Global Markets, Global Risks

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President - Center for Financial Stability

Systemic Risk Conference: What Are the Odds of a Financial Collapse?
NY Society of Security Analysts and CFA Institute
New York, NY

December 3, 2014
Global Markets, Global Risks

I. The odds of a financial crisis are worth active monitoring.

II. Unintended risks from recent policy measures actually threaten financial stability and hinder growth.

- Despite ample *monetary liquidity*, there is a shortage of *financial market liquidity*.

- Backdoor *currency wars* risk sharp market gyrations.

III. Solutions are in sight.
Lessons from Parenting for Global Markets: Behaviors and Consequences

<table>
<thead>
<tr>
<th>REWARDS</th>
<th># TICKETS GIVEN</th>
<th>CONSEQUENCES</th>
<th># TICKETS TAKEN AWAY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extra Math</td>
<td>+5</td>
<td>HITTING</td>
<td>-3</td>
</tr>
<tr>
<td>Getting along with others</td>
<td>+3</td>
<td>BULLYING</td>
<td>-4</td>
</tr>
<tr>
<td>Good Table Manners</td>
<td>+4</td>
<td>TEASING</td>
<td>-1</td>
</tr>
<tr>
<td>LOVE &amp; RESPECT</td>
<td>+5</td>
<td>LYING</td>
<td>-2</td>
</tr>
<tr>
<td>Obeying the FIRST TIME</td>
<td>+3</td>
<td>THRONING A FIT</td>
<td>-3</td>
</tr>
<tr>
<td>Calm &amp; Quiet in STORE</td>
<td>+3</td>
<td>Ignoring Parents</td>
<td>-4</td>
</tr>
<tr>
<td>Extra Reading</td>
<td>+2</td>
<td>SCREAMING or YELLING</td>
<td>-1</td>
</tr>
<tr>
<td>CLEANING up after PLAYING</td>
<td>+2</td>
<td>BAD SPORT</td>
<td>-2</td>
</tr>
</tbody>
</table>

Source: Gail Smith / Gael’s Treasures.
Global Risks for Economies and Markets...

Source: Center for Financial Stability.
"There is too little economic risk-taking, and too much financial risk-taking."

Christine Lagarde
Managing Director, IMF
October 12, 2014

It’s the Financial System that Matters: Monetary Ease and CFS Divisia Financial Data (y/y)

CFS Measure of Market Finance, Real October 2014, USD millions

<table>
<thead>
<tr>
<th>Peak</th>
<th>Fall</th>
<th>Decline 1/</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>-25%</td>
<td>16</td>
</tr>
<tr>
<td>1974</td>
<td>-17%</td>
<td>16</td>
</tr>
<tr>
<td>1979</td>
<td>-13%</td>
<td>7</td>
</tr>
<tr>
<td>1982</td>
<td>-5%</td>
<td>3</td>
</tr>
<tr>
<td>1989</td>
<td>-16%</td>
<td>29</td>
</tr>
<tr>
<td>2001</td>
<td>-4%</td>
<td>11</td>
</tr>
<tr>
<td>2008</td>
<td>-45%</td>
<td>79</td>
</tr>
<tr>
<td>Avg ‘08</td>
<td>-9%</td>
<td>13</td>
</tr>
</tbody>
</table>

1/ Cyclical peak-to-trough in months.

Note: The CFS definition of market finance includes: money market funds, repurchase agreements, and commercial paper.
Source: Federal Reserve Board, Bankrate, and the Center for Financial Stability.
Market Distortions from Quantitative Easing (QE)

“Demand for U.S. Debt Is Not Limitless”

The Wall Street Journal
March 28, 2012

http://online.wsj.com/articles/SB10001424052702304450004577279754275393064

Source: Federal Reserve Board and the Center for Financial Stability.
Policy Distortions: Risks for Markets

Source: Robert Shiller (Yale University), Bloomberg LP, and Center for Financial Stability.
Mantega was right…
“Beggar-thy-Neighbor” Currency Depreciation

“We’re in the midst of an international currency war, a general weakening of currency. This threatens us because it takes away our competitiveness.”
Guido Mantega
Brazil’s Finance Minister
September 27, 2010

“International monetary cooperation has broken down.”
Raghuram Rajan
President
Reserve Bank of India
January 31, 2014

Source: IMF, Bloomberg LP, and the Center for Financial Stability.
Slightly Different “Beggar-thy-Neighbor” Picture in Emerging Markets

Currency War Quote by Guido Mantega
Brazil’s Finance Minister
September 27, 2010

Source: IMF, Bloomberg LP, and the Center for Financial Stability.
Concluding Views

Policy behaviors will have consequences – shaping the future for global markets.

…to reduce risks…

I. Implement measures to partially restore financial market liquidity.
II. Exit smoothly and resolutely from distortionary monetary policies.
III. Embrace international cooperation.

IV. NYSSA / CFA: Systemic Risk Conference!!!!
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