Discussion:

"The Political Economy of Central Bank Balance Sheet Management"—Paul Tucker

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Columbia University SIPA & FRB of New York Workshop:

Implementing Monetary Policy Post-Crisis

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“Central Bank” independence was a mistake

- Significant research arguing in favor of independent *monetary authority*
    - Central Bank ≡ Monetary Authority

- Never intended that *whatever* activity an institution named “central bank” undertakes should be independent….such as quasifiscal operations

- Many central banks have undertaken quasifiscal policy—fiscal policy undertaken under the guise of an extra-budgetary entity

- 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*

Similarity of Operations: A United States Example
United States Treasury authorized to intervene

- Housing and Economic Recovery Act of 2008 (July 30) Section 1117
- Gave Treasury authority to purchase and sell obligations of

  Fannie Mae, Freddie Mac and the Federal Home Loan Banks

Secretary of the Treasury to determine an emergency exists and 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 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)

Similarity of Operations: A United States Example Federal Reserve Board…

- Announced plans to purchase GSE notes on September 18, 2008
- Announced program to buy direct obligations of housing related GSEs and GSE backed MBS on November 25, 2008
- Above zero lower bound restricted by the quantity of Treasuries held on the balance sheet that could be used to absorb money market liquidity
- At zero lower bound unrestricted—monetary finance unlimited
- Exactly the same policy as US Treasury yet unrestricted by Congress
- However right the policy, is this rational intelligent design?

An intermediate governance structure for an intermediate policy function?

- Monetary policy—overnight interest rate policy—political independence
- Fiscal policy—expenditure, revenue, deficit policy—political dependence

- Market intervention policy—a “third” *governance structure*

- Financial Market Intervention Authority—governed by hybrid structure including: monetary authority, financial stability authority, treasury

- However the weighting is constructed, treasury should have at least a nominal vote on the record, democratic voice and accountability

Financial Market Intervention Authority

- Independent operational authority over *its balance sheet*
- Equity and dividend distribution rule established in founding Act
- Ability to issue government debt within risk budget
- Ability to scale up in size—i.e. adequate equity provisions
  - Treasury given preauthorized authority to inject equity during a crisis sufficient to allow legislature time to consider further capital injection

- FMIA to report its activities according to IFRS

- Monetary authority to employ “near zero” balance sheet—functional accounting for budgetary resources—no longer publish p/l balance sheet

- Stella (2010) *Minimising Monetary Policy*

Canada—Textbook Monetary Authority

Bank of Canada Balance Sheet

December 31, 2015

(in C$ billions)

Assets		Liabilities	
Canadian Government bills & bonds	94.0	Banknotes in Circulation	75.5
Liquidity Providing Repos	6.1	Financial Institution Deposits	.5
		Treasury Operational Deposit	2.6
		Treasury Prudential Liquidity Deposit	20.0
		Net Other Liabilities	1.0
		Equity	.5
Total Assets	100.1	Total Liabilities	100.1

Source: Bank of Canada Financial Statements (2015) and author’s calculations

Central Bank of Chile—Reliance on Debt Financing

Central Bank of Chile Balance Sheet

December 31, 2012

(in percent of GDP)

Assets		Liabilities	
Net Foreign Assets	14.9	Banknotes in Circulation	4.7
Domestic Financial Assets	2.3	FI and Other Deposits	5.4
		Treasury Operational Deposit	0.5
		Central Bank Securities	9.9
		Equity	-3.4
Total Assets	17.2	Total Liabilities	17.2

Source: Central Bank of Chile Annual Report (2013) and author’s calculations

Asset Management with Large Balance Sheets—Foreign Exchange Assets

- Central Bank of Chile moving toward commodity currency asset allocation while Treasury Sovereign Wealth Fund moving toward exact opposite

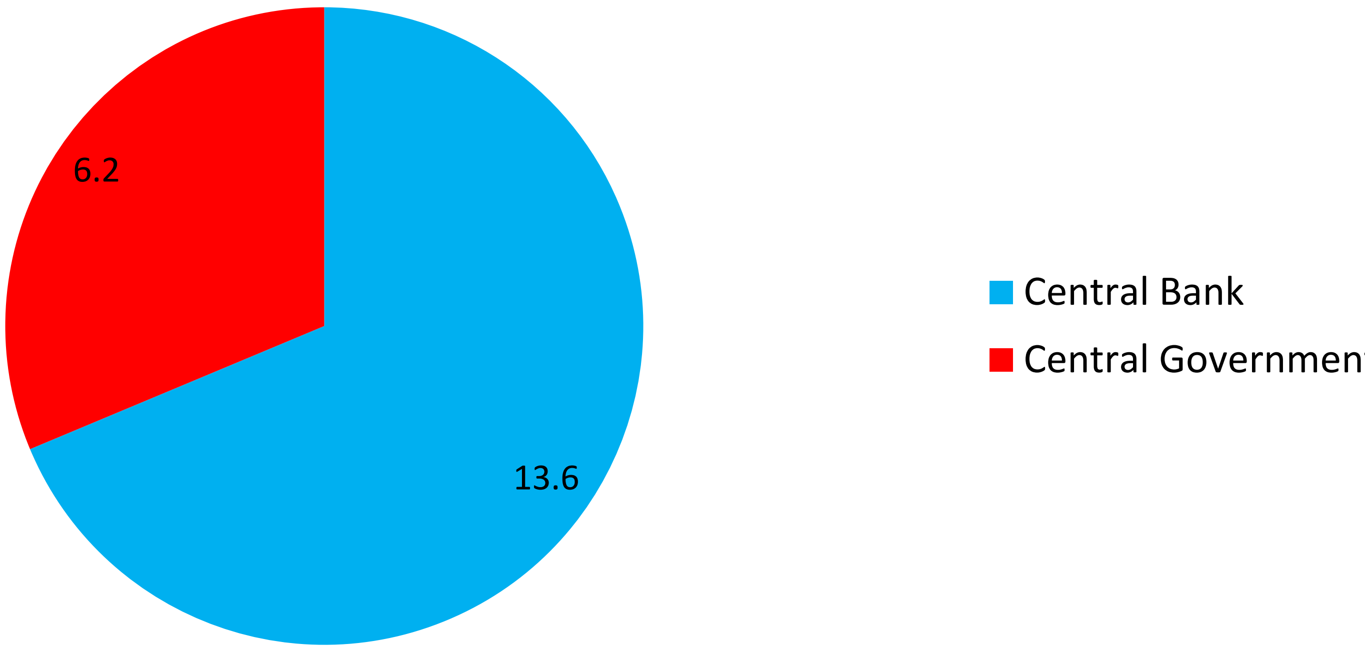
- Korean Investment Corporation—Sovereign Wealth Fund
- About USD 85 billion AUM
- Managed to a total return benchmark—quite different from BOK
- 2015 Attempted to buy an interest in Los Angeles Dodgers baseball club (CEO subsequently sacked by Congress)

- De Netherlands Bank post-Euro managing sovereign assets to an investment benchmark (set by Treasury) subsequent to capital infusion

Large Asset Portfolio Financed with Central Bank Debt may lead to Market Fragmentation

Chile: Central Government and Central Bank Debt

(2009 in percent of GDP)



Sources: OECD and Stella and Guerra (2010)

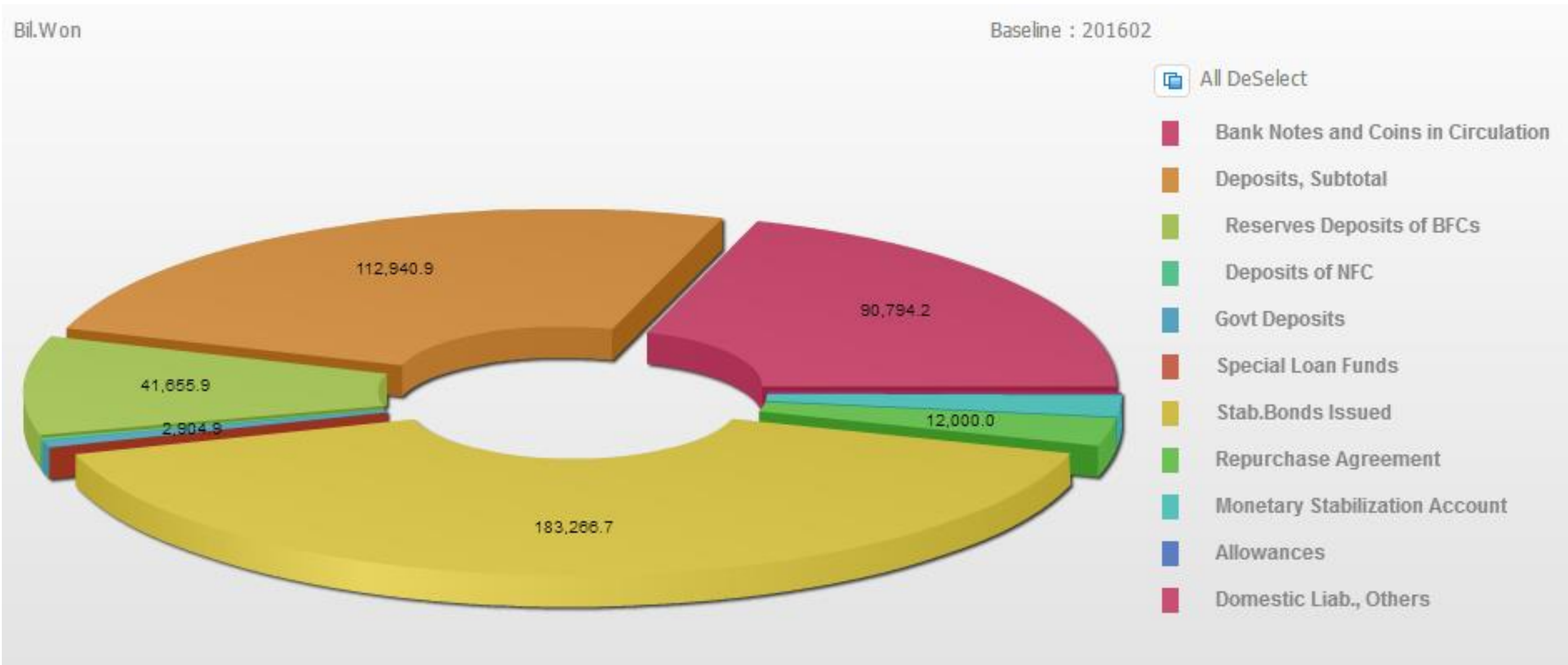
Debt issued by the Central Bank of Chile: Segmentation according to instrument

Composition of Central Bank of Chile Debt (in billions of pesos)	2012	2011	2007	2002
Discountable Promissory Notes (PDBC)		985	852	2983
Bonds in UF (BCU)	8535	8055	2556	227
Bonds in Pesos (BCP)	3906	3533	1935	374
Indexed Promissory Notes (PRC)	234	300	1488	4606
Optional Indexed Coupons in UF (CERO)	230	313	663	1149
Bonds in US Dollars (BCD)			198	1026
Indexed Promissory Notes USD (PRD)				2622
Optional Indexed Coupons in USD (CERO)				592
UF Promissory Notes Restructured (Res. 990)				327
Redenominated Forex Commercial Notes				112
CB Indexed Promissory Notes (PRBC)				60
USD CDs				4
UF Promissory Notes (Res. 1836)				1
Floating Interest Rate Promissory Notes (PFT)				1
Exchange Differential Notes	.021	.021	.021	.021
Total	12905	13186	7694	14084

14 Securities

5 Securities

Bank of Korea: About 38 percent of liabilities comprise Monetary Stabilization Bonds (≈USD 160 billion)



Quite a change in view pre and post crisis regarding need for foreign reserves—for LOLR in forex

In 2007—"So it does not appear that a foreign exchange reserve can be justified when a floating exchange rate is being operated. However, a foreign exchange reserve may be required in readiness for a switch to a fixed exchange rate."

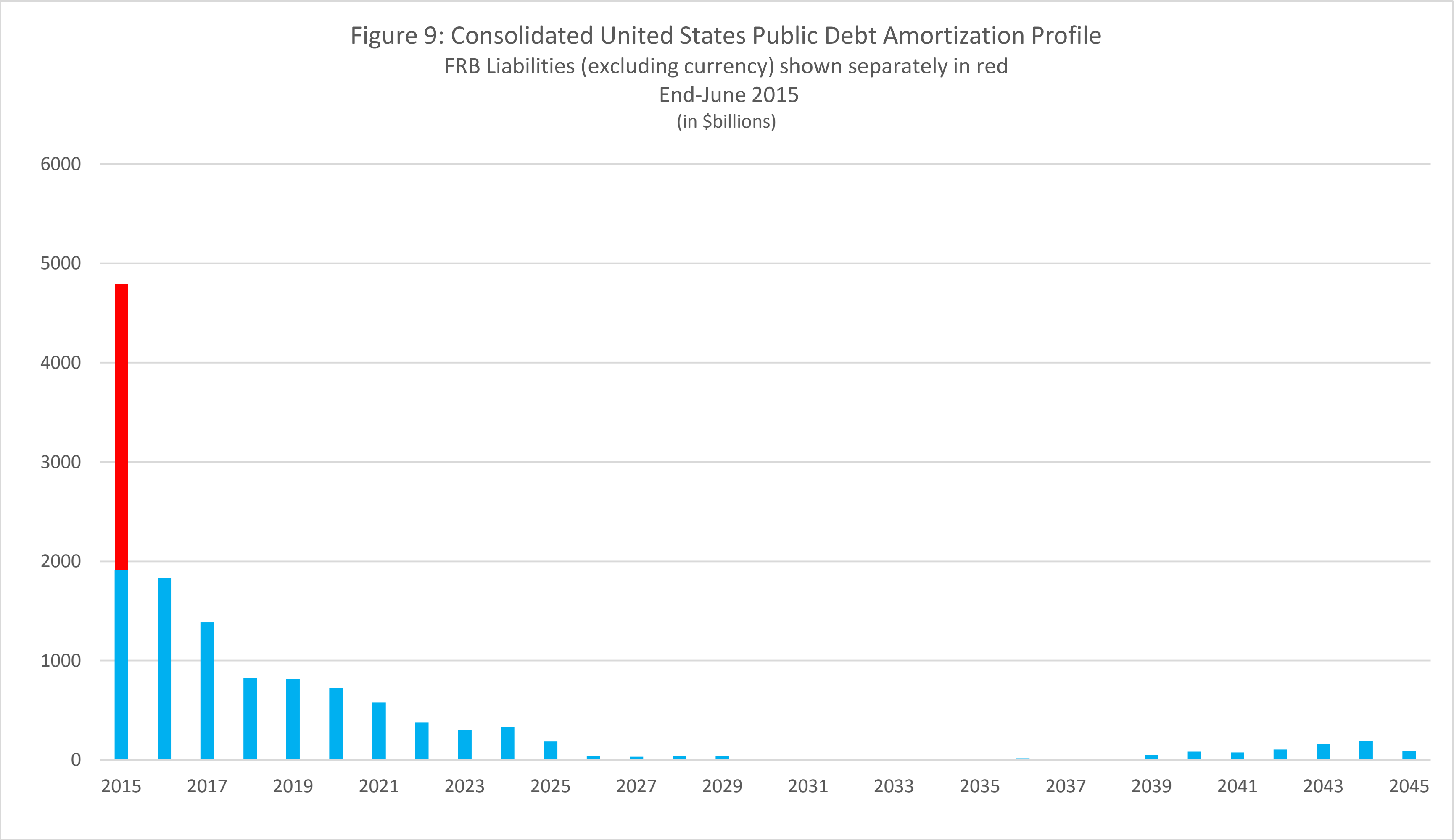
Source: Commission of Inquiry Report on the Riksbank's Financial Independence SOU 2007:51, page 55

In 2013—"The Report [Commission of Inquiry] proposes… Sveriges Riskbank should be given the right to finance its lending in foreign currency by borrowing to the extent required, without limits. This would ensure a sufficient supply of emergency liquidity to banks in distress when financial stability is threatened…."

Source: Opinion of the European Central Bank of 24 July 2013 on the financial independence of the Sveriges Riksbank (CON/2013/53)

Who/How to finance the expanded Sovereign Balance Sheet? Treasury or CB?

Who is really in charge of the amortization profile of the consolidated US public debt?



The bulk of the change in US bank balance sheets has been in deposit growth at FRBs and associated financing

Table 6: Reclassified Change in Aggregate Balance Sheet of US Commercial Banks

From 12/5/2007 to 8/26/2015

(in US$ billions)

Assets		Liabilities	
Deposits at FRBs	+2666	Nonbank Deposits to Finance Reserves	+2666
Loans and Leases	+1584	Other Nonbank Deposits	+1422
Treasury and Agency securities	+993	Equity and Residual	+554
Net Other Assets	-601		
Total Assets	+4642	Total Liabilities and Equity	+4642

Source: Stella (2015), *Exiting Well*, Federal Reserve Board Release H.8, H.4.1 and Author's calculations

Expanded bank balance sheets combined with post-crisis legislation aimed at reducing leverage and reliance on short-term financing are problematic

- Strengthened US regulations require US chartered banks to pay FDIC insurance charges on all non-equity financing (2011) and to hold capital under eSLR for all assets—including deposits held at central banks (2018)

- US G-SIBs could be subject to a maximum 20x simple leverage ratio with zero carve-out for deposits held at the central bank

- Basle Committee similarly did not carve out bank reserves from any regulation—all this before ECB began large scale asset purchases

The crisis has broken the somewhat artificial barriers between policies and institutions

- As Paul Tucker has said—

  time to think hard about to whom to delegate what

Central banks and treasuries manage large portions of sovereign debt and assets—sometimes at cross purposes

Financial regulators, macroprudential authorities, central banks and treasuries are all engaged in financial market intervention—how to coordinate and avoid unintended consequences while ensuring democratic legitimacy?