Global Markets and the Center for Financial Stability

Lawrence Goodman
President and Founder

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INSIDE THIS WEEK: A 14-PAGE SPECIAL REPORT ON GLOBALISATION

Who killed New Labour?
The war in Pakistan's tribal areas
America's unending culture wars
How to save fish
The last typewriter-repair man

What next?
The U.S. Response

- **The House fails to pass the $700B rescue package**
  - Date: 9/29/08

- **Fed, OCC, OTS, FDIC issue final guidance on incentive compensation**
  - Date: 6/21/10

- **CFTC proposes governance rules for derivatives clearinghouses and trading platforms**
  - Date: 10/1/10

- **Mitsubishi UFJ to acquire a 21% stake in Morgan Stanley**
  - Date: 9/29/08

- **Pres. Obama proposes Financial Crisis Responsibility fee on banks**
  - Date: 1/14/10

- **CFTC proposes rules to impose position limits on energy trading**
  - Date: 1/14/10

- **Pres. Obama proposes to limit the size and activities of the country’s largest banks**
  - Date: 1/21/10

- **SEC to bar naked access**
  - Date: 11/3/10

- **SEC plans a large trader reporting system/trader ID system**
  - Date: 4/14/10

- **SEC narrowly approves short selling restrictions**
  - Date: 2/24/10
The U.S. Response Today: Bodies and Budgets

- SEC requests $263M budget increase and 612 growth in headcount
- CFTC requests $139M budget increase and 316 growth in headcount
- New Financial Stability Oversight Council (FSOC)
- New Office of Financial Research (OFR)
- New Consumer Financial Protection Bureau
- Competing and overlapping responsibilities

The bottom line…More of the same
Current Barriers to Success

- Lack of objectivity clouded by political agendas
- Organizational power building
- “Big picture” or academic perspective often misses “nuts and bolts” essentials unique to markets
- Lack of knowledge of market mechanics requisite for the formulation of financial policies
Mission

The Center for Financial Stability is dedicated to becoming the leading, nonprofit, nonpartisan, and independent think tank focused on financial markets for the benefit of investors, officials, and the public.

*The CFS is a non-profit tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code.*
Governments

• Risk Free rates are no longer “Risk Free.”
• Public spending propped demand in many nations. Limits will soon be reached and markets will increasingly scrutinize sovereign balance sheets and income statements.
• Sovereign credit crisis and FX volatility are opposite sides of the same coin…expect more sovereign credit difficulties.
Fiscal Stimulus and Capacity to Expand

Source: Datastream and Center for Financial Stability Inc.
Debt Restructuring: The Way Forward

The Economic Subcommittee (ESC) to Bank Advisory Committees during the Brady Debt restructuring era provides a blueprint for identifying common ground, deepening communication, and paving the way for the benefit of creditors and debtors alike.
Economic Growth Improvement Post Debt Reduction

Source: Datastream, IMF and Center for Financial Stability Inc.
New Strategy: Financial Program

Substitute Math for Rhetoric

- **Economics** – restoring growth for a long-term solution,
- **Finance** - identifying sustainable levels of debt and potentially needed support for banks,
- **Official Institutions** - highlighting available official resources to support and ensure implementation of a successful program.
Component Currency Strains in the Euro

Source: IMF and Center for Financial Stability Inc.
Cumulative Deficits in Deep Downturns, % of GDP

Source: Office of Management and Budget, Historical Financial Statistics and Center for Financial Stability Inc.
USG Debt Maturities Spike in Coming Year

Note: Interest bearing public debt held by private investors. Source: US Treasury and Center for Financial Stability Inc.
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CFS Solution: Business Platform and Community

CFS facilitates development of a **community** of market participants, officials, and academics.

The community is built on **research**, **events**, and **outreach** to officials.

**Technology** is at the heart of the CFS.
Advisory Board

- **Eduardo Aninat, Ph.D.** – former Deputy Managing Director of the International Monetary Fund and Minister of Finance for Chile

- **Senator Bill Bradley** – served in the U.S. Senate from 1979-1997 and was a candidate for the Democratic nomination for President of the United States

- **The Honorable Carole Brookins** – former United States Executive Director to the World Bank and leading consultant on international policy and commodity markets

- **Charles Goodhart, CBE, FBA** – Member of the Financial Markets Group at the London School of Economics and former Member of Bank of England’s Monetary Policy Committee

- **Henry Kaufman, Ph.D.** – President of Henry Kaufman & Company Inc and former Vice Chairman, Member of the Executive Committee, and Chief Economist at Salomon Brothers Inc.

- **Judge Richard A. Posner** – Judge on the United States Court of Appeals for the Seventh Circuit in Chicago and a Senior Lecturer at the University of Chicago Law School

- **The Honorable Randal Quarles** – Managing Director at the Carlyle Group and former Under Secretary of the Treasury for Domestic Finance

- **Richard Sandor, Ph.D., Dr.Sc.h.c.** – Former Chairman and CEO of the Chicago Climate Exchange and Honoree as the “father of financial futures” by the City of Chicago

- **Myron Scholes, Ph.D.** – Nobel Prize recipient in Economic Sciences for work in Finance and Derivatives, E. Buck Professor of Finance Emeritus at Stanford University
Educational Tools

• **Historical Financial Statistics** – CFS formed a joint venture with Johns Hopkins University to develop the HFS, which is now the central, online source in the world for free economic and financial data.

• **Advances in Monetary and Financial Measurement (AMFM)** – CFS Director William A. Barnett directs a program to deepen state-of-the-art advances in monetary and financial measurement and to make the result in data available to the public.

• **Financial Policy Library** – Brief synopsis of key issues and relevant studies across 14 major financial policy.

• **Financial Stability Reports** – Monthly compilation of a broad range of Financial Stability reports by financial regulators and central banks in over 60 countries plus new Rule of Law Index (RLI).

• **Financial Crisis Timeline** – Key events from 2007 to the present across markets, the Fed, Treasury, institutions, and other areas.
Technology

Technology is at the heart of CFS stretching from analytics to creative uses of the web

- The Globe: Visitors from 83 countries (1,299 cities/top 200 pictured)
- Educational Institutions: Visitors from 92 top schools and universities
- Government: Highest traffic from the U.S. Treasury, Federal Reserve, House of Representatives, State Department, and the White House

Source: Google Analytics and CFS.
Getting It Wrong

How Faulty Monetary Statistics Undermine the Fed, the Financial System, and the Economy

WILLIAM A. BARNETT

Beverly for the recent financial crash and subsequent recession has commonly been assigned to everyone from Wall Street firms to individual homeowners. It has been widely argued that the crisis and recession were caused by “greed” and the failure of mainstream economics. In Getting It Wrong, leading economist William Barnett argues instead that there was too little use of the relevant economics, especially from the literature on economic measurement. Barnett contends that as financial instruments became more complex, the simple-numerical-aggregation formulas used by central banks, including the US Federal Reserve, became obsolete. Instead, a greater emphasis on public availability of two pieces of data was needed. Households, firms, and governments, lacking the requisite information, increasingly assessed systemic risk and significantly increased their leverage and risk-taking activities. Better statistical data, Barnett argues, could have signaled the misperceptions and prevented or lessened systemic-risk transactions.

Barnett explains that the value of the “right” measures is not available from the central bank, increased regulation can ameliorate the adverse consequences of ill-informed decisions. Instead, there was deregulation. The result: Barnett argues, was a worst-case basic risk increase, increasing complexity of financial instruments, inadequate and poor-quality data, and declining regulations.

Following the accessible narrative of the deep causes of the crisis and the long history of pervasive and policy errors, Barnett provides technical approaches, consulting the multidisciplinary analysis supporting his arguments.

WILLIAM A. BARNETT is Oswald Distinguished Professor of Macroeconomics at the University of Kansas, Director of the Center for Financial Stability in New York City, and Senior Fellow at the IC3 Institute at the University of Texas at Dallas. He is Editor of the review Journal Macroeconomic Dynamics and coeditor with Nobel Laureate Paul A. Samuelson of the book Inside the Economist’s Mind, translated into seven languages. He was on the staff of the Federal Reserve Board from 1974 to 1992.

“Treading on this financial crisis, investors lacked an informed assessment of systemic risk and significantly increased their leverage and risk-taking activities. Barnett’s case for better Federal Reserve data could have signaled the error in time. This error led to the credit-driven asset price bubble in the US housing market. He also has shown that as a result of measurement errors, monetary policy was damaged, with tragic consequences. He is in the world’s foremost authority on the study of monetary and financial aggregates using index number and aggregation theory.”

James J. Heckman, University of Chicago and University College Dublin; Nobel Laureate in Economics

“I would never fly in an airplane designed by an economist. Unfortunately, I have to live in an economy where policy makers listen to economists. Professor Barnett, a former model scientist, shows clearly how important it is that economists pay attention to indexed and fraction economics how to do it better. Until economists attend these lessons, the policy makers they advise will be flying blind.”

Kenneth L. Sol, Harvard Institute, Stanford University

“Getting It Wrong is a gripping combination of colorful mini-biographies, evidence from a close witness to our financial situation, and well argued case for better monetary statistics. The book is a must for everyone interested in monetary policy.”

Julio J. Rotemberg, William Ziegler Professor of Business Administration, Harvard Business School

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