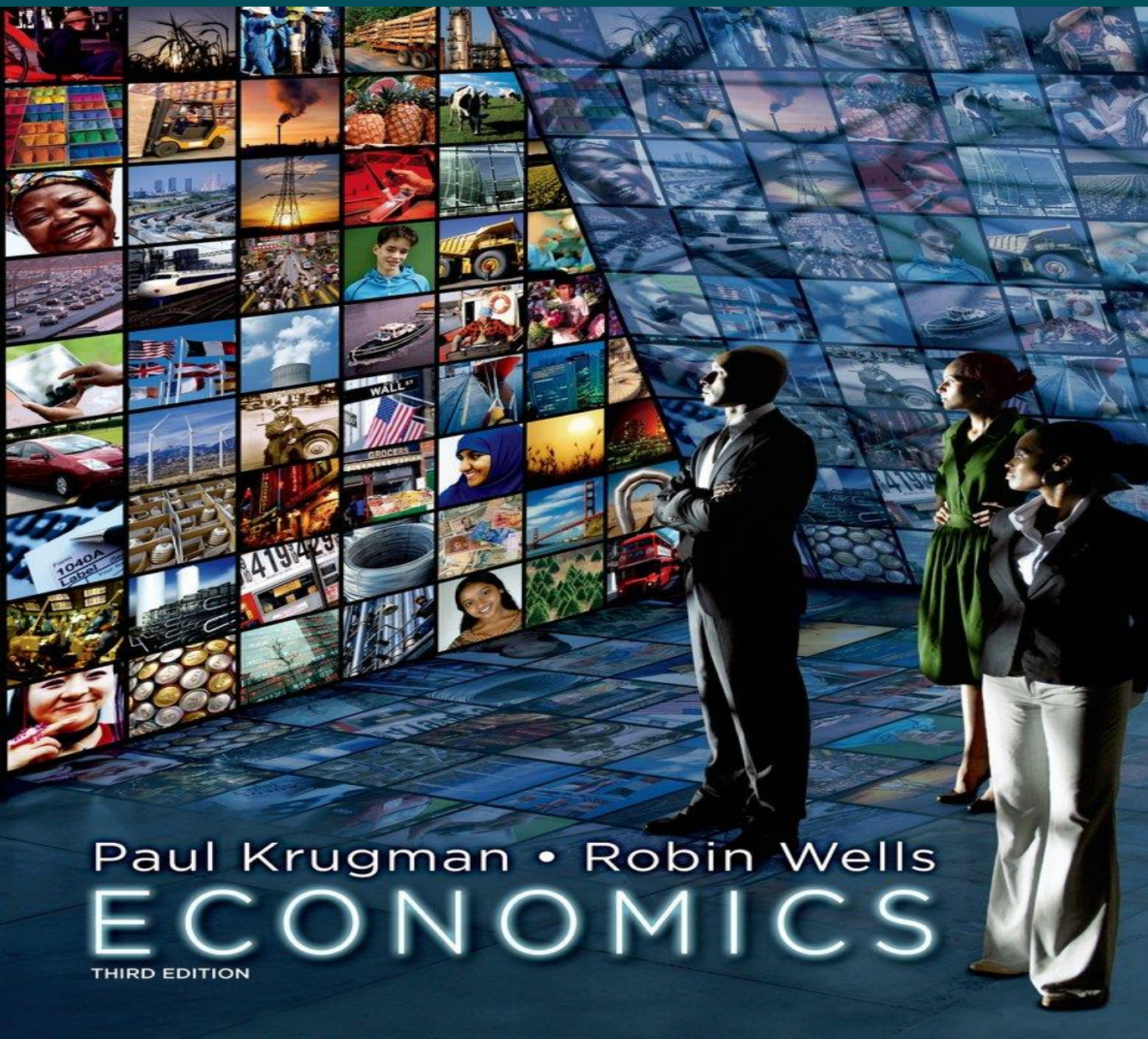


“Even in the most advanced industrial economies, if we *peel off the obscuring layer of money*, we find that trade largely boils down to barter.”

Paul Samuelson



Presentation title
DATE

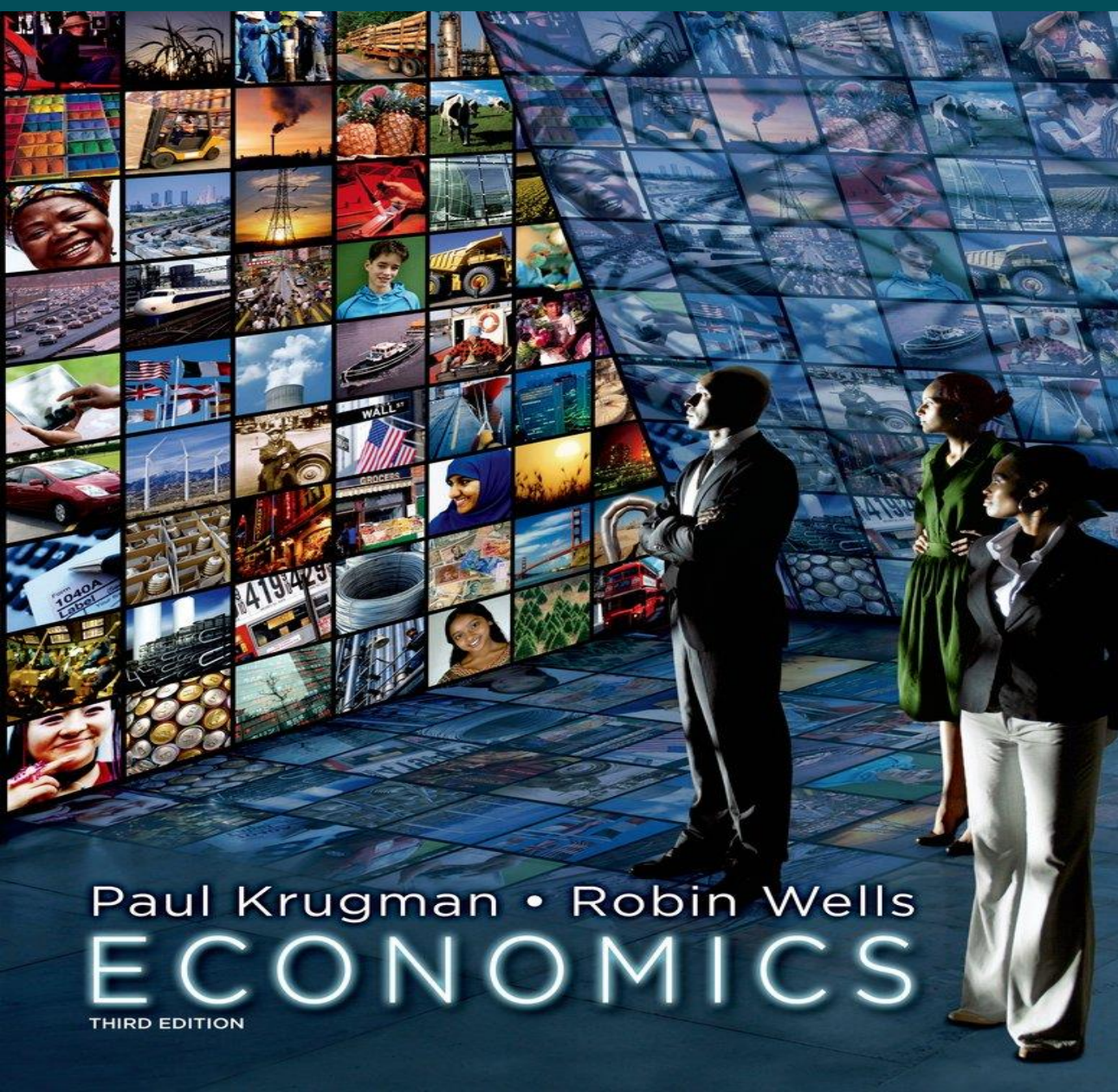


Bank: “a financial intermediary.”

Paul Krugman and Robin Wells



Presentation title
DATE



Loan: “a lending agreement between an individual lender & an individual borrower.”

Krugman and Wells:



BANK OF ENGLAND

“The majority of money in the modern economy is created by commercial banks making loans.”

Quarterly Bulletin 2014 Q1





Borrowers CREATE the money supply

- OR -

CONTRACT the money supply



“Credit and credit alone is money.

Credit and not gold or silver” (or Bitcoin) “the acquisition of which is the aim and object of all commerce.”

Mitchell Innes ‘What is Money’ May, 1913.



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LOANS





PRIVATE COMMERCIAL BANKS

– Not the Central Bank

- ‘PRINT’ THE MONEY SUPPLY



Private, licensed, commercial banks “print”

- 99% of Broad Money in the US

- 95% of Broad Money in the UK



SAVINGS NOT NEEDED FOR INVESTMENT

The money for a loan is not in the bank when a borrower applies for a loan.



BANK OF ENGLAND

“Banks do not act simply as intermediaries, lending out deposits that savers place with them,

...

and nor do they ‘multiply up’ central bank money to create new loans and deposits.”

Quarterly Bulletin 2014 Q1



Once loan application made, collateral supplied, interest rate agreed, contract signed...hey presto..





DEREGULATION OF MONEY- CREATION, POST 1960s



LIFTING OF MACROPRUDENTIAL TOOLS/MEASURES TO TARGET CREDIT DEVELOPMENTS



(i) demand-side measures, such as limits on loans-to-value ratios, margin requirements, loan maturities, and tax policies;



(ii) and supply-side actions, including lending and interest rate ceilings, reserve and capital requirements, portfolio restrictions, and supervisory guidance.



‘REGULATION Q’ in the US placed limits on interest that banks could offer savers to attract deposits.

Phased out 1981–1986 by Depository Institutions Deregulation and Monetary Control Act of 1980.



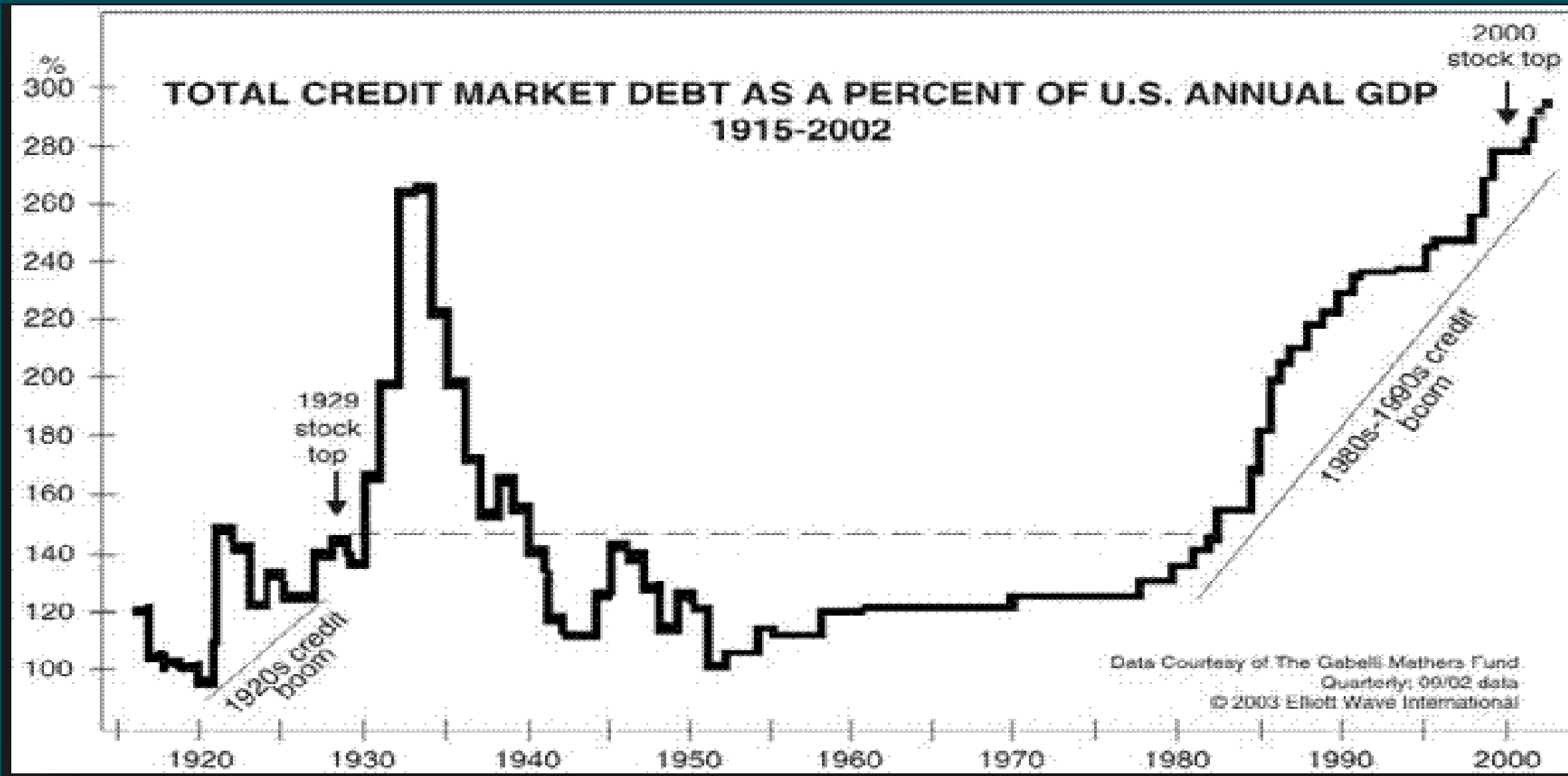
COMPETITION AND CREDIT CONTROL – 1971

“All Competition and No Control”



IN THE US THE 1969 CREDIT CONTROL ACT

- phased out in 1982.





External financial assets and liabilities around 110% of GDP in 1900, troughed in 1945 at about 25%, and soared to around 400% of GDP in 2015.



UK financial sector and government borrowing has continued to grow since 2008

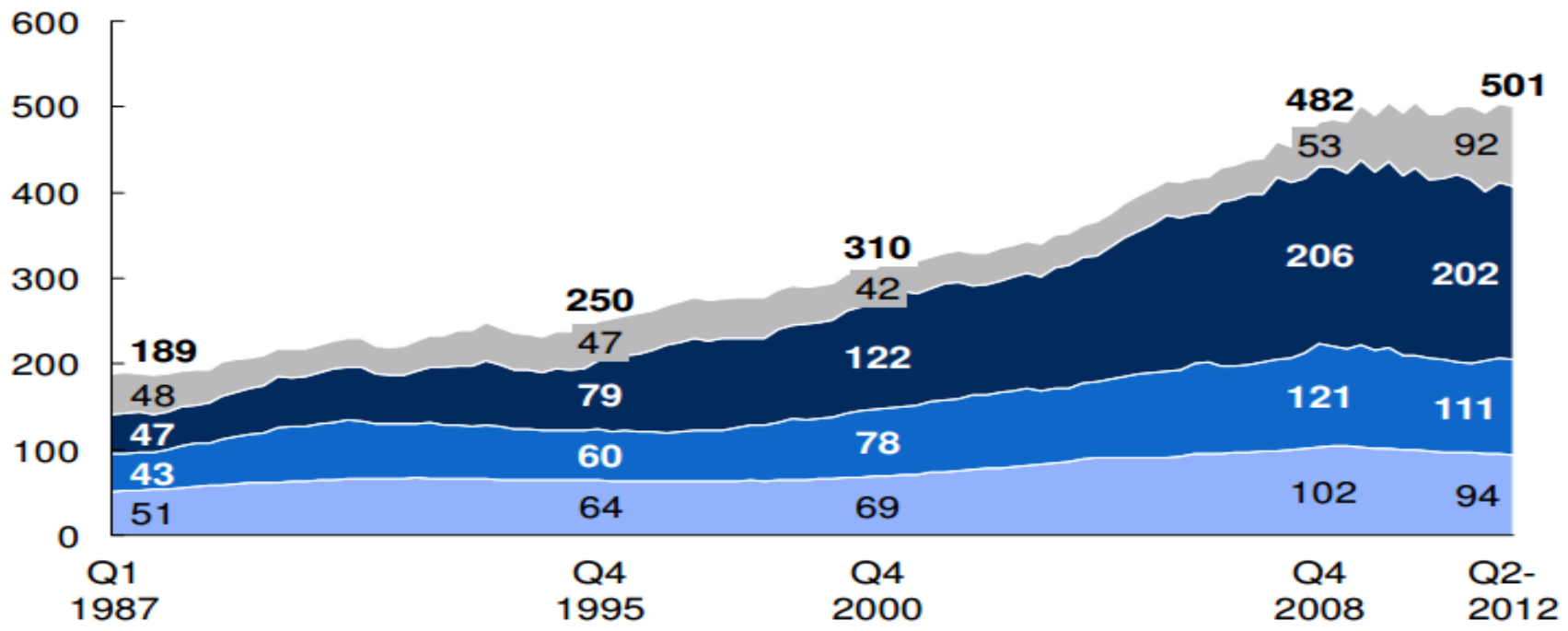
Debt¹ by sector, 1987–2012Q2
% of GDP

- Government
- Financial institutions
- Nonfinancial corporations
- Households



McKinsey&Company

Rectangular Snip



Change	
Percentage points	
Q4 2000– Q4 2008	Q4 2008– Q2 2012
172	18
11	41
85	-4
43	-10
34	-8

¹ Includes all loans and credit market borrowing (e.g., bonds, commercial paper); excludes asset-backed securities to avoid double-counting of the underlying loan.
NOTE: Numbers may not sum due to rounding.



BANK FOR INTERNATIONAL SETTLEMENTS

“The global stock of external assets and liabilities rose nearly 190 percentage points between 2000 and 2007.”

BIS 87th Annual Report 25 June, 2017.



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THE RATE OF INTEREST



“Henceforth bank lending controlled on the basis of cost, that is, through interest rates...”

Duncan Needham *UK Monetary Policy from Devaluation to Thatcher, 1967-82*
2014. P. 3



“Loans would be granted to those companies and individuals that could pay the highest rate, rather than those that fulfilled authorities’ qualitative criteria.”

Duncan Needham, as above.



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“Adjustable rate mortgages on FIVE houses “and a condo”” *The Big Short.*



Figure 3: UK real interest rates by decade, percentage points

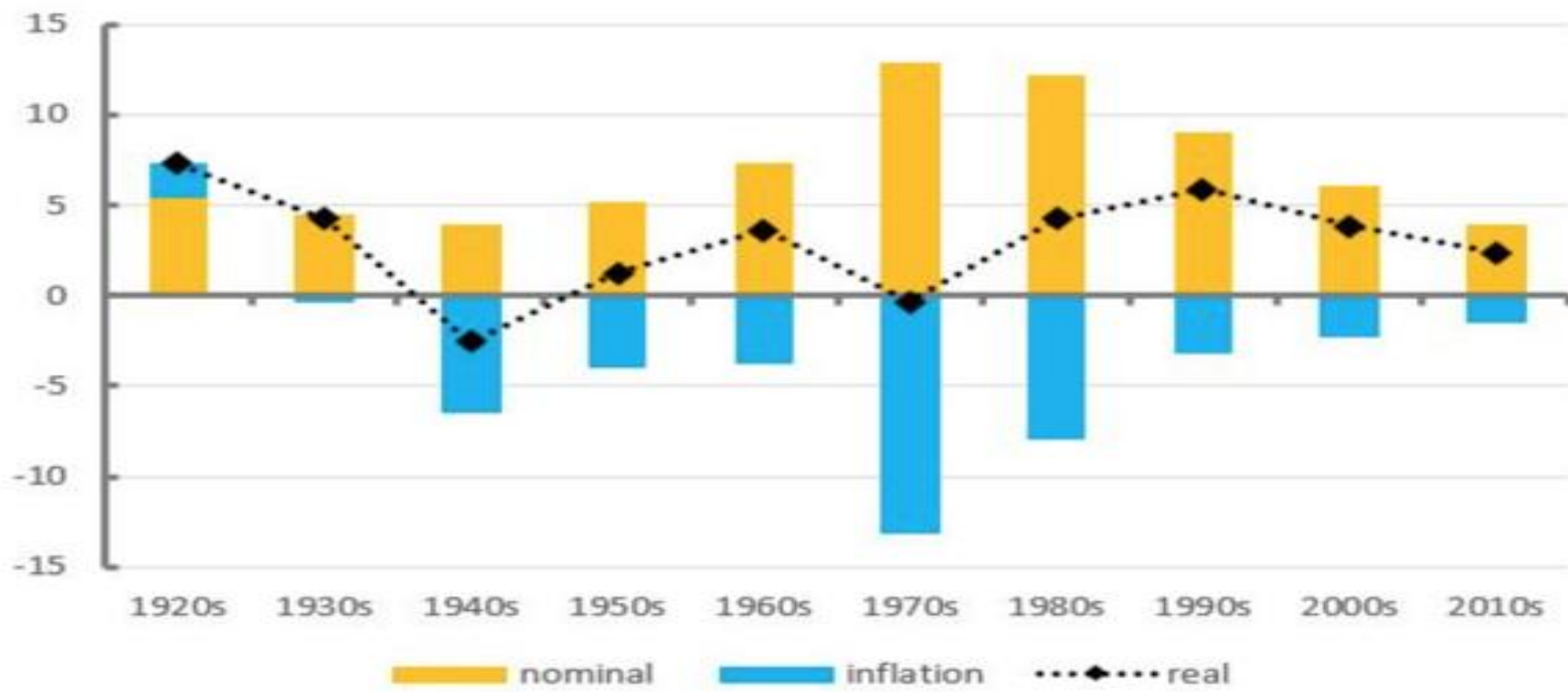
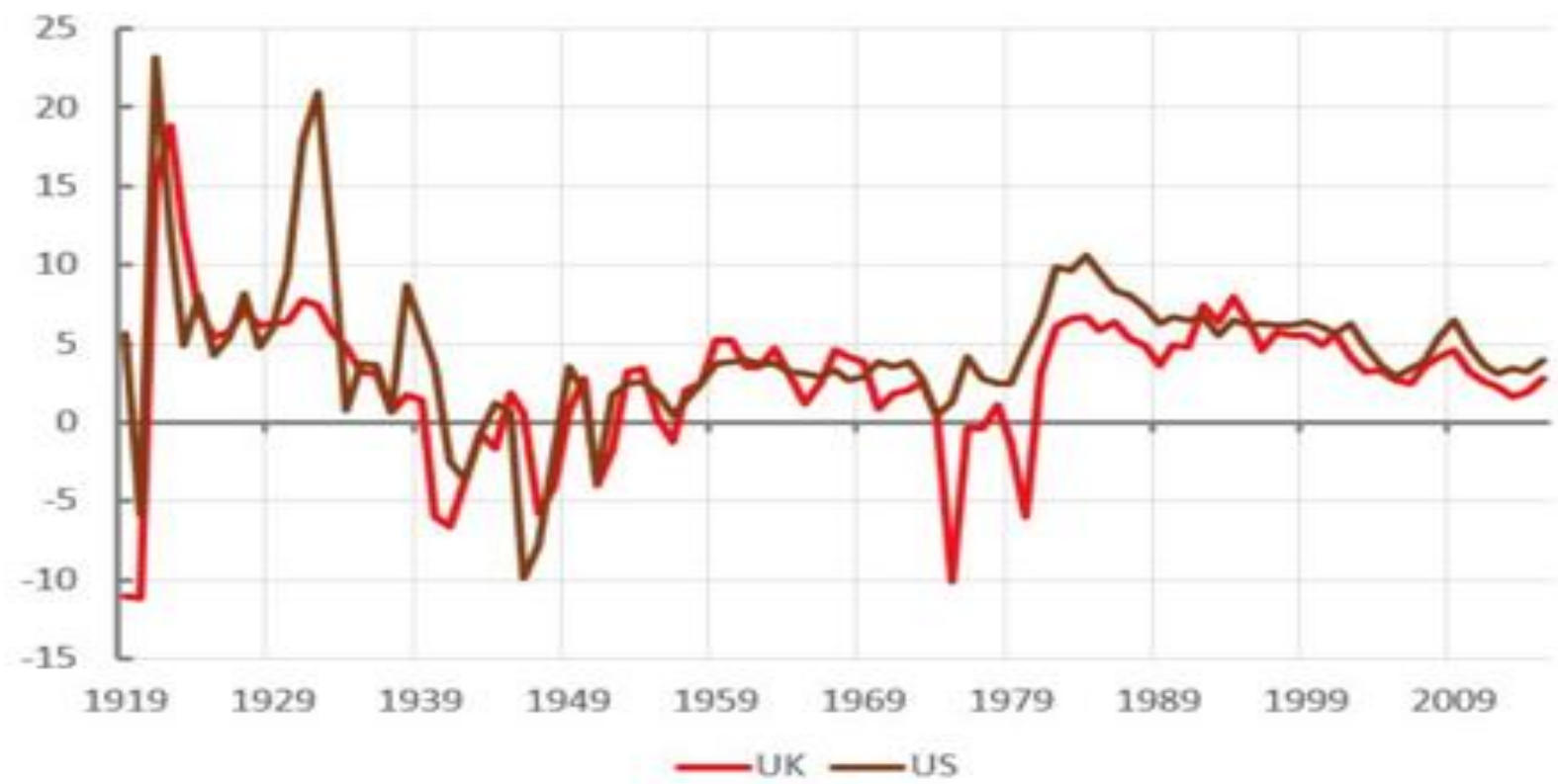


Figure 2: UK and US long-term corporate real rates of interest



Movements can be examined in more detail by decomposing real rates into nominal rates and price change. For clarity figure 3 shows the decomposition by decade (inflation is shown with a negative sign), and figure 4 shows decade to decade change. (R is nominal rate; P is inflation and r the real rate.)



The rate of interest

“the villain of the piece”

(Keynes)



International Interest Rates

Rises and falls and the financial crisis

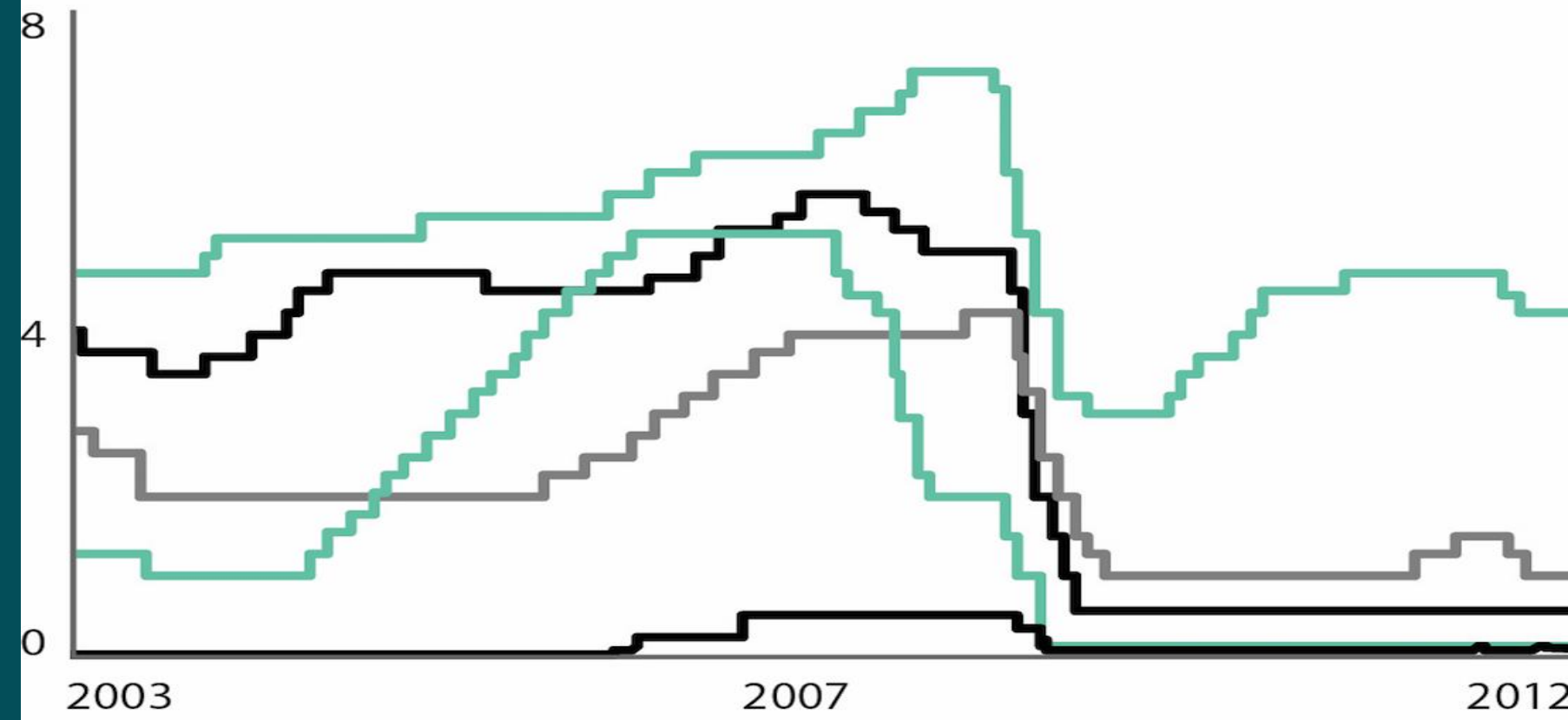


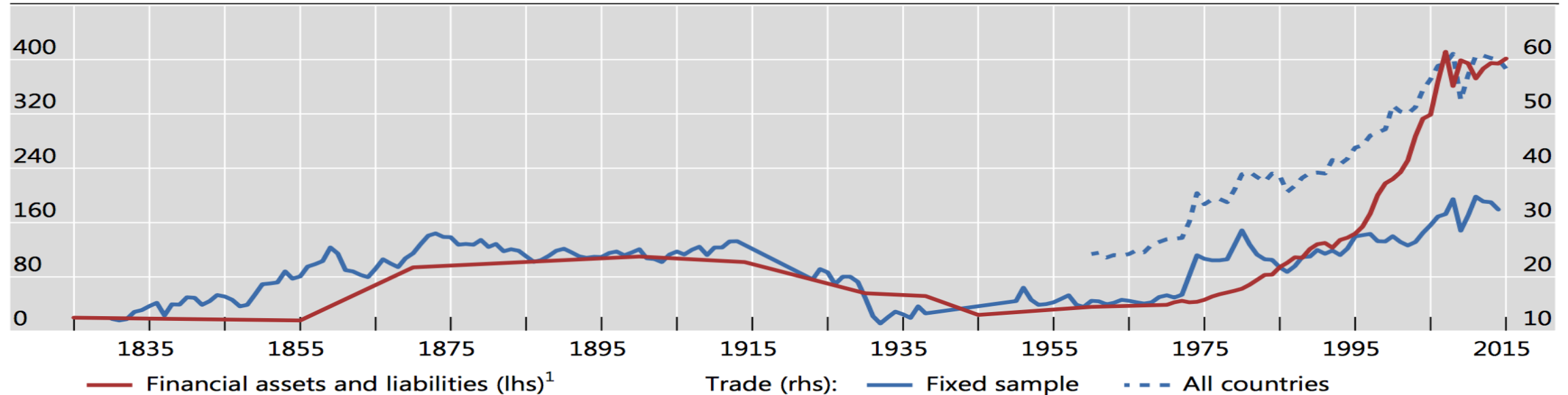
Chart taken from presentation
by Richard Koo, Chief Economist,
Nomura Research Institute, Tokyo,
to the INET Conference, Berlin,
14th April, 2012.



The two historical waves of economic globalisation

As a percentage of country sample GDP

Graph 1



¹ Prior to 1970, calculated as external financial assets multiplied by two.

Sources: G Federico and A Tena-Junguito, "A tale of two globalizations: gains from trade and openness 1800-2010", *Review of World Economics*, pp 1-25, August 2017; P Lane and G Milesi-Ferretti, "International financial integration in the aftermath of the global financial crisis", *IMF Working Papers*, no 17/115, May 2017; M Obstfeld and A Taylor, "Global capital markets: integration, crisis, and growth", Cambridge University Press, 2004; Federal Reserve flow of funds accounts; IMF, *Balance of Payments Statistics*; World Bank; US Department of the Treasury; McKinsey Global Institute analysis; BIS calculations.





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THE GLOBAL ECONOMY TODAY





Global Debt

2007 = 269% GDP

2015 = 286% of GDP

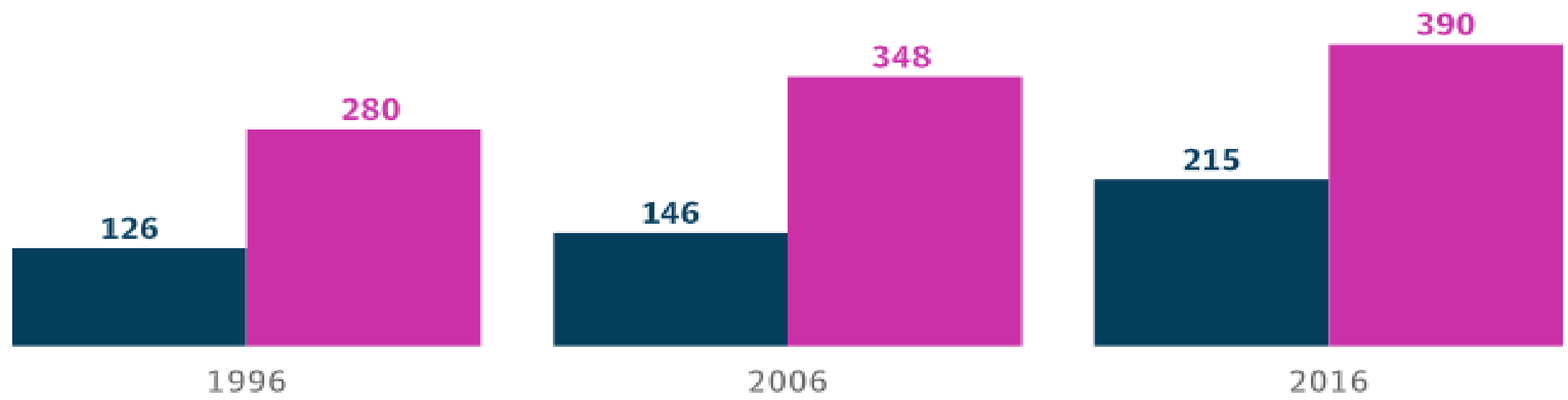
2017 = 325% of GDP

McKinsey, as above. IIF, 4 April, 2017.



Global debt has ballooned *% of GDP*

◆ Emerging markets ◆ Mature markets



SOURCE: IIF, BIS, HAVER

Source: Daily Telegraph: Global debt explodes at 'eye-watering' pace to hit £170 trillion. 04 April, 2017.



"Platform Capitalism" Monopolies, Rentierism (un-earned wealth)



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airbnb



Alibaba Group



UBER





COLLATERAL – at the heart of the GFC

CAUSE OF THE NEXT CRISIS?



Traditional Banking

- Bank money arises from credit creation via relationship banking, funding assets held to *maturity*



SHADOW BANKING?

- Shadow money arises from credit creation through securities markets, funding securities (collateral) that are *continuously* re-priced in repo transactions

(Peer 2015 quoted by Daniela Gabor, as above.)



Zoltan Pozsar, Tobias Adrian, Adam Ashcraft, and Hayley Boesky

Fed Reserve Bank of NY

Economic Policy Review

18 July, 2013.

SHADOW BANKING

- Shadow banks are financial intermediaries that conduct maturity, credit, and liquidity transformation without explicit access to central bank liquidity or public sector credit guarantees.
- The banks have played a key role in the market-based financial system, particularly in the run-up to the financial crisis.



FSB: "Banks (the Big Four) are considerably stronger, more liquid and more focused."





August 9, 2007 (Reuters)

BNP Paribas: “The complete evaporation of liquidity in certain market segments of the U.S securitisation market has made it impossible to value certain assets fairly, regardless of their quality or credit rating”



“Securities lending largely responsible for the collapse of
AIG when the market seized in September, 2008.”

Stephen C. Cecchetti and Kermit L. Schoenholtz. BIS November, 2016.



“Assets Under Management (AUM) are currently estimated at around \$87 trillion globally.”

(TheCityUK (2013)).

Andy Haldane, Bank of England:
The Age of Asset Management, April, 2014.



- AUM: Market-based banking model
 - Increased activities in securities and derivatives markets
 - Cross border
 - Off-balance sheet (shadow banking)

Daniela Gabor, Presentation to PRIME event, 09 August, 2017

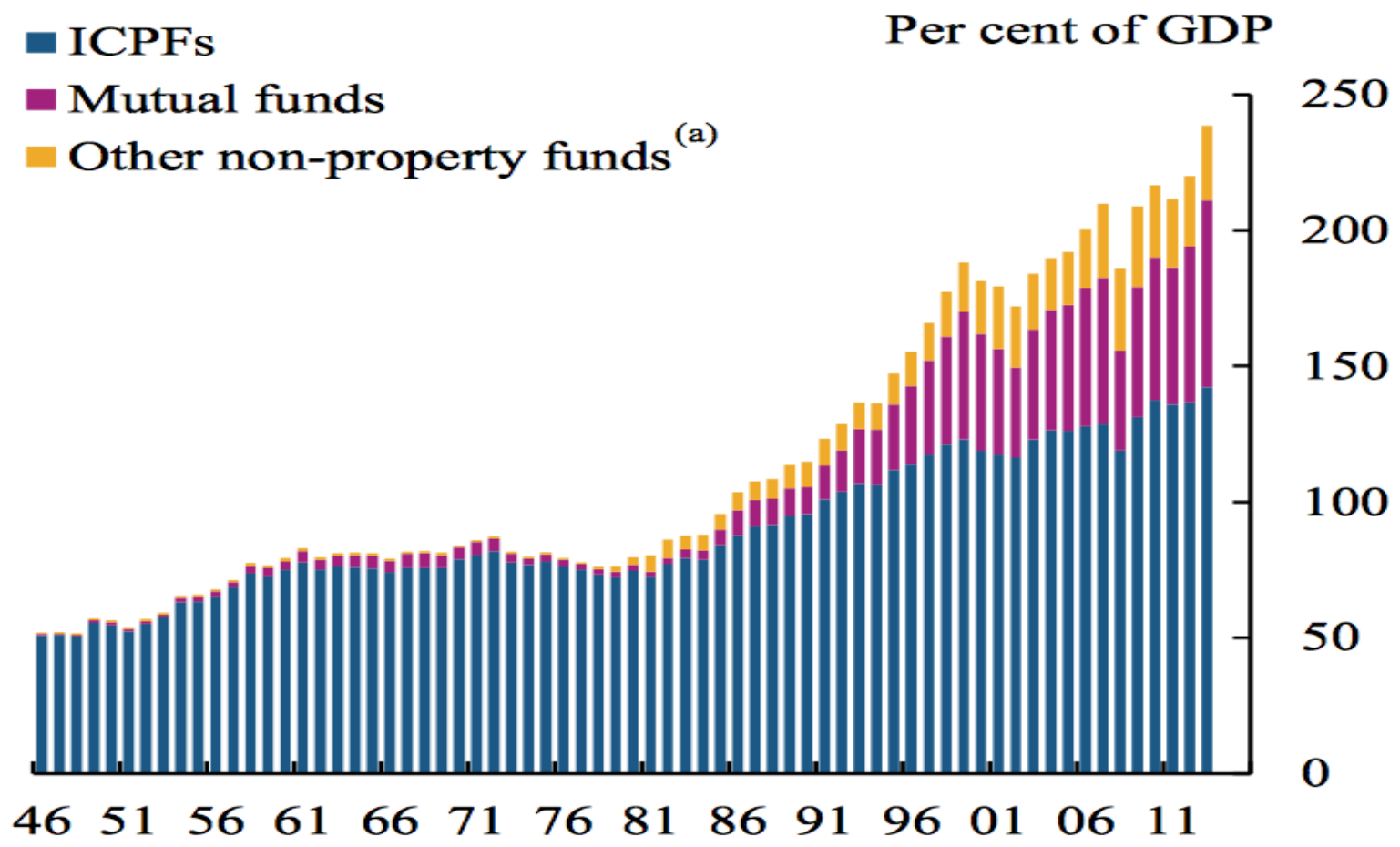


Bank of England

The Age of Asset
Management?

Andy Haldane,
April, 2014

Chart 1 Total AUM of US insurance companies, pension funds, mutual funds and other funds, 1946 – 2013

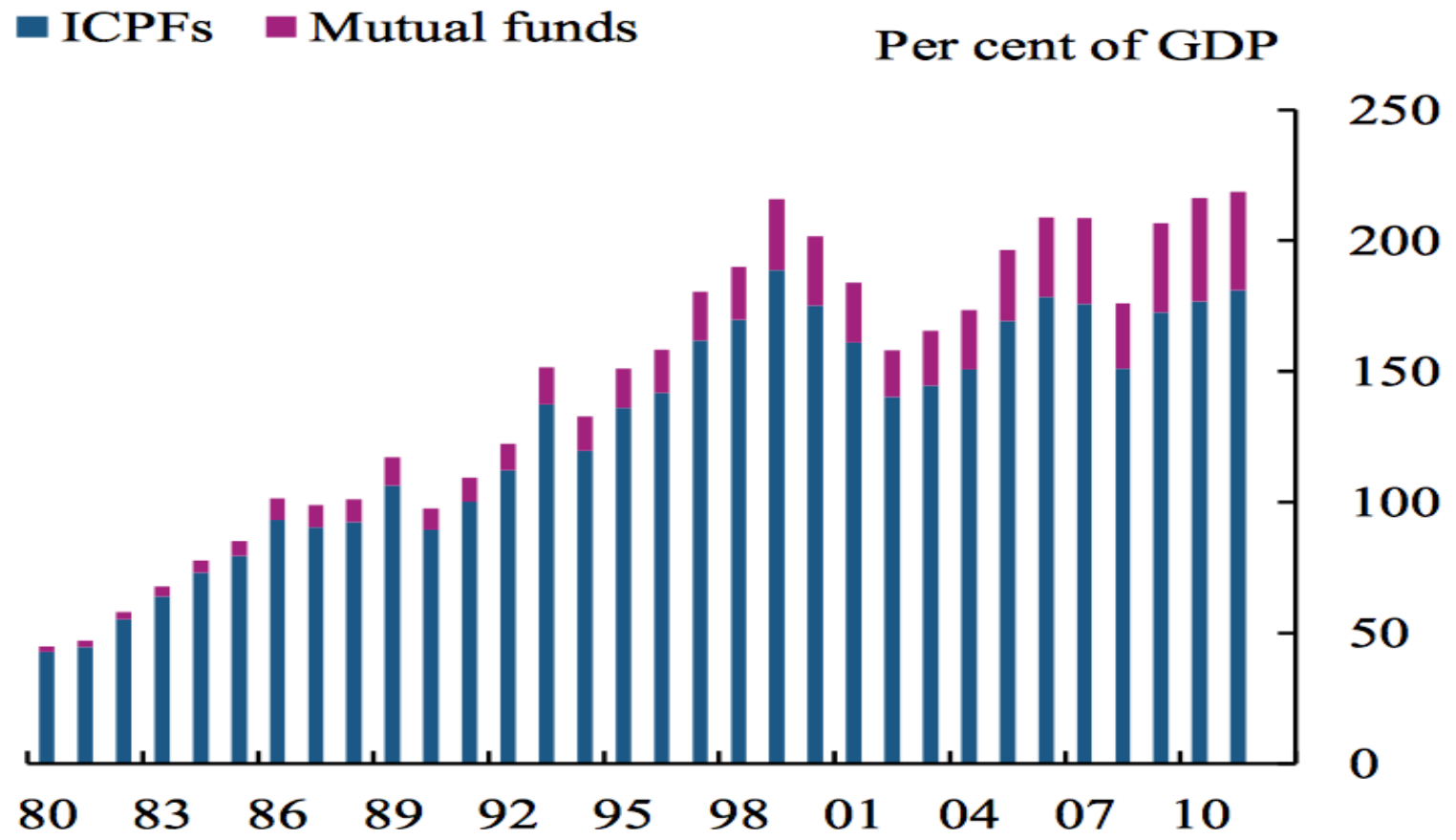


Source: US flow of funds

(a) Other non-property funds include closed-end funds, exchange-traded funds and money market mutual funds



Chart 2 Total AUM of UK insurance companies, pension funds and mutual funds, 1980 – 2012



Source: OECD, ONS, Investment Management Association and Bank calculations

Bank of England

The Age of Asset
Management?

April, 2014



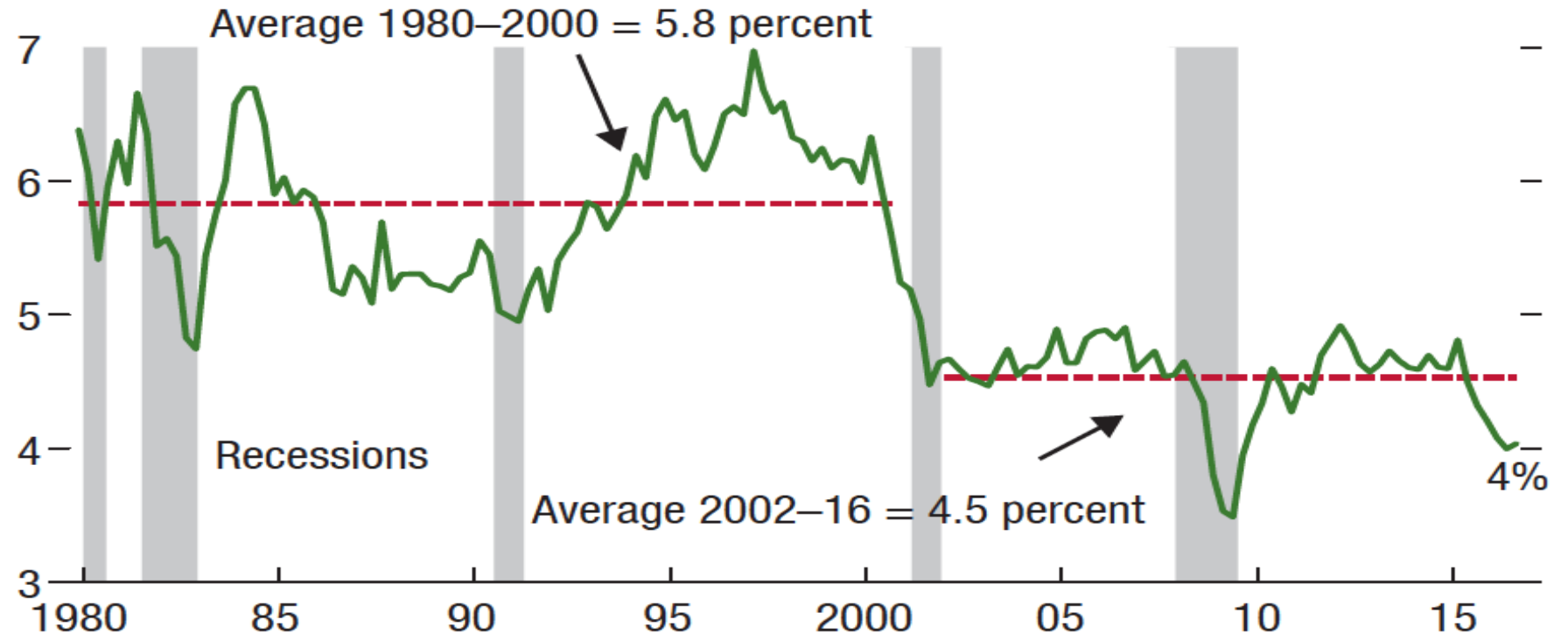
The U.S. Federal Reserve raised short-term interest rates in December 2016 and March 2017, as expected, with markets pricing in two additional rate increases by the end of 2017 or early 2018.



BACK IN THE REAL WORLD...



2. Capital Expenditures as a Share of Total Firm Assets (Nonfinancial corporate sector; percent)

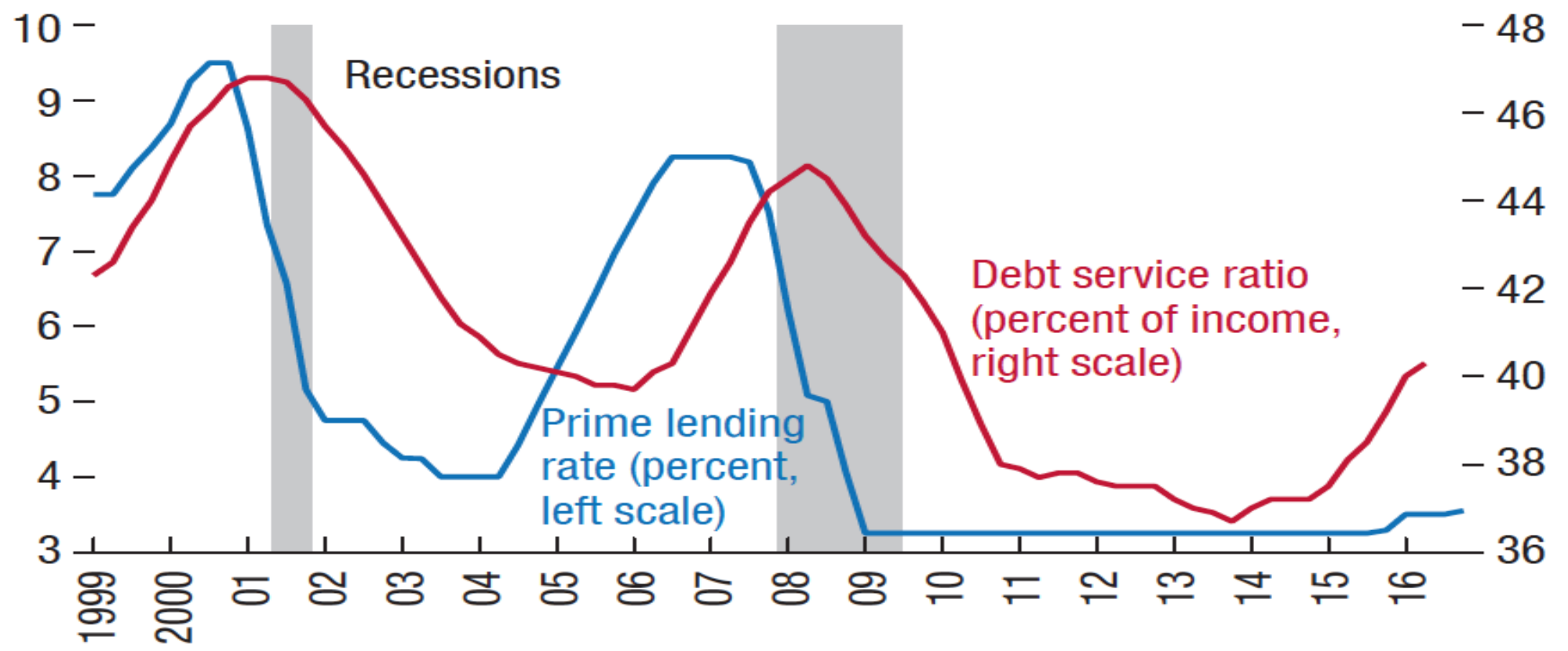


Sources: Federal Reserve; National Bureau of Economic Research; National Federation of Independent Business; and IMF staff estimates.
Note: Shaded areas indicate economic recessions.



The debt service burden for the corporate sector as a whole has risen strikingly despite low rates.

1. Corporate Debt Service and Interest Rates



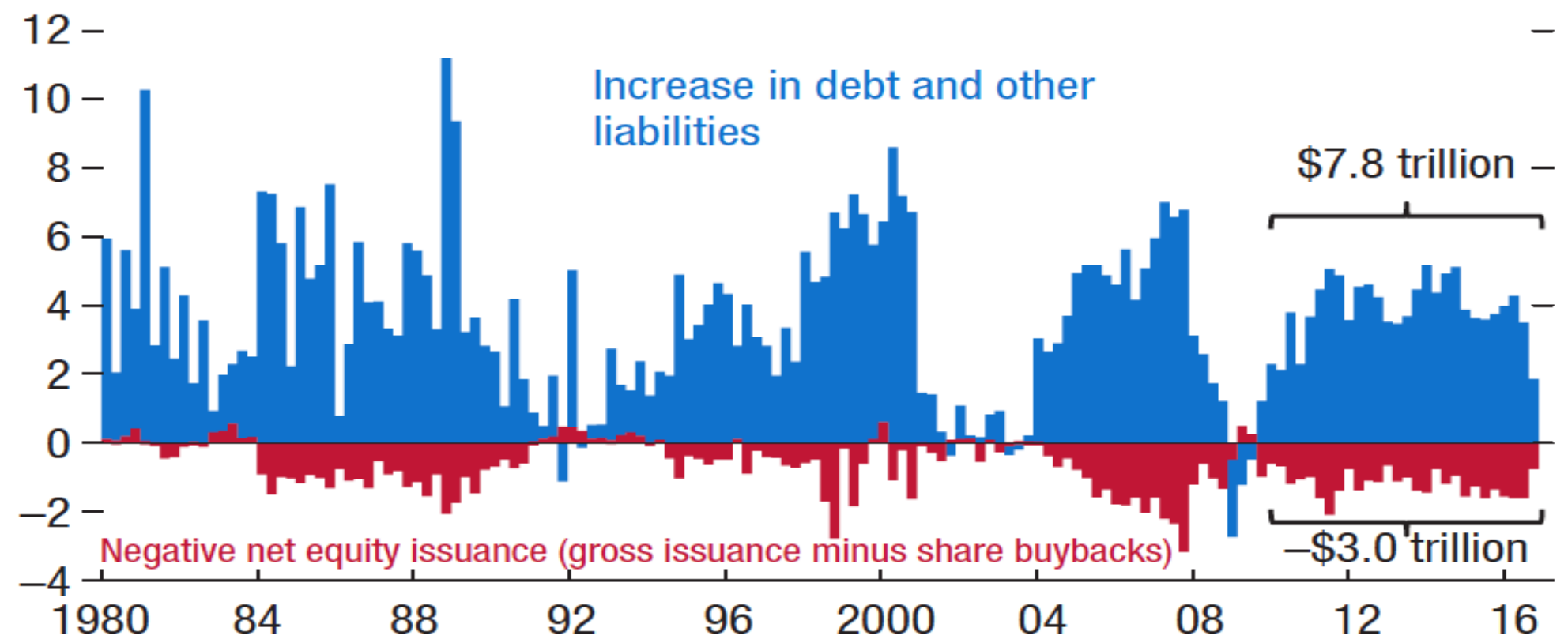


IMF

April,
2017

Net equity financing has been falling the past four decades, as debt finance has continued to rise.

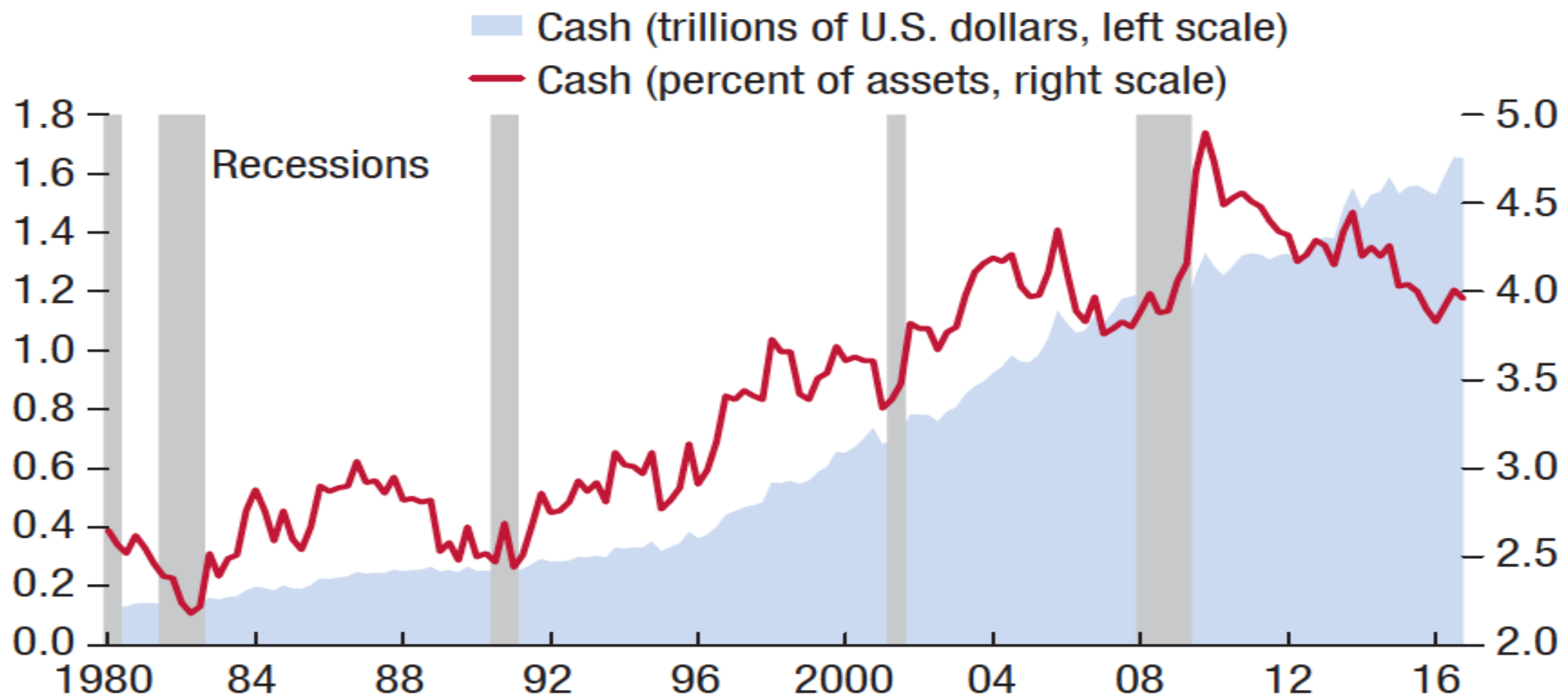
3. Corporate Liabilities and Net Equity Issuance (Percent of assets)





Corporate cash holdings are tapering ...

1. Corporate Cash Holdings on Balance Sheet



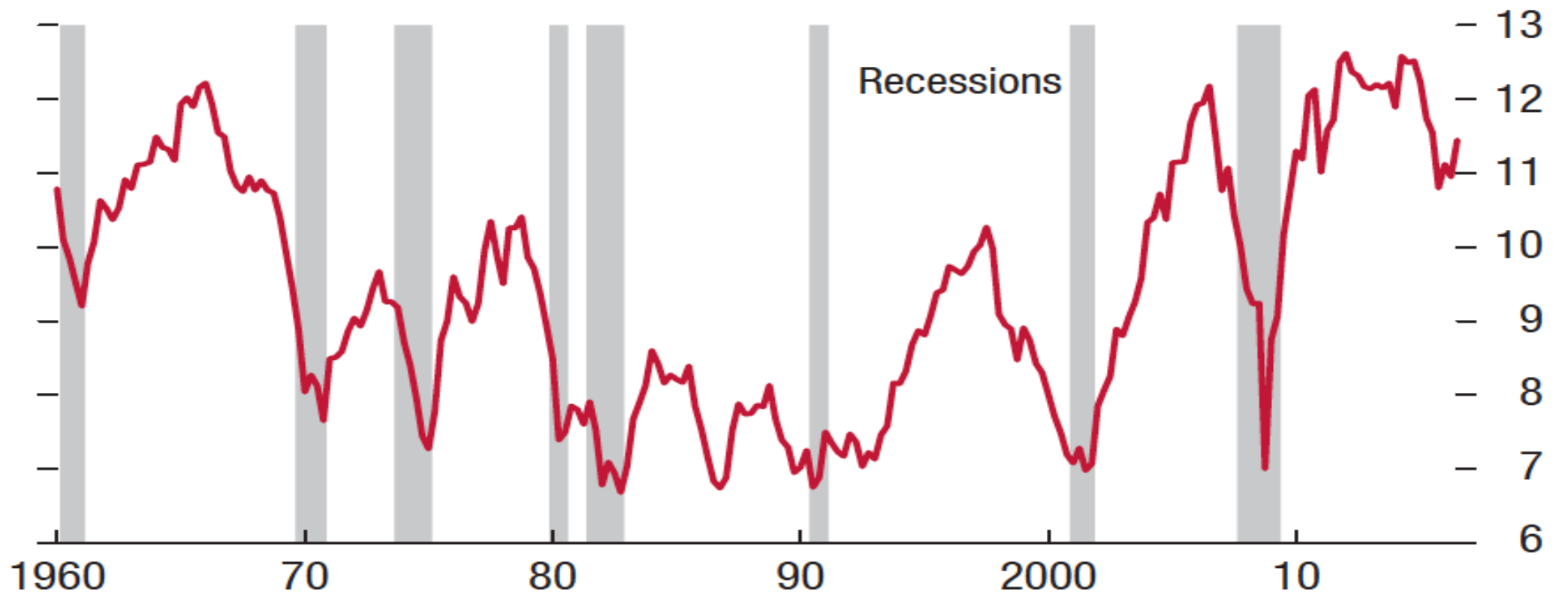


... as profits recede from a high level.

2. Corporate Profits (Percent of GDP)

IMF

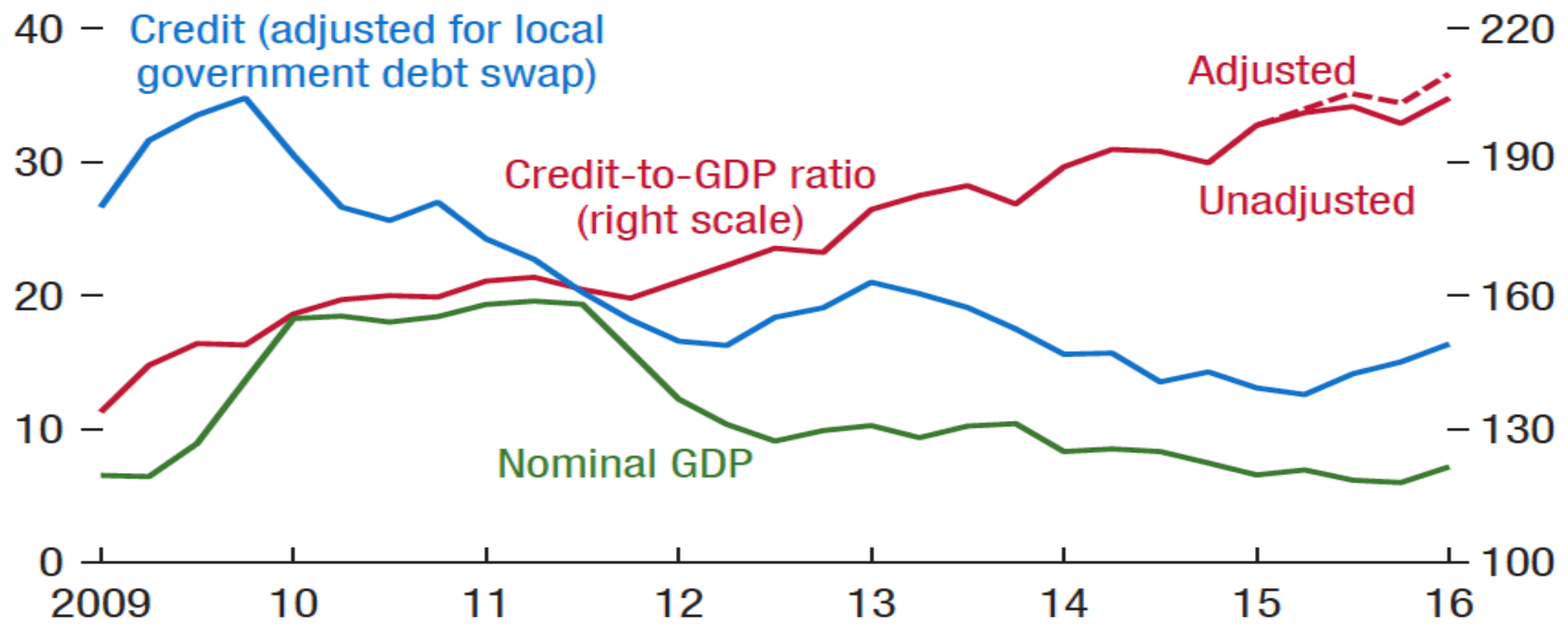
April 20
17





China's credit continues to rise faster than GDP ...

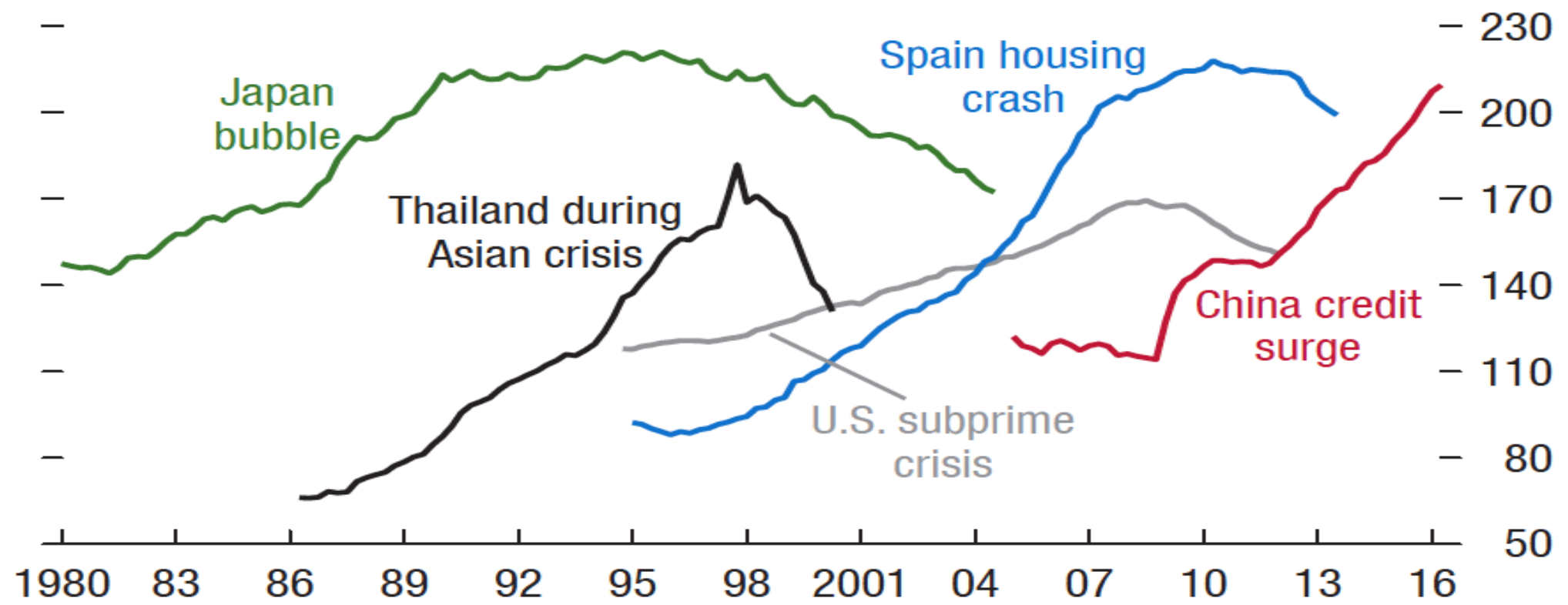
1. Credit and GDP Growth (Percent change year over year)





... and signals financial crisis risk, as suggested by international experience.

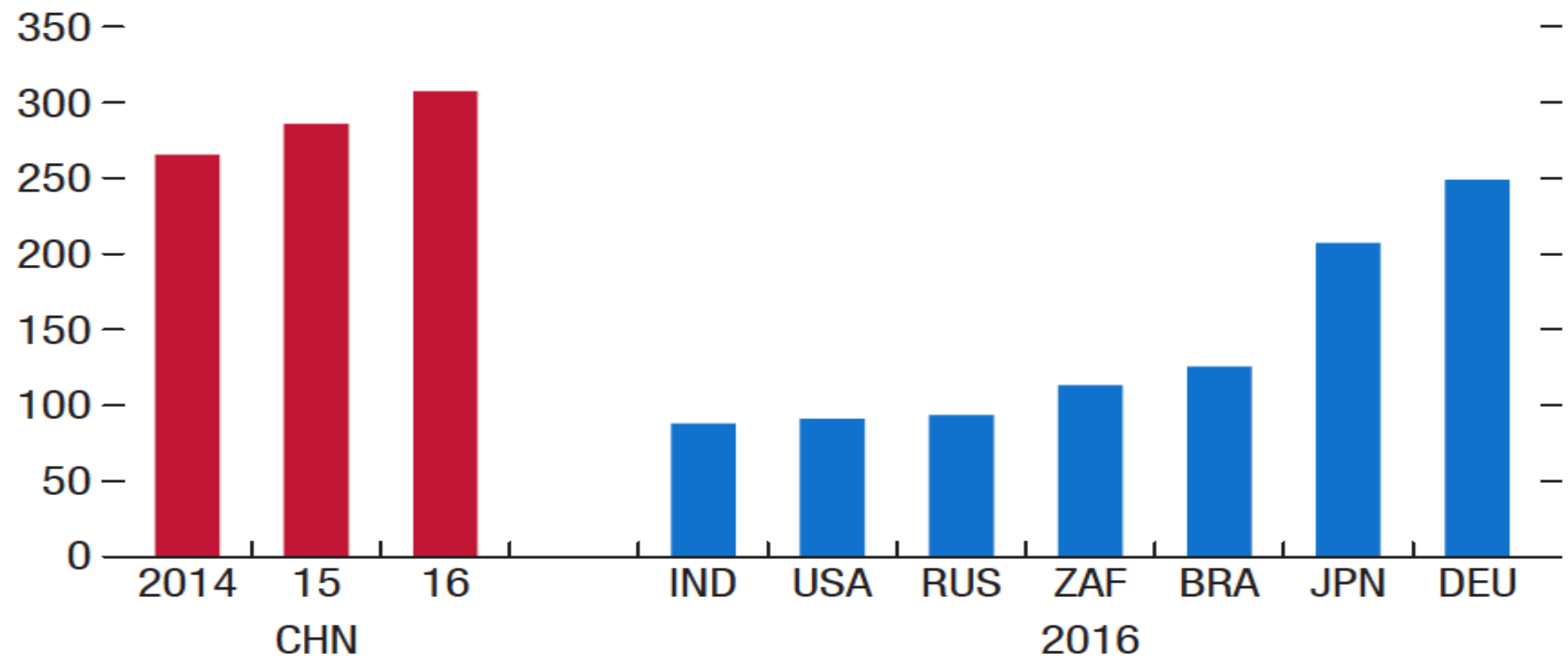
2. Fast Credit Growth and Past Major Crises (Percent of GDP)





Chinese banks are now among the largest in the world, also relative to the size of the economy ...

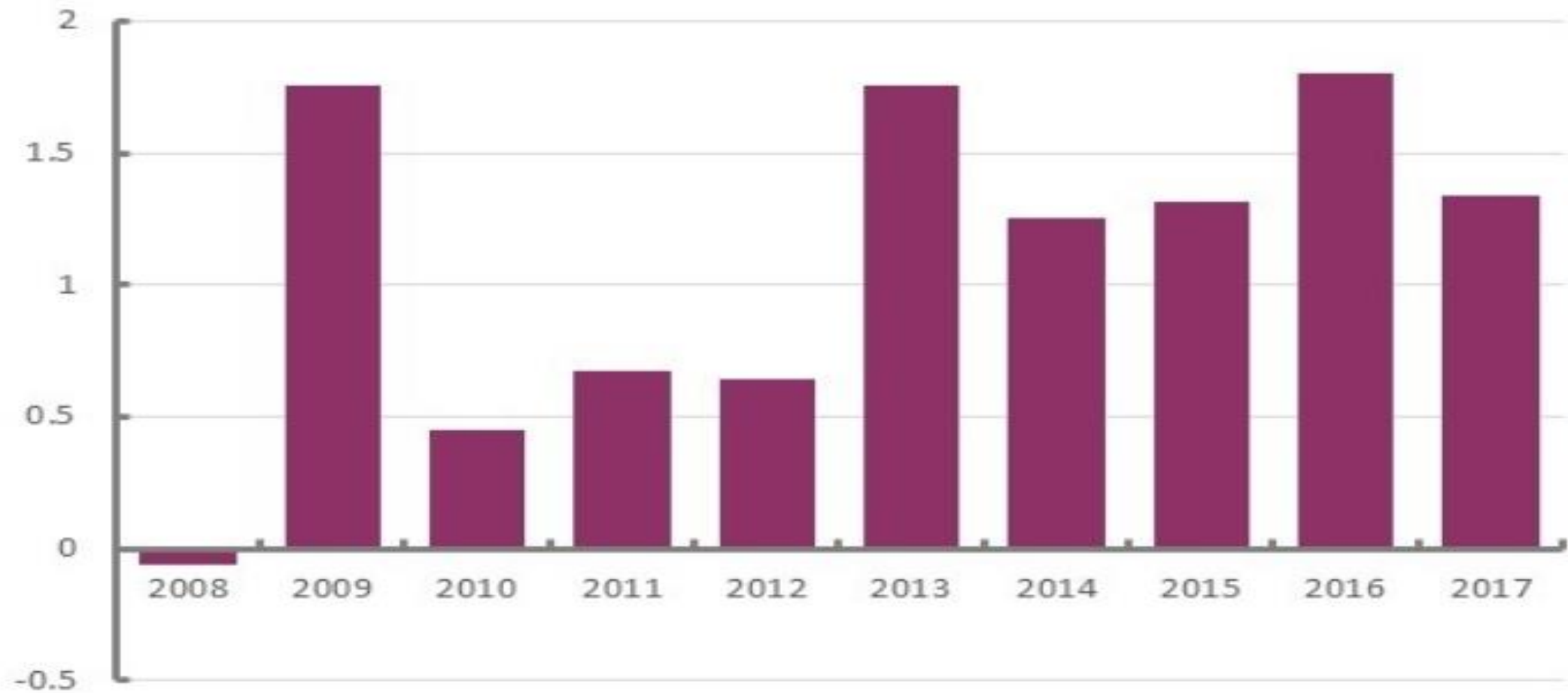
3. Bank Total Assets to GDP (Percent)





QE – LIFE SUPPORT FOR SEMI-COMATOSE BODY OF THE GLOBAL ECONOMY?

Figure 1: G4 central bank asset purchases, \$ trillion



Source: Mark Carney, *[De]Globalisation and inflation*, speech, 18 September 2017

Acknowledgement: TUC blog, Geoff Tily , 21 September, 2017.



G4 central banks will have pumped \$11
trillion

(\$10,917,000,000,000)

into their economies by the end of 2017.



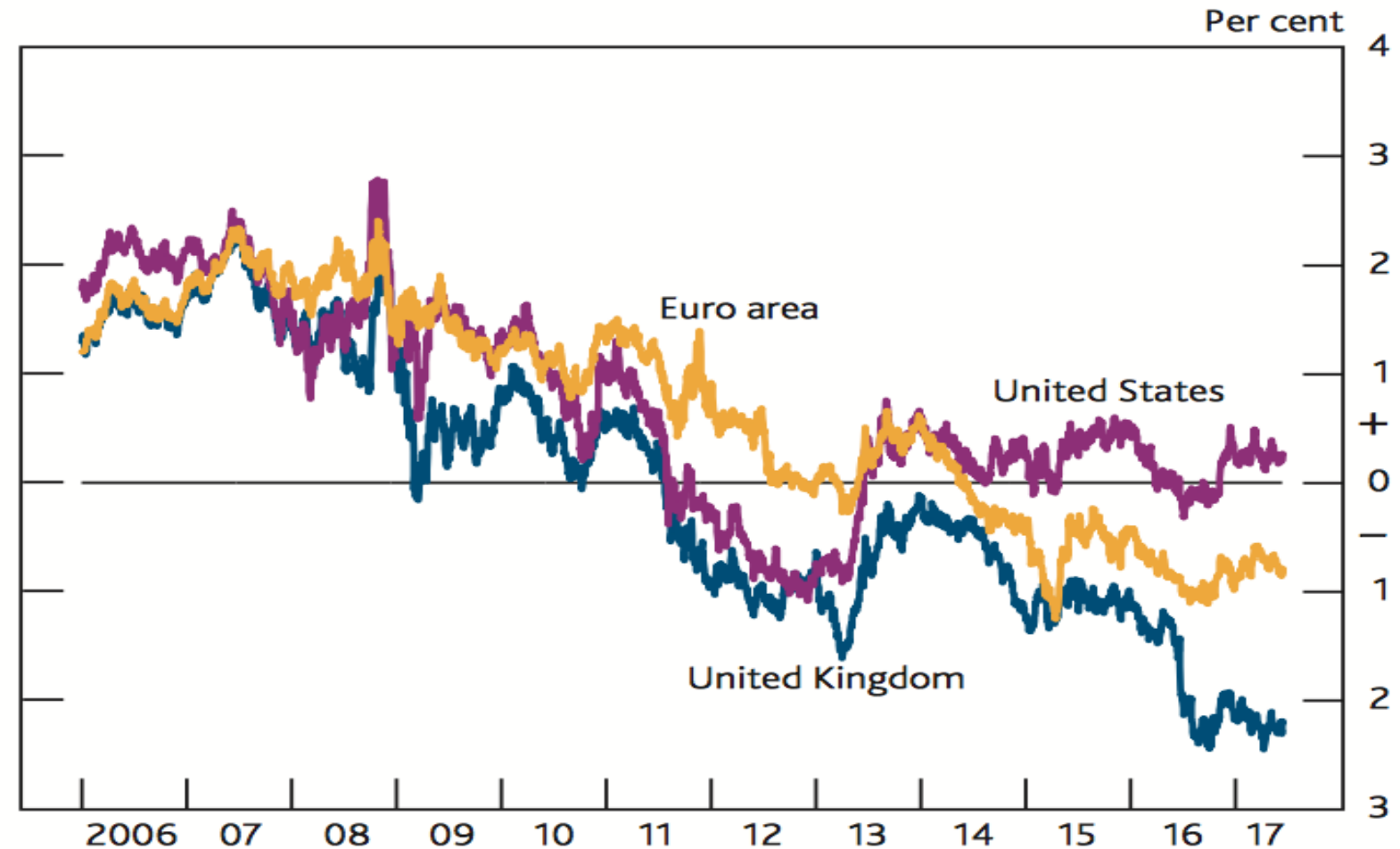
Bank of
England

Financial
Stability
Report

June, 2017

Chart D Advanced-economy risk-free real interest rates remain close to historically low levels

International ten-year real government bond yields^(a)

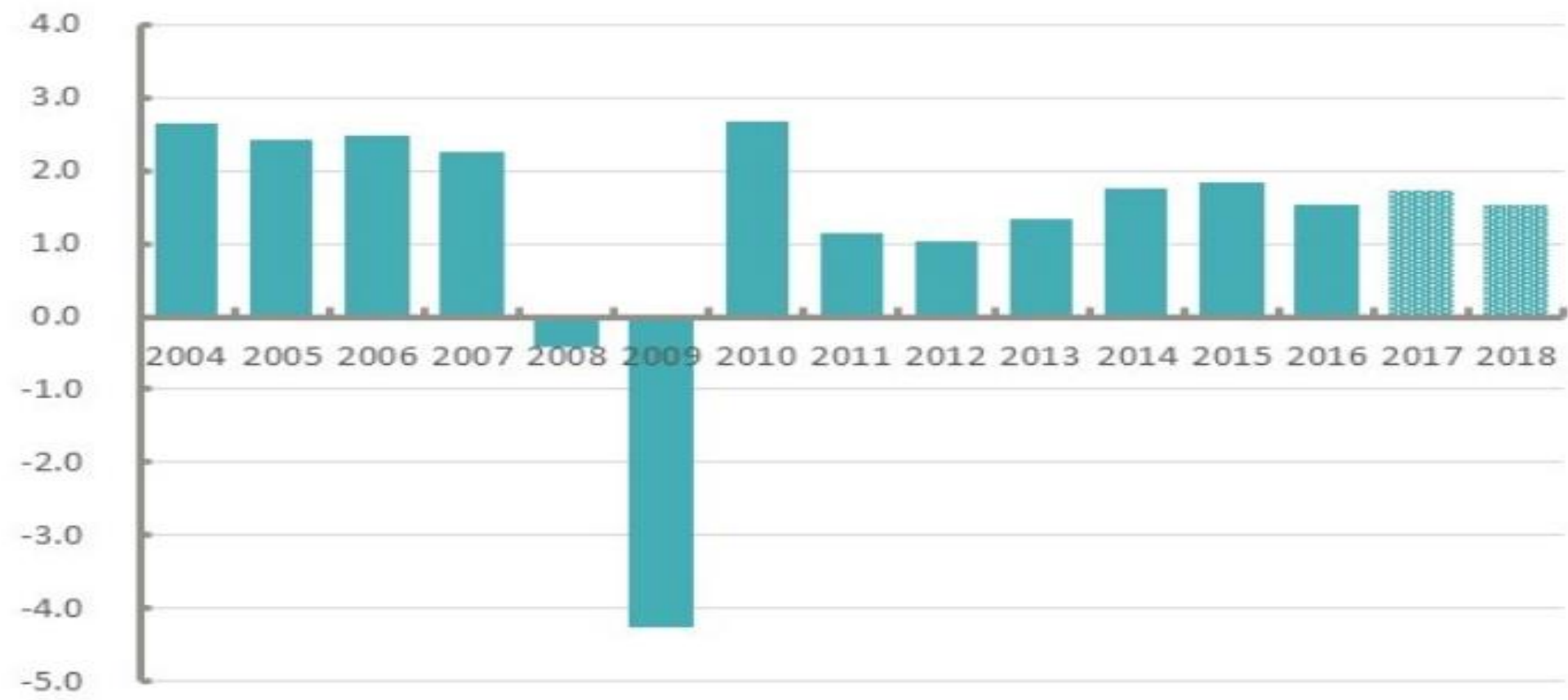


Sources: Bloomberg and Bank calculations.

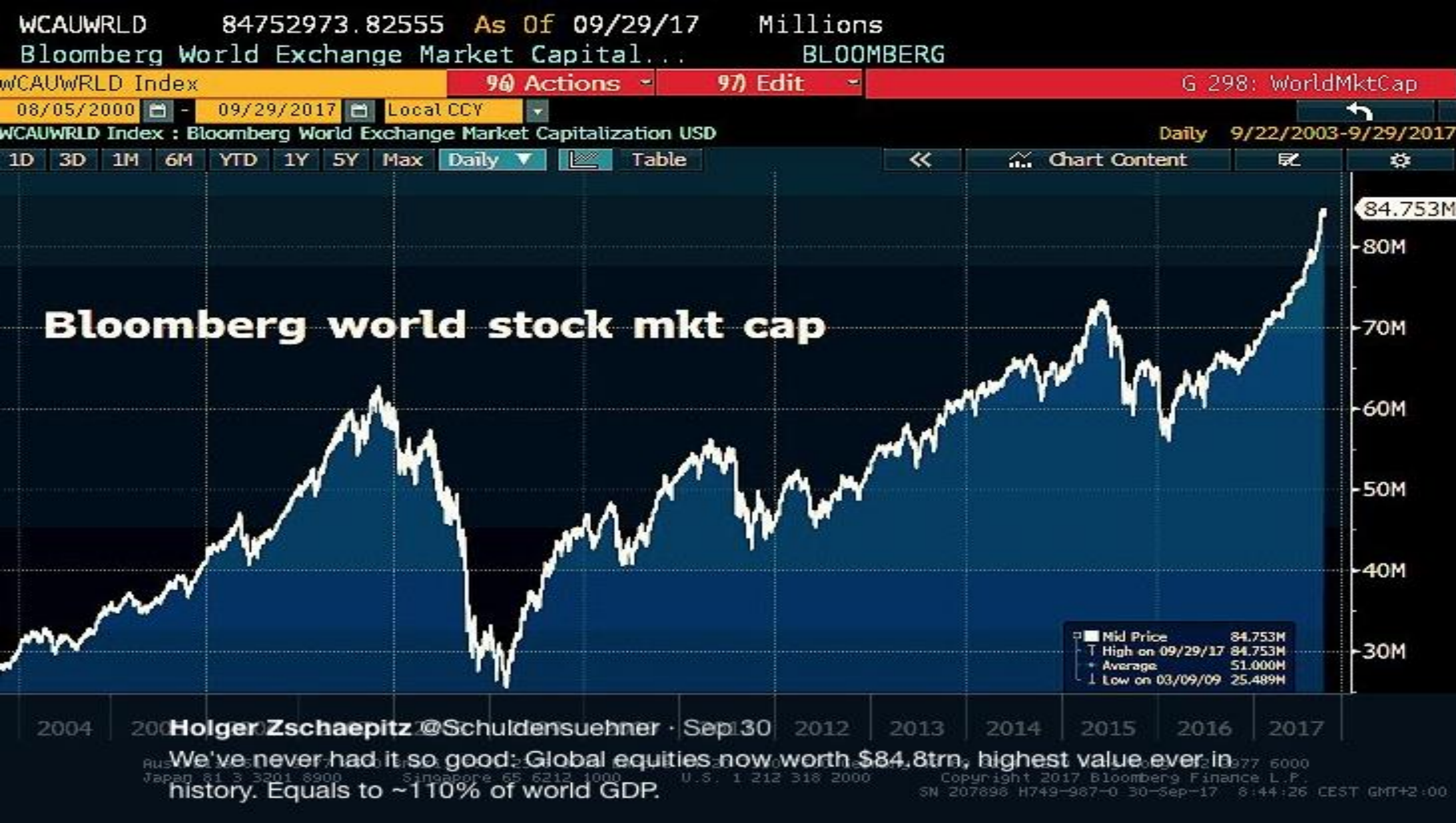
(a) Zero-coupon bond yields derived using inflation swap rates. UK real rates are defined relative to RPI inflation, whereas US and euro-area real rates are defined relative to CPI and HICP inflation respectively.



Figure 3: G4 GDP growth, %



Source: *OECD*, average across of G4 countries



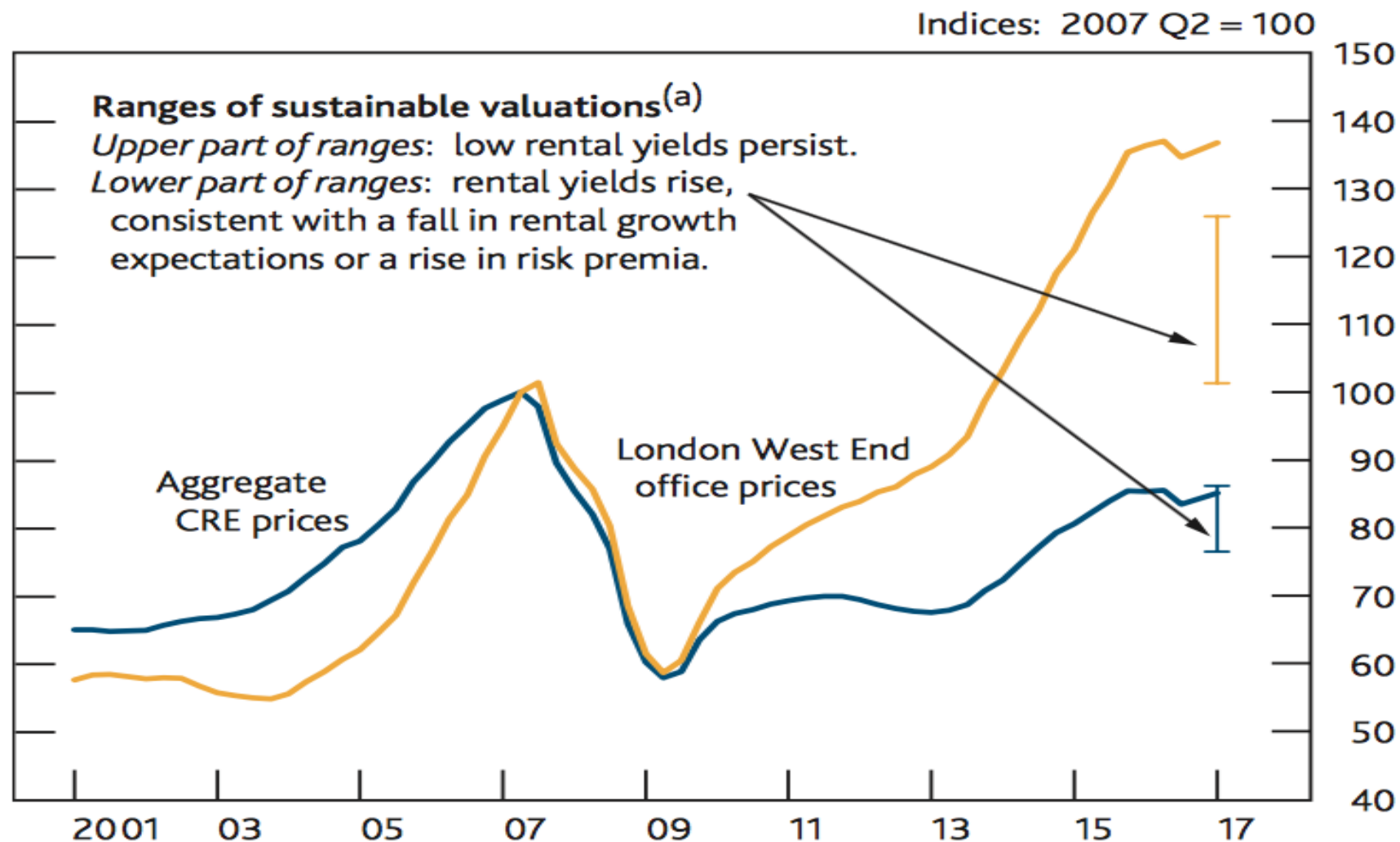


Bank of
England,

June, 2017

Chart A.35 UK commercial real estate prices look stretched based on ranges of sustainable valuations

Commercial real estate prices in the United Kingdom and ranges of sustainable valuations



Sources: Bloomberg, Investment Property Forum, MSCI Inc. and Bank calculations.



Central Banks Retreat from QE?

ECB begins discussions on tapering QE despite stronger euro

Draghi says appreciation adds uncertainty but expects decisions on stimulus in October



7th September, 2017



“... the precise degree and timing of this effect are subject to considerable uncertainty”



“The US stock market today looks a lot like it did at the peak before all 13 previous price collapses.”

Sep 21, 2017 Robert J. Shiller, Project Syndicate.



“According to my data, real S&P Composite stock earnings have grown 1.8% per year, on average, since 1881.



“....From the second quarter of 2016 to the second quarter of 2017, by contrast, real earnings growth was 13.2%, well above the historical annual rate.”

Robert J. Shiller, as above.



“...my analysis should serve as a warning against complacency.

Investors who allow faulty impressions of history to lead them to assume too much stock-market risk today may be inviting considerable losses.”



FT View

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FINANCIAL TIMES EDITORIALS

“Without fear and without favour”: Since 1888, the FT has argued for free markets, free trade, and liberal democracy. These commitments are renewed daily by the leader writing team, which offers opinion and analysis on behalf of the FT.

“It is only with trembling fingers, then, that this column declares: the stock market is roaring, and that makes perfect sense.

Financial Times editorial, October 6, 2017.



Presentation title
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FINANCIAL TIMES EDITORIALS

“Without fear and without favour”: Since 1888, the FT has argued for free markets, free trade, and liberal democracy. These commitments are renewed daily by the leader writing team, which offers opinion and analysis on behalf of the FT.

“The rise is supported, first, by synchronised global growth. Company performance has been impressive in the US in particular. Earnings growth in the first and second quarters was in the double-digits.”

Financial Times editorial, October 6, 2017.



The crisis of capitalism

Brazil and the crisis of the liberal world order

Polarised politics and the rise of nationalism echo Trump's US and Brexit Britain

“Gideon Rachman



Discontent from Germany's eastern states boosts AfD

Ryanair still flies a flag of contempt for customers

Regulators cannot allow the ch...

Catalan independence vote greeted with truncheons and rubber bullets

Regional leader claims people have earned right to independence

Bitter divisions over Uber board spill into public

Kalanick's appointment of two new directors is 'highly unusual' and 'disappointing'

The Big Read

Trump's war on trade deficit backfires

UK Politics & Policy

Labour's galvanising conference in Brighton

The UK opposition party gathered for their annual conference this week and it was a success for leader Jeremy Corbyn. But how united is the party behind the scenes? And what can we expect to hear from the Conservatives next week?



Is the system safer?



Is it simpler?



Is it fairer?



Presentation title
DATE

ANN PETTIFOR

THE PRODUCTION *of* MONEY

HOW TO BREAK THE
POWER OF BANKERS



Thank you.

Ann Pettifor
Director, Policy Research in Macroeconomics
www.primeeconomics.org