Never judge central banks' books by their covers

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Outline

- By *design*, advanced country central bank policy-related assets were very small in absolute and relative size in the decade preceding 2008.
- The subsequent expansion in those policy-related assets was much more stunning than that of the total balance sheet, yet the naïve policy multiplier effect appears to have been small.
- Indeed, I would argue that the multiplier associated with pure quantitative easing has been zero or negative, e.g. Japan in the 1990s.
- In order to understand "how" balance sheet policy works we need to focus on the quality, not the quantity, of central bank operations.
- If, as I contend, the effective essence of central bank balance sheet policy is quasifiscal, i.e. by conventional institutional design intended to be under the administration of political authorities, we face an existential question—was *central bank* independence a mistake?

Bank of Canada—Sized for Purpose

Bank of Canada

December 31, 2007

(in percent of GDP)

Assets		Liabilities	
Canadian Government Securities	3.15	Bank notes in circulation	3.21
Liquidity Providing Repos	0.25	Financial Institution Deposits	0.03
Loans to CPA members	0.00	Government Operational Deposits	0.13
		Other liabilities net	0.03
		Equity	0.01
Total Assets	3.41	Total Liabilities	3.41

Sources: Bank of Canada Financial Statements Annual Report 2007 and Author's calculations

IMF WEO Database (March 2016) 2007 GDP C$ billions 1573.5320

US Federal Reserve Banks Consolidated Balance Sheet

Consolidated Balance Sheet of the Federal Reserve Banks

December 31, 2007

(in percent of GDP)

Assets		Liabilities	
US Treasuries	5.16	FR Notes Outstanding	5.48
Liquidity Providing Repos	0.32	Bank Deposits (Overnight)	0.14
Loans to Banks	0.34	Reverse Repos	0.30
		US Treasury Deposits	0.11
Net Other Assets	0.48		
		Equity	0.26
Total Assets	6.29	Total Liabilities	6.29

Source: Federal Reserve Board Annual Report 2007 and Author's calculations

IMF WEO Database 2007 GDP (April 2019) 14451.875

The degree of US commercial bank balance sheet displacement caused by Large Scale Asset Purchases (LSAP) is truly astonishing

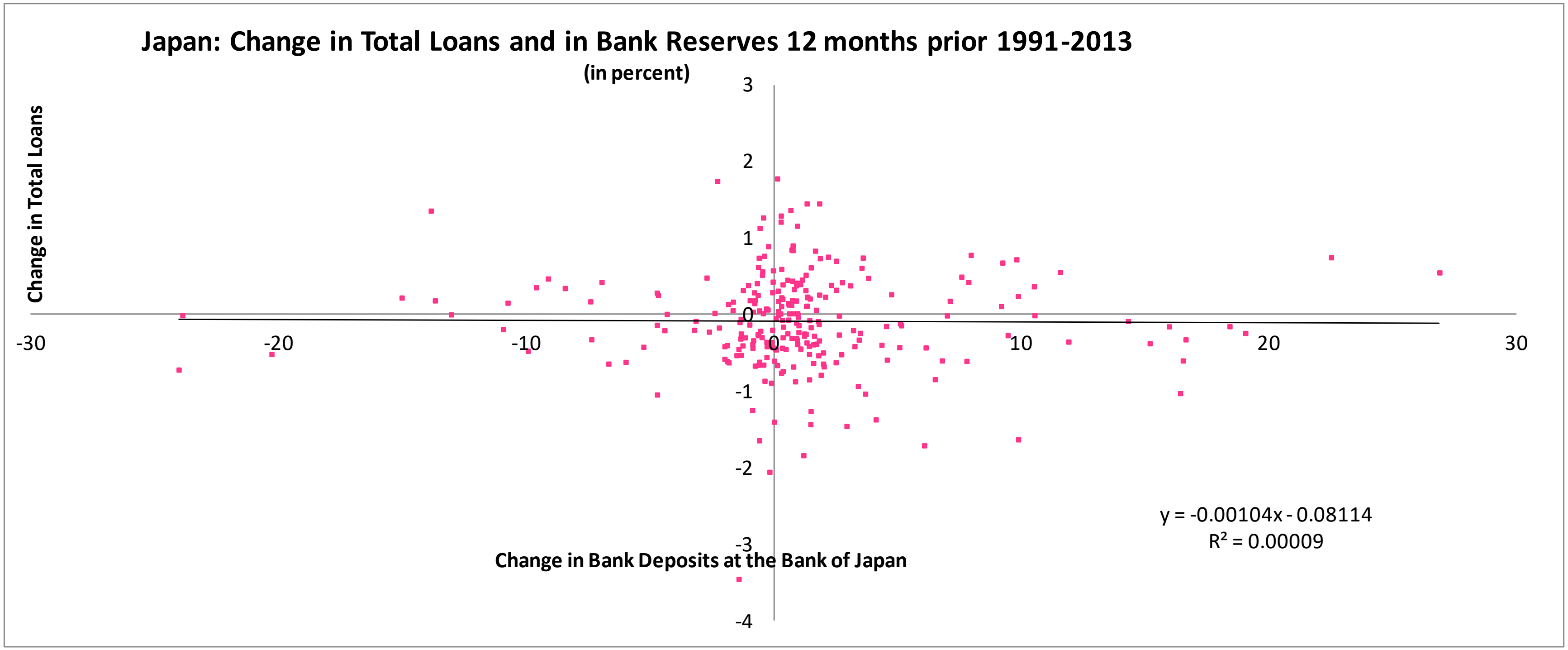
- "Bank balances held at Federal Reserve Banks (FRBs) increased from USD 20 billion to USD 2.7 trillion (+13,000 percent)."
- "Increased deposits at FRBs account for *57 percent* of the total growth of US bank assets since the onset of the Great Recession".

- In 2006, JP Morgan Chase (JPM) held USD 2.2 billion at FRBs.
  At end-March 2015, JPM held USD 447 billion (+ 20,000 percent).
- "More than 21 percent of JPM total assets are claims on FRBs".

- In 2006, State Street held USD 103 *million* at FRBs.
  At end-March 2015, State Street held USD 56 *billion* (+ 53,000 percent)
- "More than 20 percent of State Street total assets are claims on FRBs".

Source: Stella (2015) Exiting Well

Bank of Japan employed QE to no avail



What "works" are quasifiscal operations: conventionally under the domain of fiscal authority

- *"Measures to take on individual credit risk such as corporate debt are extraordinary steps for a central bank since they come close to …fiscal policy which deals with resource allocation at the micro level….since it is in essence close to the realm of fiscal policy, a clear understanding of which authorities are taking on the risk involved is indispensable."*

  Bank of Japan Governor Shirakawa (2009)

- *"Our lending programs…run contrary to a long-standing and sound Fed practice of trying to minimize the effect of its actions on the allocation of credit across market segments….My…final suggestion is to draw a clear distinction between monetary policy and fiscal policy to ensure the Federal Reserve retains its independence to conduct sound monetary policy.*

  FRB Philadelphia President Plosser (2009)

- Robinson & Stella (1988) *Amalgamating Central Bank and Fiscal Deficits*
- Fry (1993) *Fiscal Abuse of Central Banks*
- Mackenzie & Stella (1996) *Quasifiscal Operations of Public Financial Institutions*

Is the ambiguity of fiscal/monetary overstated? US Example: United States Treasury authorized to intervene in financial markets

- Housing and Economic Recovery Act of 2008 (July 30) Section 1117
- HERA gave US Treasury authority to purchase and sell obligations of Fannie Mae, Freddie Mac and the Federal Home Loan Banks

Required Secretary of the Treasury to determine an emergency exists and that action is necessary to (i) provide stability to financial markets (ii) prevent disruptions in the availability of mortgage finance (iii) protect the taxpayer

- PL 110-289 (HERA) Required periodic reports to Congress
- Authority extended only to December 31, 2009
- Any funds used "shall be deemed appropriated" when purchases made
- Funding subject to US Code Title 31 Chapter 31 Public Debt (limit)

US Example: Compare Similarity of Treasury Operations with those of the FOMC

- Announced *GSE and Agency Securities and MBS Purchase Program* on November 25, 2008

- FOMC initially authorized purchase of up to $600 billion in direct obligations of housing related GSEs and GSE backed MBS. In March 2009 FOMC authorized purchases of up to an additional $850 billion more

- Above the zero-lower bound the Federal Reserve “financed” the acquisition of additional assets by selling other assets, primarily UST securities so that there would be no increase in money market liquidity
- At zero lower bound unrestricted—monetary finance unlimited

- Same operations yet under different governance and accountability set up

Further color….

- “Treasury’s mission does not typically include managing a large mortgage portfolio….State Street Global Advisors is the manager of the Treasury’s portfolio”
- “The operational and financial characteristics of MBS purchases are complex and require specialized technology and expertise to transact. The Federal Reserve chose external investment managers as a means of implementing the MBS program quickly….New York Fed retained Wellington Management Company LLC…and BlackRock Inc. ….”

- “Is the Treasury planning to reinvest the proceeds in any other assets? No. As mandated under HERA and the Dodd-Frank Act, the proceeds from the MBS sales will be deposited in the General Fund of the Treasury”.
- On August 10, 2010 the FOMC directed the FRBNY to keep constant the Fed’s holdings of securities by reinvesting principal payments from agency debt and agency MBS in longer-term Treasury securities. “Any future decisions abou the investment strategy….will be made by the FOMC”.

- US Treasury Website “Frequently asked questions on Treasury’s program to sell MBS” and FRBNY Website “FAQs: MBS Purchase Program”

Norway: A clear vision for what should, and should not, be delegated to an independent monetary authority

- *Norway Government Asset Swap Scheme: at the outset of the crisis Parliament approved a government financed auction of treasury bills for mortgage backed securities held by Norwegian banks.*

- *Although the scheme was suggested by Norges Bank, the government assumed the risk of these extraordinary liquidity operations onto its own balance sheet:*

- *"…funding support for banks came from the government's balance sheet, not as loans from Norges Bank. This provided transparency…The Norwegian measures were designed in such a way that Norges Bank's balance sheet has not increased to the same extent as that of a number of other central banks."*

Source: Norges Bank Governor Svein Gjedrem, "Experiences with the financial crisis", presentation given at the Norwegian School of Management, 30 September 2009.

Warning signs are flashing red….

- Swiss National Bank holdings of net foreign assets & gold increased from 15 to 94 percent of GDP from end-2005 to end-2015.
- This has led SNB to invest in “alternative assets” including equities such as fossil fuel producers Exxon Mobile, Arch Coal and Chevron…
- Resulting in pushback from the legislature
- “Swiss lawmakers are preparing a campaign that would make targeting climate change one of the policy objectives of the Swiss National Bank”

  (Reuters online 10 December 2019)
- Financing the “Green New Deal” and the irony of “MMT” in a negative rate world
- “time to think hard about to whom to delegate what” (Paul Tucker)