CENTER FOR FINANCIAL STABILITY

Dialog• Insight• Solutions

Shriveling Shadow Banking Limits Liquidity and Damages the Economy: CFS Money Supply Statistics

BASED ON DATA RELEASED AT 9:00 A.M. ET, NOVEMBER 19, 2014

Lawrence Goodman

November 19, 2014

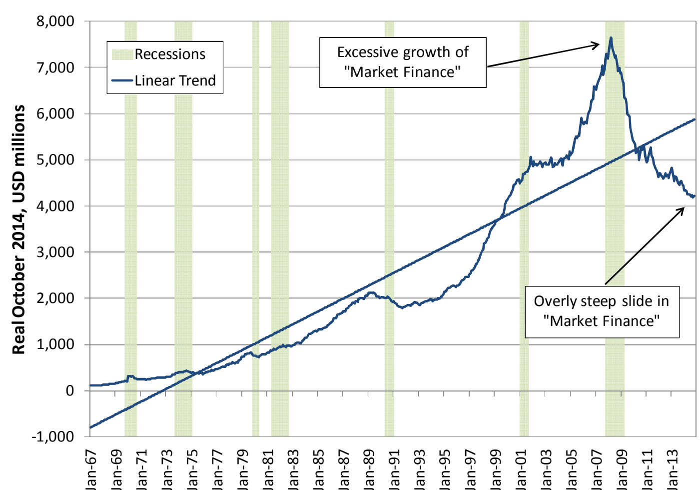
The Center for Financial Stability (CFS) Divisia monetary aggregates and components often reveal nuances surrounding future moves in the economy and markets as well as a real time perspective of the US financial system. The November release is no exception.

- "Market finance" (or what some like to call "shadow banking") is shriveling to the detriment of the economy and financial market liquidity.
- Access to market finance has shriveled by 45% in real terms since 2008 – the largest cyclical drop in the last 40 years.

"Shadow Banking" is Really "Market Finance"

The tainted image of shadow banking along with the nefarious sounding name is a disservice to the U.S. economy. Shadow banking to a substantial degree is simply "market finance." In fact, many cite access to "market finance" as essential to provide the U.S. financial system with strength and flexibility. This market or non-bank based finance provides a stark contrast with the more rigid and heavily bank dominated system in Europe.

Figure 1. Plunge in Market Finance (Shadow Banking) Overshoots



Note: The CFS definition of market finance includes: money market funds, repurchase agreements, and commercial paper.
Source: Federal Reserve, Bloomberg LP, and Center for Financial Stability.

Over the last four decades, market finance has largely provided fuel for corporations in the form of commercial paper and money market funds as well as liquidity for financial markets (see Figure 1). Yet, it also played a central role in enabling many financial crises. In fact, the proliferation of market finance reached unforeseen highs prior to the recent crisis and facilitated numerous excesses.

However, CFS data reveal that the reduction in the role of market finance in the economy is likely excessively steep and detrimental to future growth. The shadow banking system is under severe strain. Of course, market finance grew too large in advance of the recent financial crisis and the reduction in the sector provides a healthier base for the US economy and markets. Yet, the deterioration is unprecedented (see Figure 2).

Figure 2. CFS Measure of Market Finance (Shadow Banking), Real October 2014, USD millions

Peak	Fall	Decline /1
1970	-25%	16
1974	-17%	16
1979	-13%	7
1982	-5%	3
1989	-16%	29
2001	-4%	11
2008	-45%	79
Avg ex '08	**-9%**	**13**

1/ Cyclical peak-to-trough in months.
Source: Center for Financial Stability.

Liquidity provided to corporations and financial market participants via market finance is down a stunning 45% in real terms since its peak in March 2008! In fact, the availability of market finance shows no sign of stabilization with a series of successive drops from the beginning of the crisis to the latest CFS monetary data available through October 2014.

The shriveling nonbank financial sector threatens the health of the U.S. economy through the curtailment of funds available to corporations and liquidity for financial markets. Typically, the shadow banking system contracts coincident with recessions, but by an average of only 9% in contrast with the 45% witnessed through October 2014. Likewise, the decline from peak-to-trough in market finance is typically much faster at a scant 13 months later.

The cyclical low in October 2014 marks the 79th month of crises in nonbank finance!

Figure 3. Major CFS Monetary Aggregates and Reserve Balances, % year-over-year

	2009	2010	2011	2012	2013	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14
CFS DM4	-5.0%	-0.7%	0.7%	6.7%	1.9%	2.4%	2.4%	2.5%	2.4%	1.9%	1.7%
CFS DM4-	-5.1%	-0.5%	2.5%	6.8%	2.4%	3.6%	3.7%	3.6%	3.8%	2.9%	2.7%
CFS DM3	-2.4%	0.2%	3.4%	6.7%	2.3%	3.9%	3.8%	3.7%	3.7%	2.9%	3.0%
Reserves	35.0%	-5.3%	46.5%	-2.1%	60.8%	34.9%	31.5%	28.0%	25.9%	20.3%	13.3%

Source: Center for Financial Stability and Federal Reserve Board (total reserves of depository institutions).

Accessing CFS Divisia Data

We are delighted to announce that our monetary and financial statistics are now available via the Bloomberg terminal.

Bloomberg users can access the CFS data by any of the four options:

1) {ALLX DIVM <GO>}
2) {ECST T DIVMM4IY<GO>}
3) {ECST<GO>} --> 'Monetary Sector' --> 'Money Supply' --> Change Source in top right to 'Center for Financial Stability'
4) {ECST S US MONEY SUPPLY<GO>} --> From source list on left, select 'Center for Financial Stability'

CFS Divisia indices can also be found on our website at http://www.centerforfinancialstability.org/amfm_data.php. Broad aggregates are available in spreadsheet, tabular and chart form. Narrow aggregates can be found in spreadsheet form.

About CFS Money Supply

CFS Divisia monetary measures were developed under the direction of Professor William A. Barnett - one of the world's leading experts on monetary and financial aggregation theory. CFS money supply data are essential, especially since the Federal Reserve ceased production of M3 in 2006. Similarly, Divisia measures are superior, as they accurately weight various classifications of money from cash to leverage in the shadow banking system.

For more information about CFS Divisia please contact:

William A. Barnett	(Methodology)	(212) 626-2660 / wbarnett@the-cfs.org
Lawrence Goodman	(Policy and Market Application)	(212) 626-2660 / lgoodman@the-cfs.org

Next release – December 17, 2013 at 9:00 A.M. ET

Additional information: www.CenterforFinancialStability.org