Minsky and the Flat Ocean Theorists

Scott Fullwiler
UMKC & Binzagr Institute for Sustainable Prosperity

26th Annual Hyman P. Minsky Conference ♦ Levy Institute, Bard College ♦ April 2017

1

Digression on Unwinding the Fed's Balance Sheet

If we consolidate the books of all the government agencies, then the Treasury debt held by the Federal Reserve Banks would appear as both an asset and a liability of the government. Such internal financial arrangements are usually ignored - the debt to all practical purposes does disappear once it enters the Federal Reserve System's portfolio.

HP Minsky

http://digitalcommons.bard.edu/cgi/viewcontent.cgi?article=1445&context=hm_archive

Assets		
Gold certificate account		11,037
Special drawing rights certificate account		5,200
Coin		1,899
Securities, unamortized premiums and discounts, repurchase agreements, and loans		4,413,341
Securities held outright (1)		4,258,966
U.S. Treasury securities		2,464,546
Bills (2)		0
Notes and bonds, nominal (2)		2,339,280
Notes and bonds, inflation-indexed (2)		107,233
Inflation compensation (3)		18,034
Federal agency debt securities (2)		13,329
Mortgage-backed securities (4)		1,781,091
Unamortized premiums on securities held outright (5)		169,292
Unamortized discounts on securities held outright (5)		-14,941
Repurchase agreements (6)		0
Loans		24
Net portfolio holdings of Maiden Lane LLC (7)		1,708
Items in process of collection	(0)	90
Bank premises		2,198
Central bank liquidity swaps (8)		45
Foreign currency denominated assets (9)		20,115
Other assets (10)		28,860
Total assets	(0)	4,484,492

5. Consolidated Statement of Condition of All Federal Reserve Banks (continued)

Millions of dollars

Assets, liabilities, and capital	Eliminations from consolidation	Wednesday Apr 12, 2017
Liabilities		
Federal Reserve notes, net of F.R. Bank holdings		1,494,338
Reverse repurchase agreements (11)		357,433
Deposits	(0)	2,582,696
Term deposits held by depository institutions		0
Other deposits held by depository institutions		2,367,767
U.S. Treasury, General Account		119,157
Foreign official		5,174
Other (12)	(0)	90,598
Deferred availability cash items	(0)	651
Other liabilities and accrued dividends (13)		8,783
Total liabilities	(0)	4,443,900
Capital accounts		
Capital paid in		30,592
Surplus		10,000
Other capital accounts		0
Total capital		40,592

2

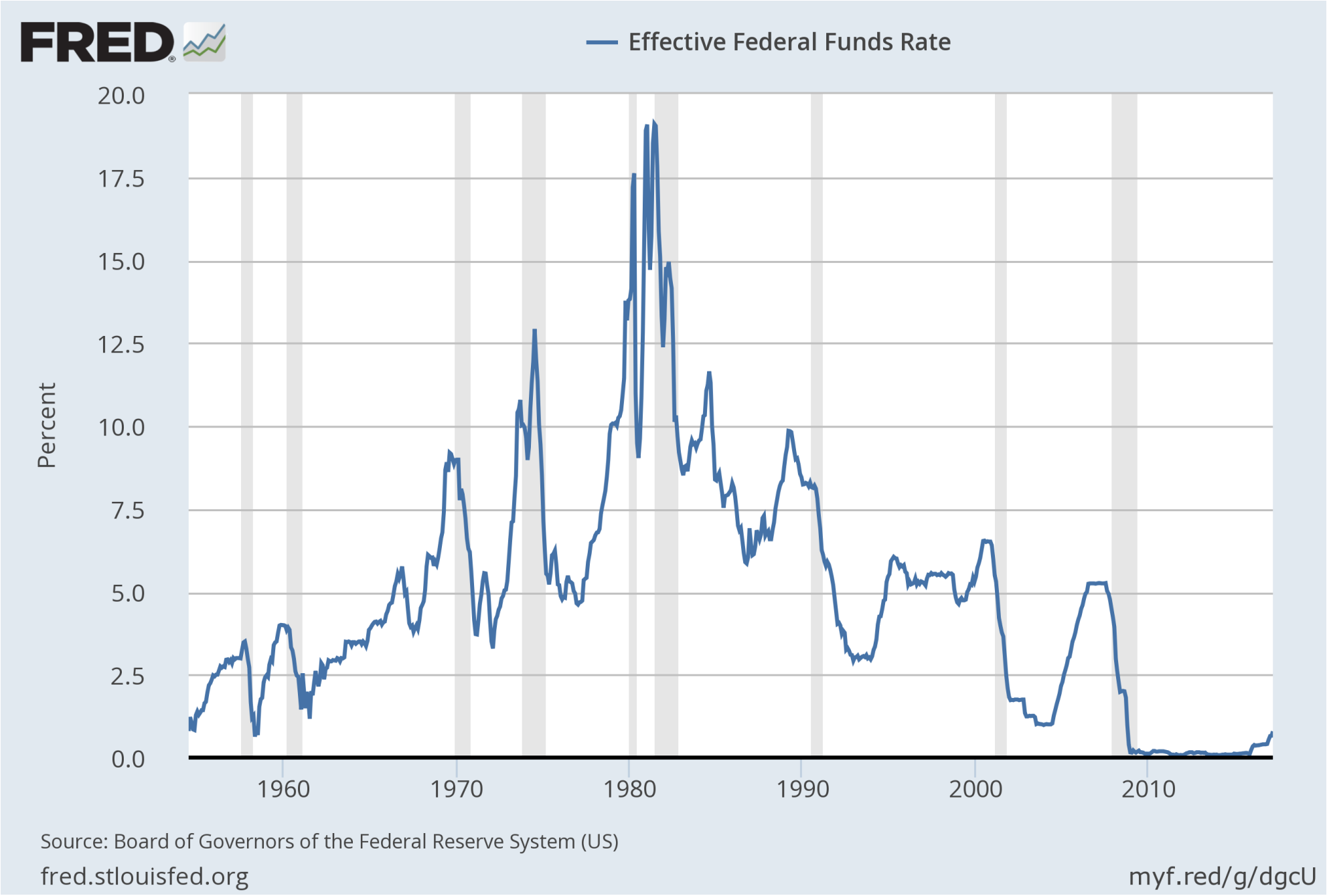
Back to the Originally-Planned Presentation

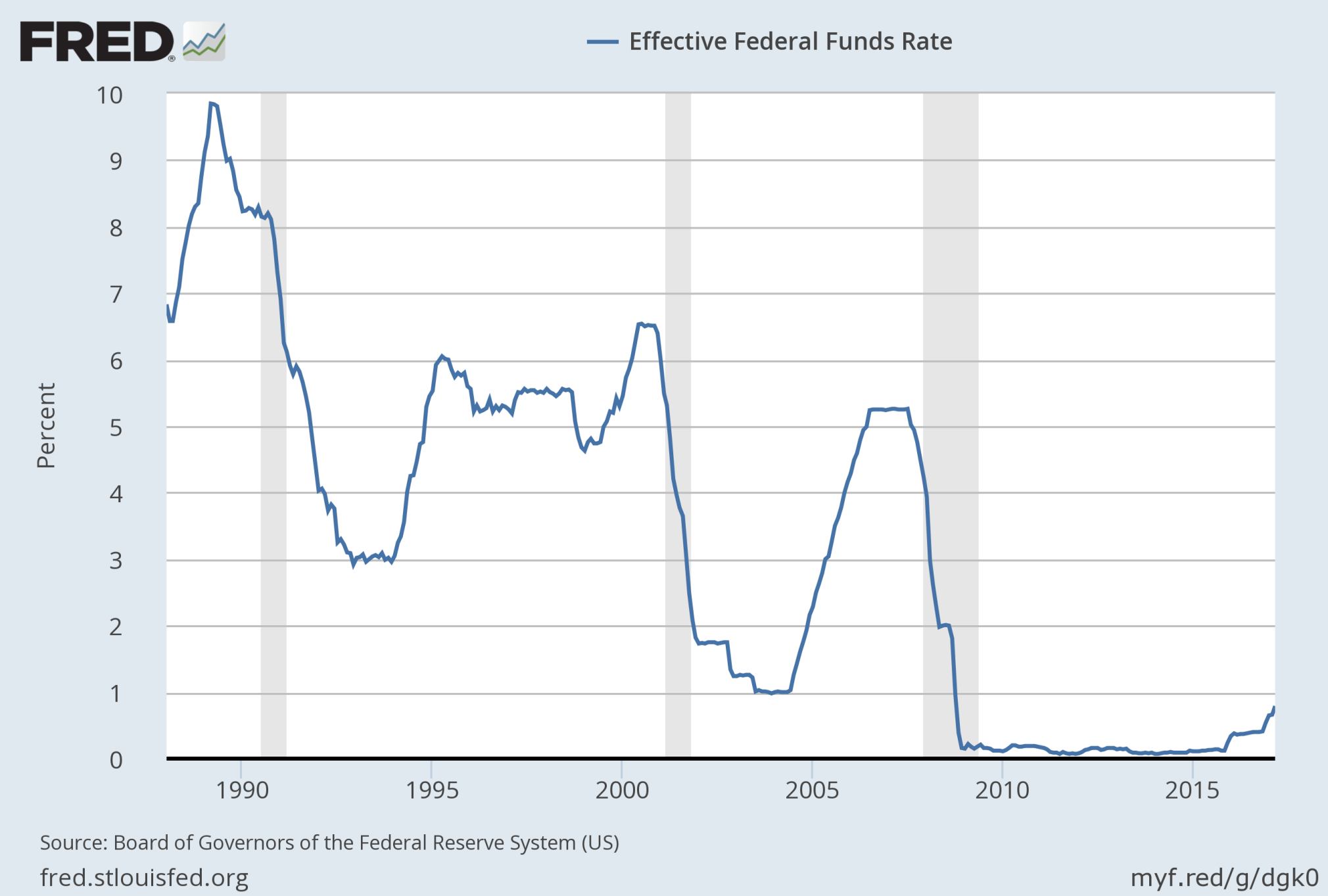
Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is past the ocean is flat again.

JM Keynes
***A Tract on Monetary Reform*, p. 80**

3

Key Query


FRED
Effective Federal Funds Rate
Percent
20.0
17.5
15.0
12.5
10.0
7.5
5.0
2.5
0.0
1960
1970
1980
1990
2000
2010
Source: Board of Governors of the Federal Reserve System (US)
fred.stlouisfed.org
myf.red/g/dgcU


FRED
Effective Federal Funds Rate
Percent
10
9
8
7
6
5
4
3
2
1
0
1990
1995
2000
2005
2010
2015
Source: Board of Governors of the Federal Reserve System (US)
fred.stlouisfed.org
myf.red/g/dgk0

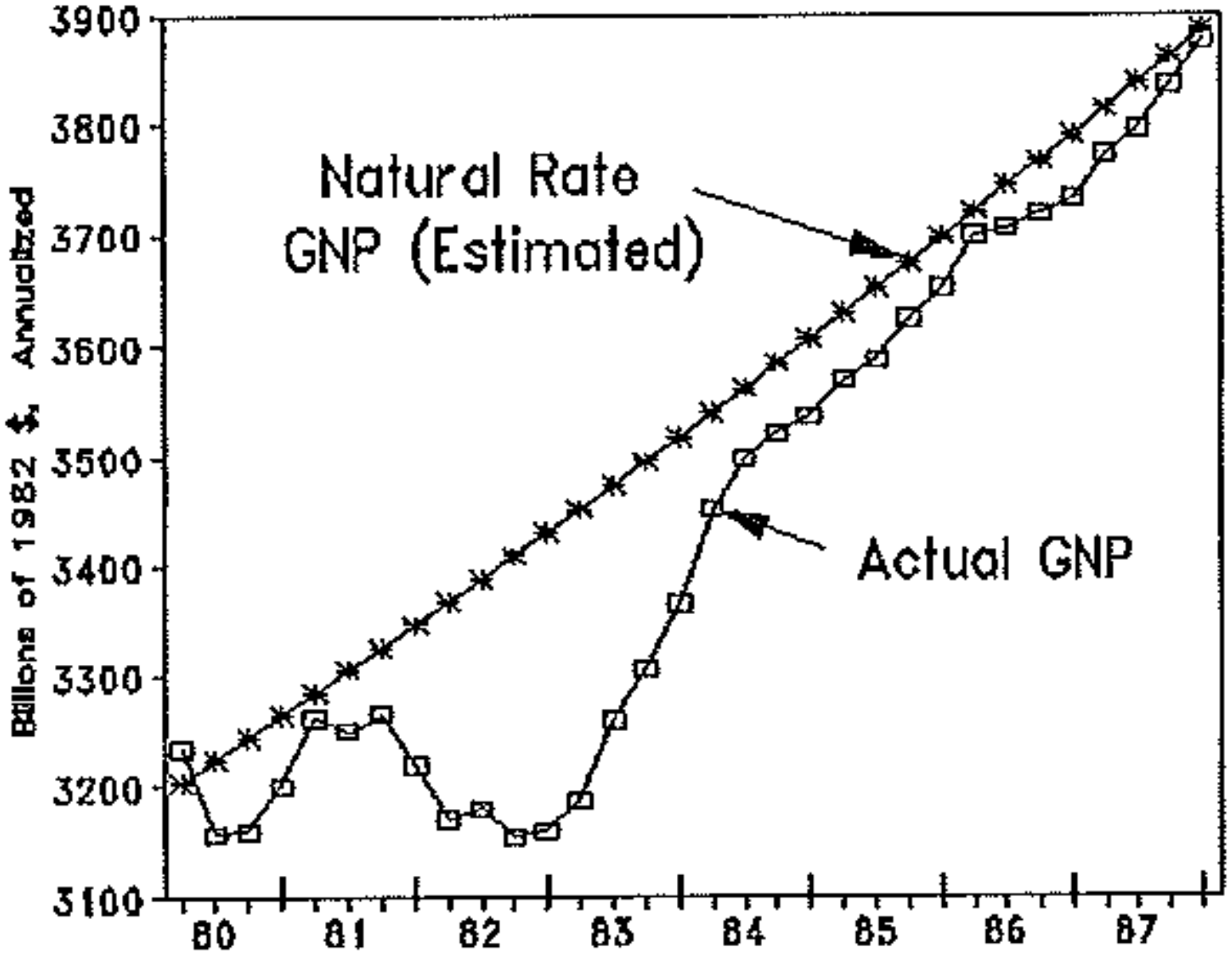
- Real GDP = f (trend growth, shocks)

- Real GDP = f (trend growth, shocks)
- Inflation = f (expected inflation, GDP vs. Potential)

- Real GDP = f (trend growth, shocks)
- Inflation = f (expected inflation, GDP vs. Potential)
- Interest Rate Target = f (natural rate of interest, Taylor's Rule, gradualism, forward guidance, etc.)

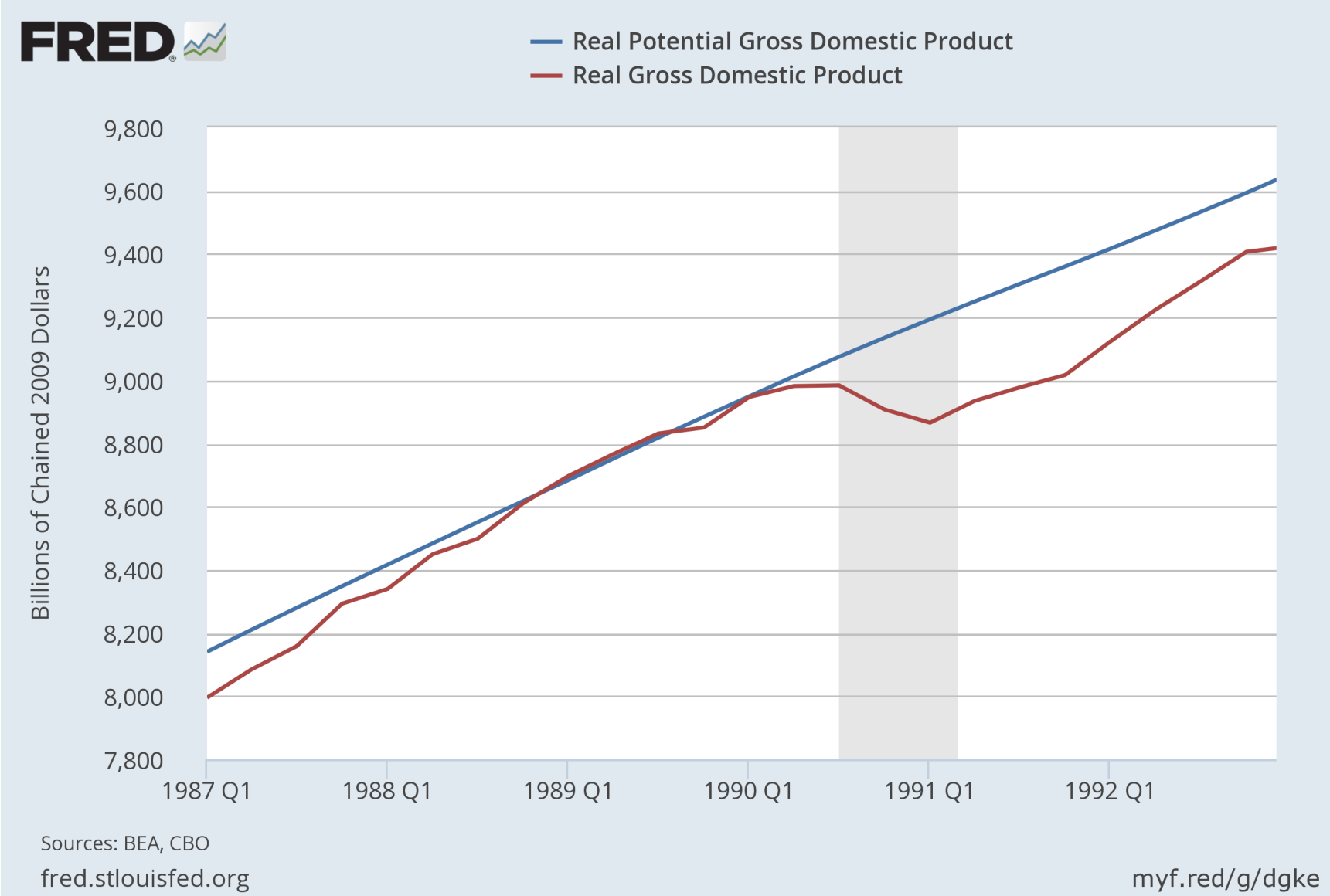
- Real GDP = f (trend growth, shocks)
- Inflation = f (expected inflation, GDP vs. Potential)
- Interest Rate Target = f (natural rate of interest, Taylor's Rule, gradualism, forward guidance, etc.)
- Monetary Policy Dominance = f ("sound" fiscal policy)

Late 1980s—The First Soft Landing

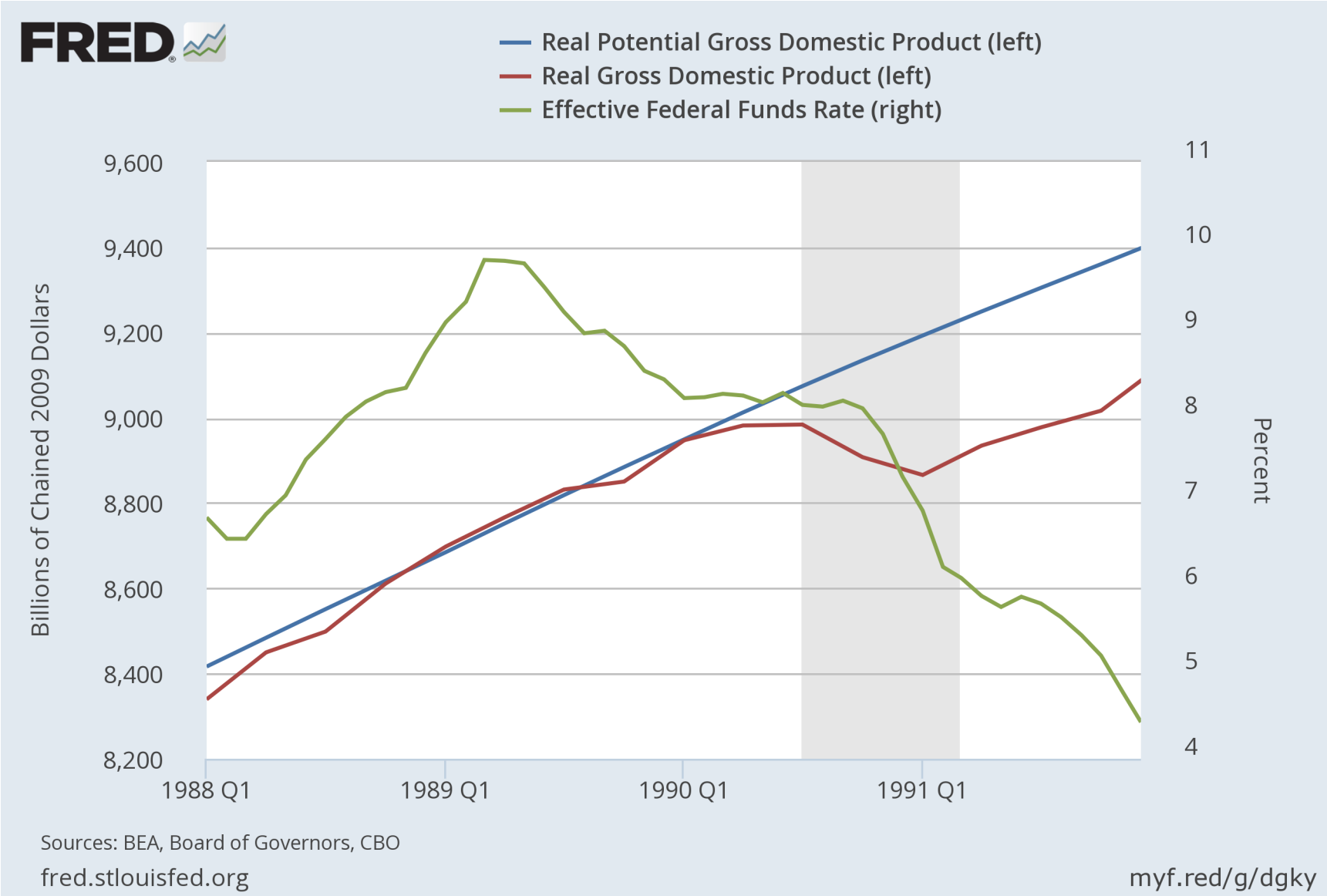


Carolyn Clark, 1992, Ch. 9

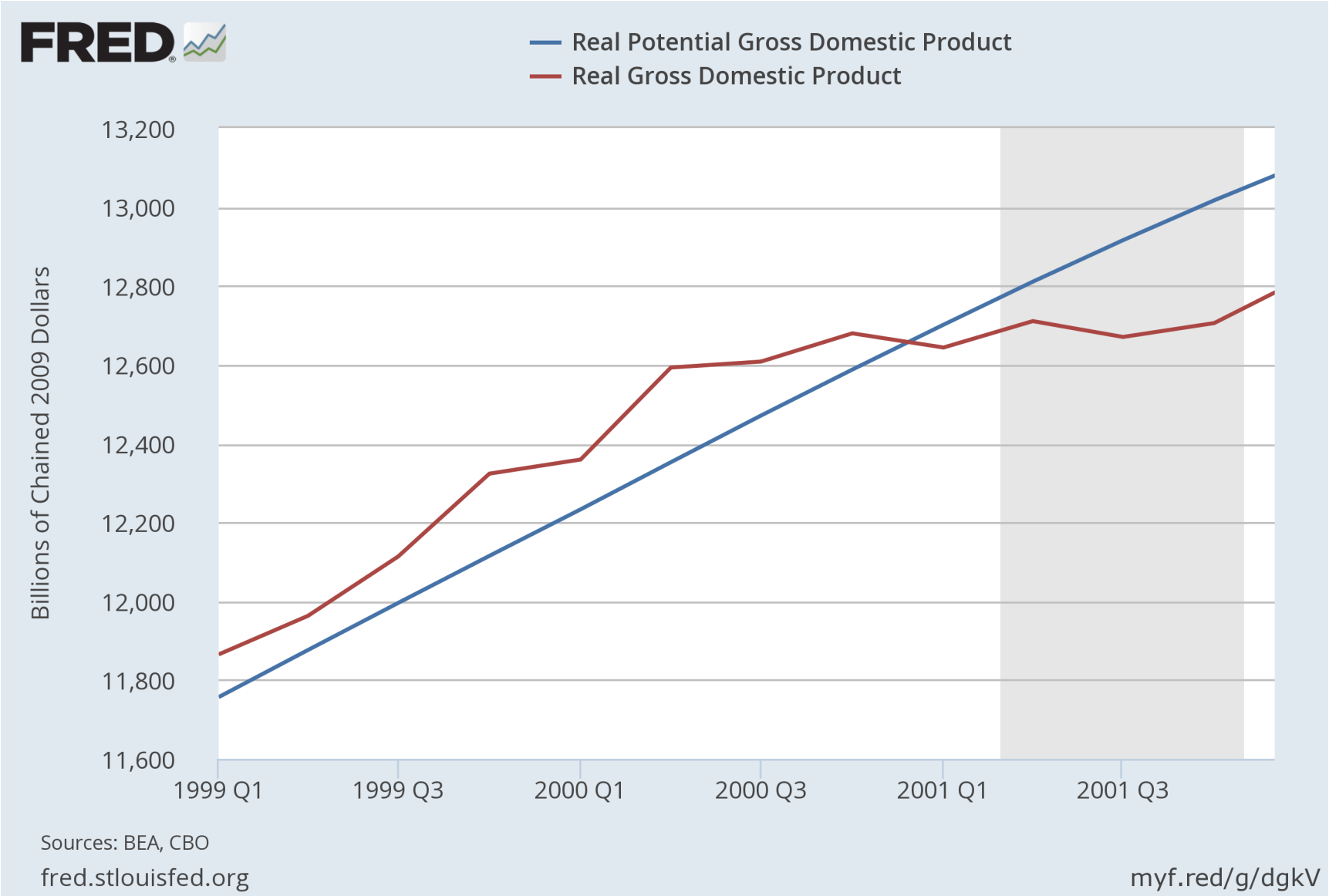
Late 1980s—The First Soft Landing



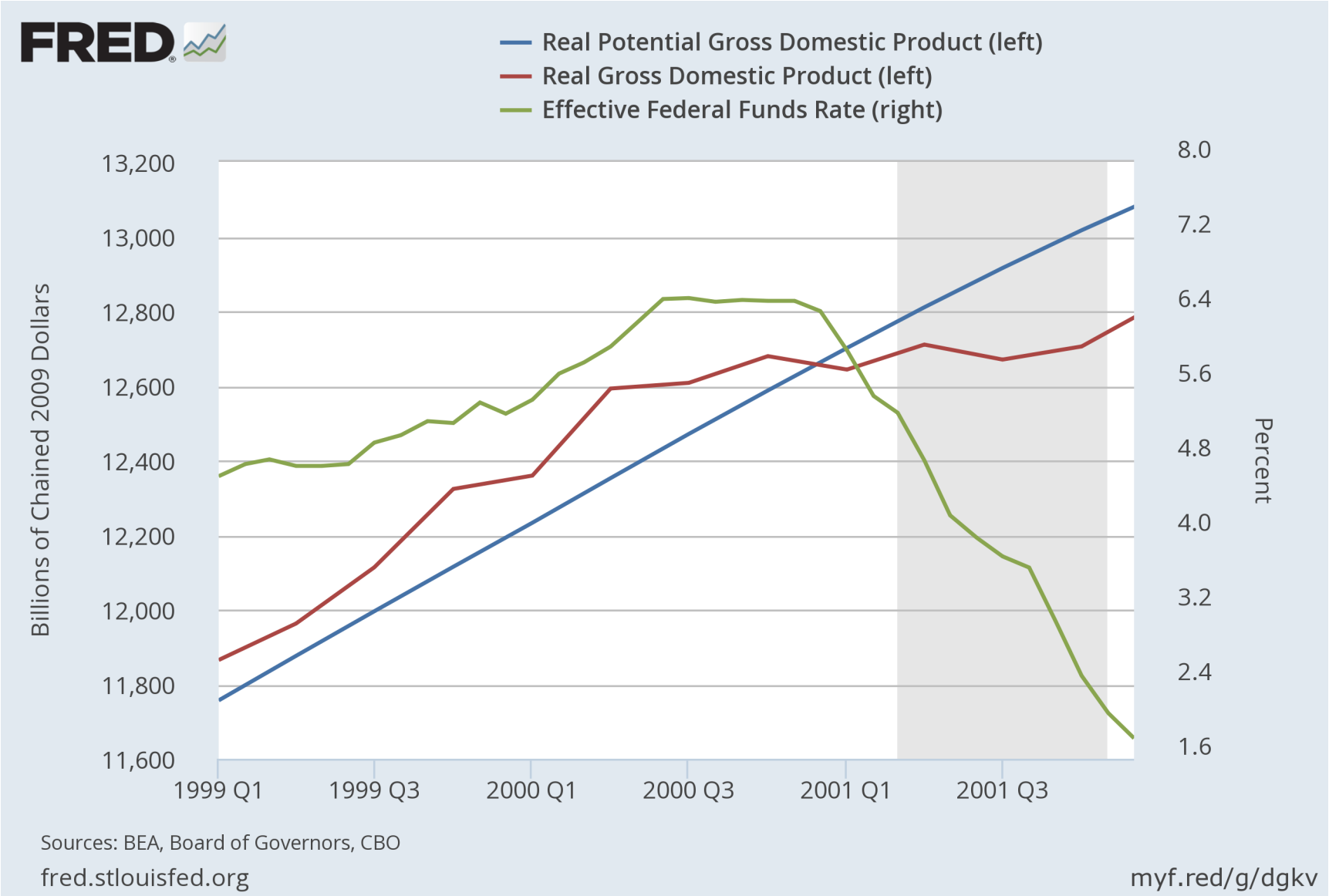
Late 1980s—The First Soft Landing



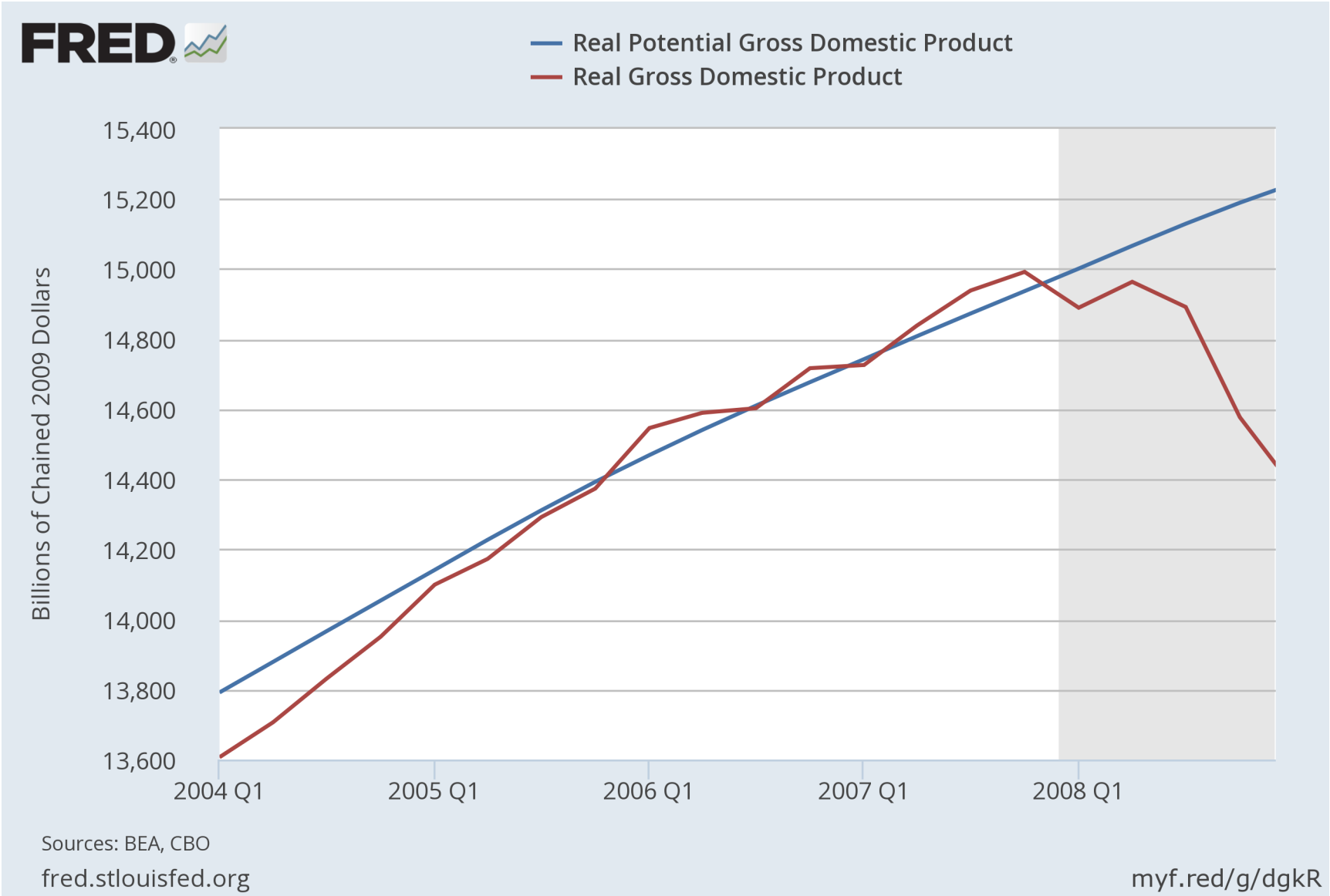
Late 1990s—Soft Landing the New Economy



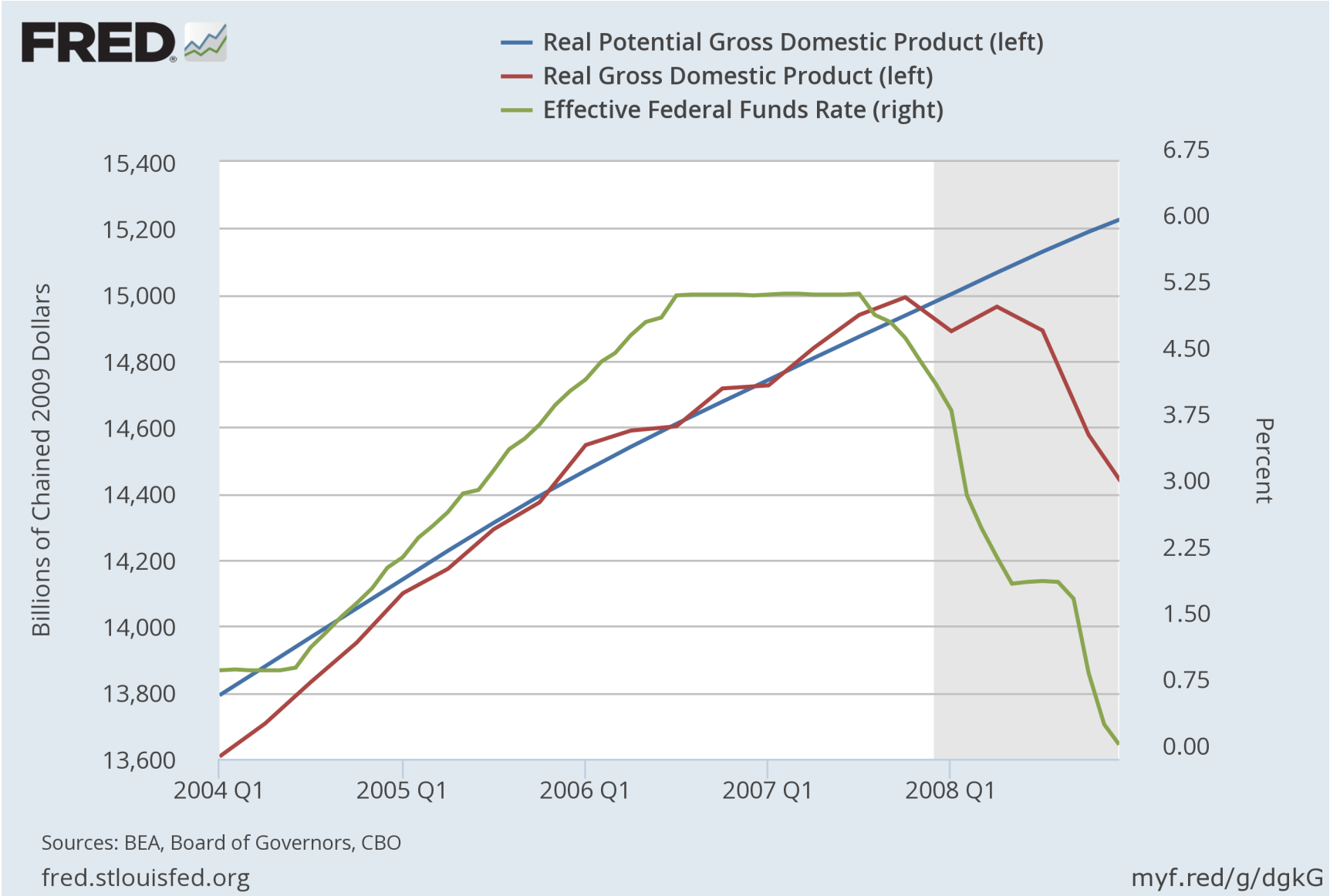
Late 1990s—Soft Landing the New Economy



Late 2000s—Soft Landing the Great Moderation



Late 2000s—Soft Landing the Great Moderation



"Taylor-type rules have been out of fashion. While the policy rate's at zero, they're kind of useless.

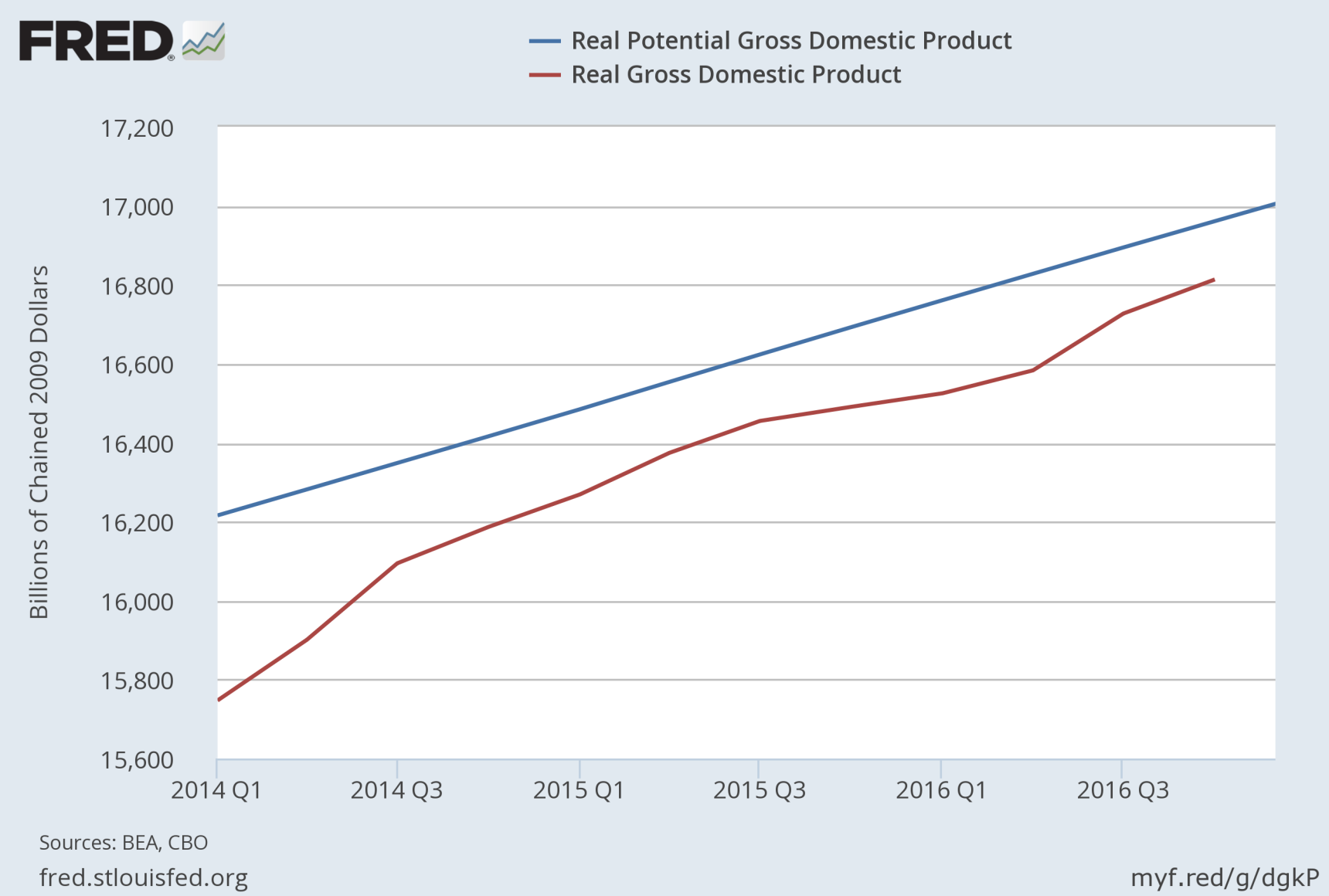
But now that we're talking about normalization, it's interesting to look at the policy prescriptions of Taylor-type policy rules.

The particular rule that's … been around policy circles for the last decade or more . . . suggests that we should have already lifted off."

St. Louis Fed Pres. James Bullard
Minsky Conference, 2015
Proceedings, p. 19

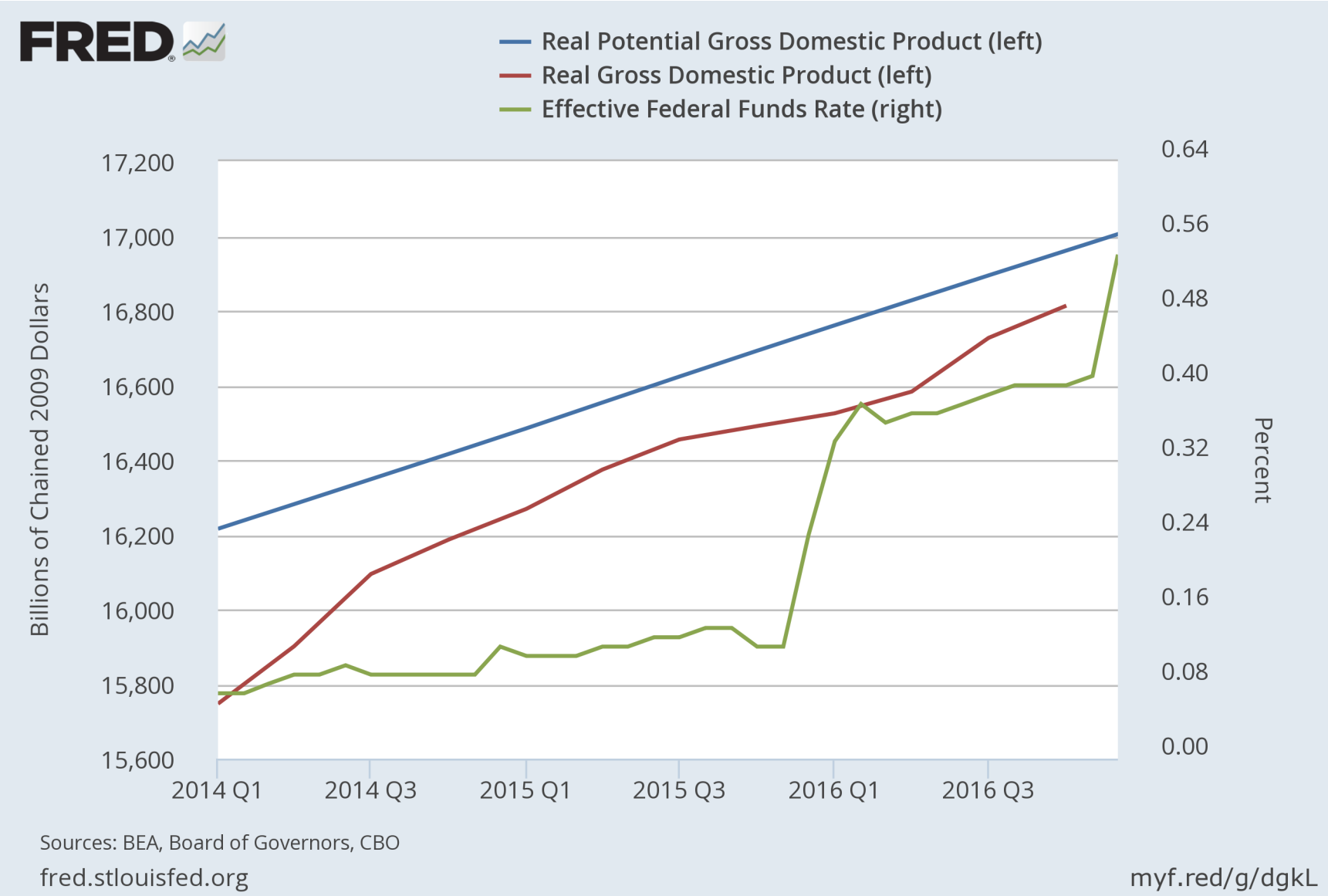
Late 2010s—

Soft Landing the Age of Diminished Expectations



Late 2010s—

Soft Landing the Age of Diminished Expectations



The FOMC policy rate projections vs. reality

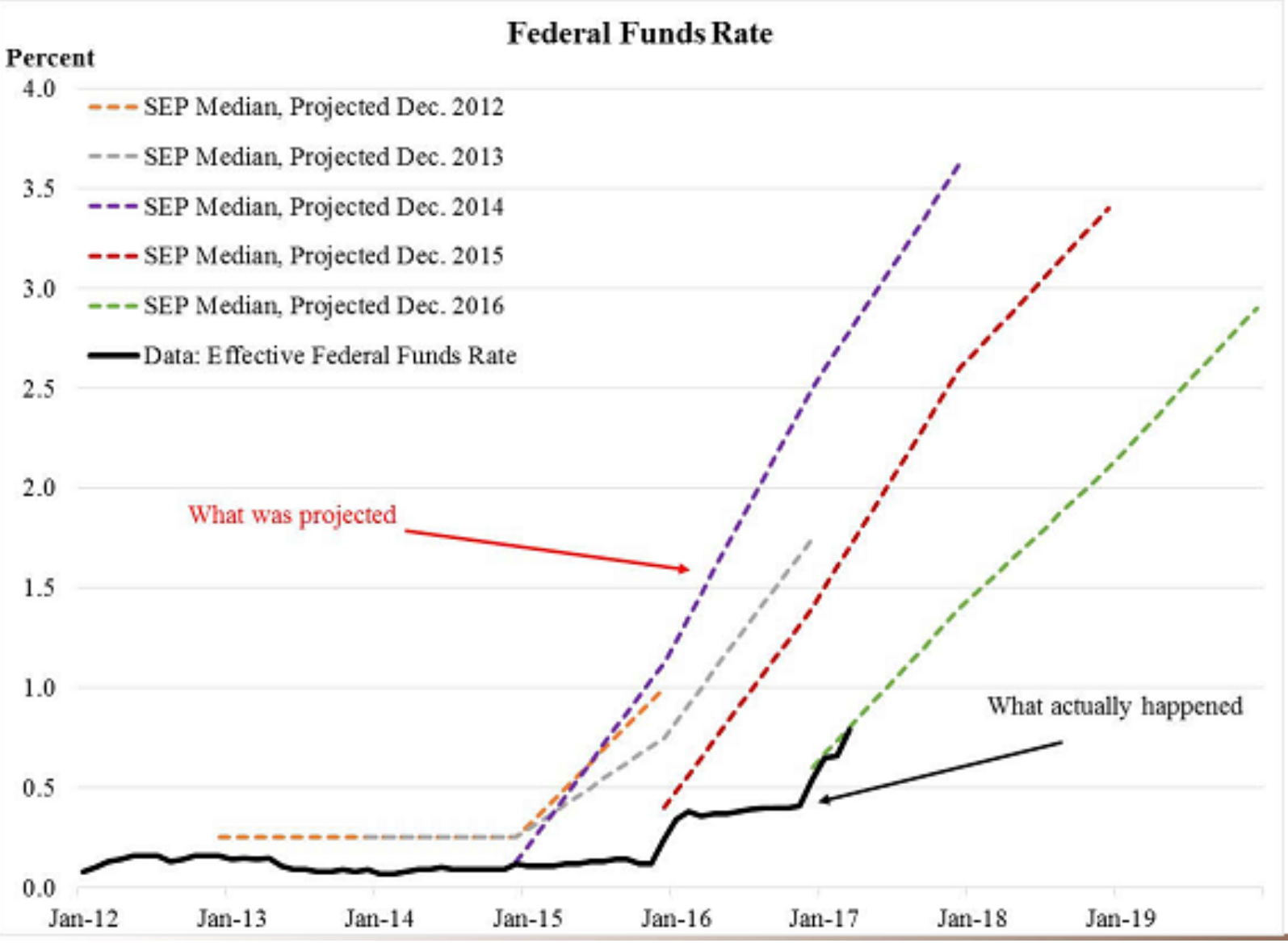
The U.S. Macroeconomic Outlook

James Bullard

President and CEO, FRB-St. Louis

Australian Centre for Financial Studies
International Distinguished Lecture

April 10, 2017
Melbourne, Australia



The policy rate path dichotomy

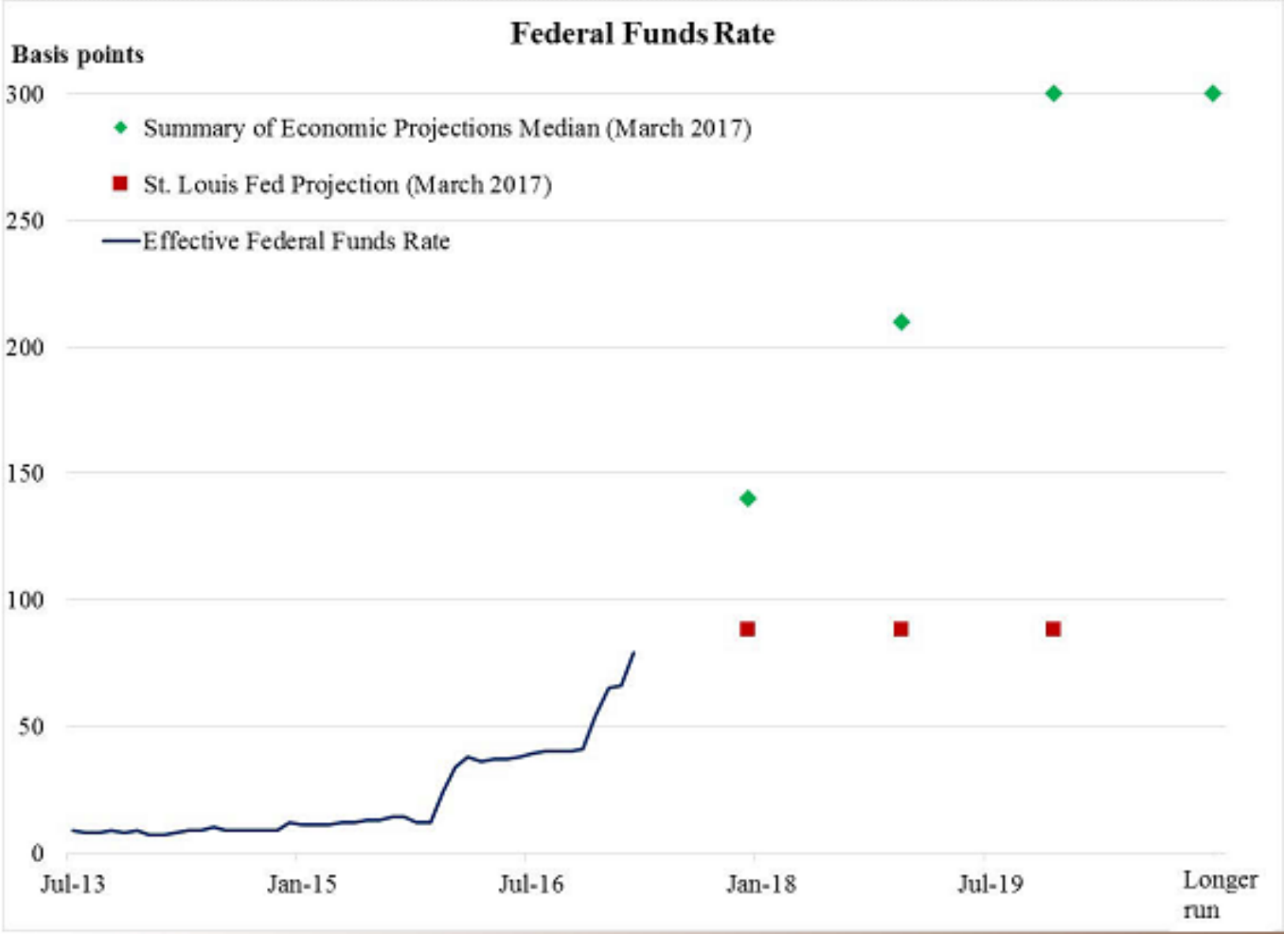
The U.S. Macroeconomic Outlook

James Bullard

President and CEO, FRB-St. Louis

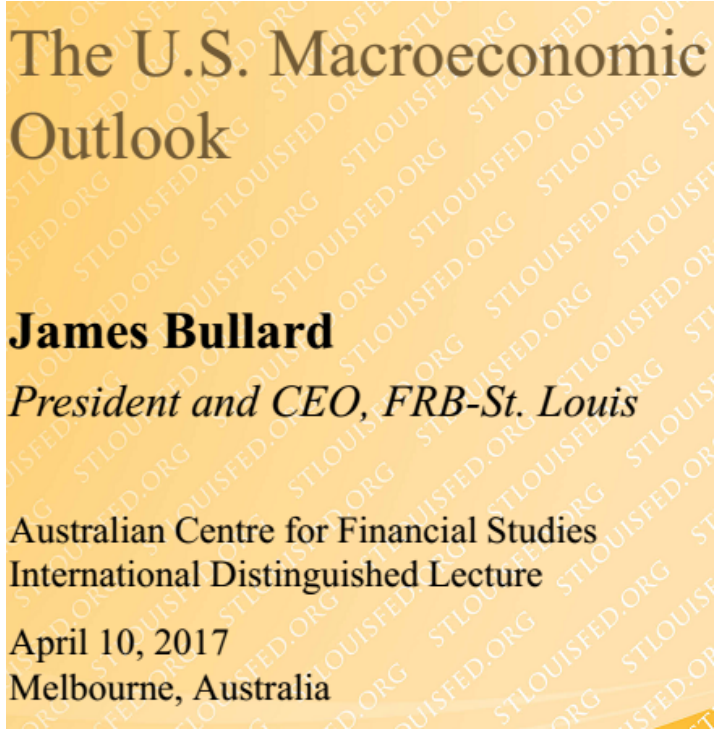
Australian Centre for Financial Studies
International Distinguished Lecture

April 10, 2017
Melbourne, Australia



Conclusion

- The U.S. economy has arguably converged to a low-real-GDP-growth, low-safe-real-interest-rate regime.
- Because of this, the Fed's policy rate can remain relatively low while still keeping inflation and unemployment near goal values.



4

What Would Minsky Do?

Not only is stability an unattainable goal; whenever something approaching stability is achieved, destabilizing processes are set off.

HP Minsky
***John Maynard Keynes*, p. 59**

A capitalist economy can be described by a set of interrelated balance sheets and income statements.

HP Minsky
Levy WP 69, p. 12

Assets	Liabs/Equity
Cash	Payables
Receivables	Non-Debt Liabilities
Inventories	Short-Term Borrowing
Financial Investments	Long-Term Borrowing
Fixed Capital	Preferred Stock
	Common Stock
	Retained Earnings

Non-Financial Corporation

Assets	Liabs/Equity
Cash	Payables
Receivables	Non-Debt Liabilities
Inventories	Short-Term Borrowing
Financial Investments	Long-Term Borrowing
Fixed Capital	Preferred Stock
	Common Stock
	Retained Earnings

Valuation
Project Evaluation

Non-Financial Corporation

Assets	Liabs/Equity
Cash	Payables
Receivables	Non-Debt Liabilities
Inventories	Short-Term Borrowing
Financial Investments	Long-Term Borrowing
Fixed Capital	Preferred Stock
	Common Stock
	Retained Earnings

Valuation
Project Evaluation

Minsky

Non-Financial Corporation

Assets	Liabs/Equity
Vault Cash	Core Deposits
Reserve Balances	Time Deposits
Liquid Securities	Short-Term Borrowing
Other Securities	Discount Window Borrowing
Business Loans	Long-Term Borrowing
Household Loans	Preferred Stock
	Common Stock
	Retained Earnings

Banks

Assets	Liabs/Equity
Vault Cash	Core Deposits
Reserve Balances	Time Deposits
Liquid Securities	Short-Term Borrowing
Other Securities	Discount Window Borrowing
Business Loans	Long-Term Borrowing
Household Loans	Preferred Stock
	Common Stock
	Retained Earnings

Underwriting

Banks

Assets	Liabs/Equity
Vault Cash	Core Deposits
Reserve Balances	Time Deposits
Liquid Securities	Short-Term Borrowing
Other Securities	Discount Window Borrowing
Business Loans	Long-Term Borrowing
Household Loans	Preferred Stock
	Common Stock
	Retained Earnings

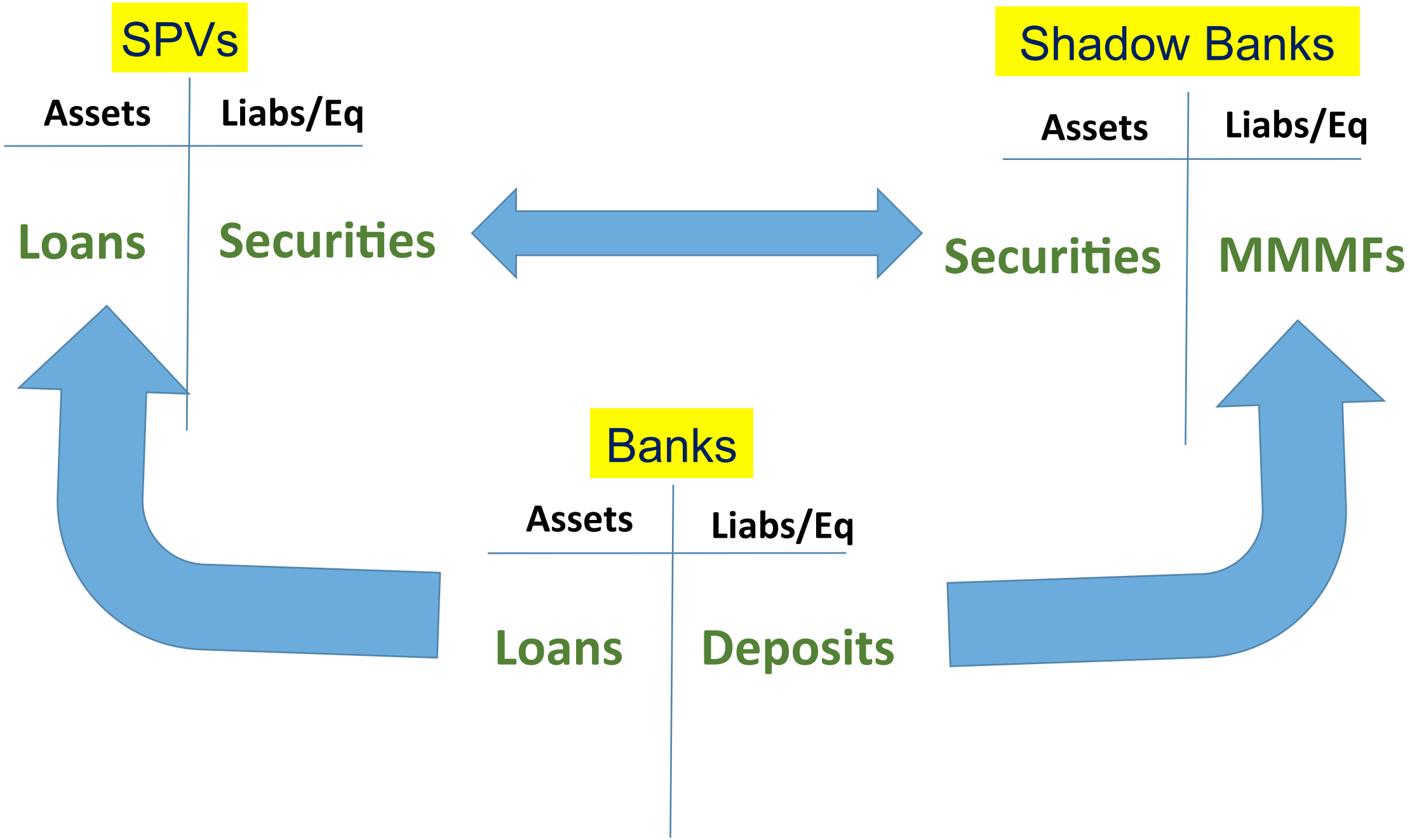
Refinance

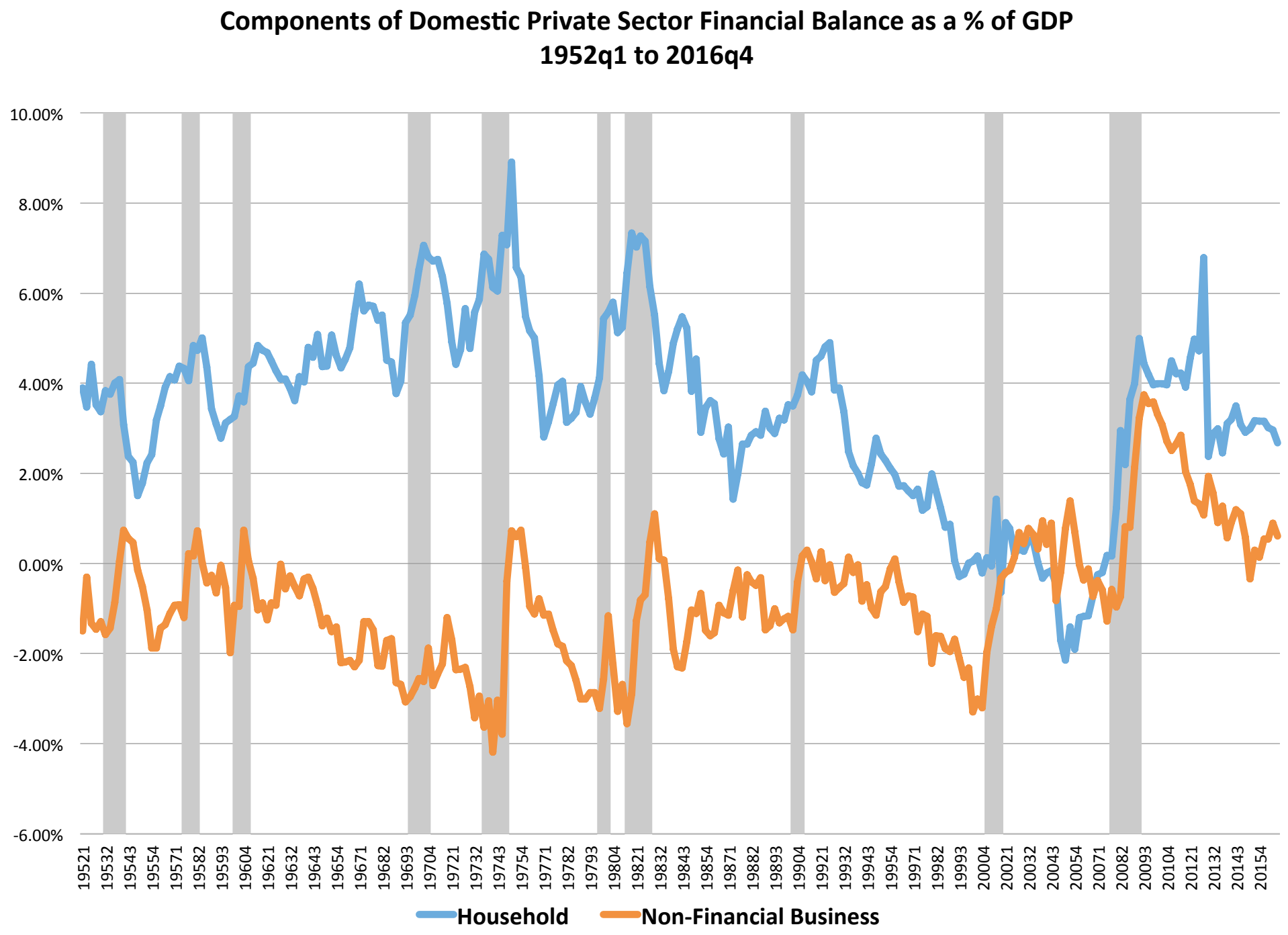
Underwriting

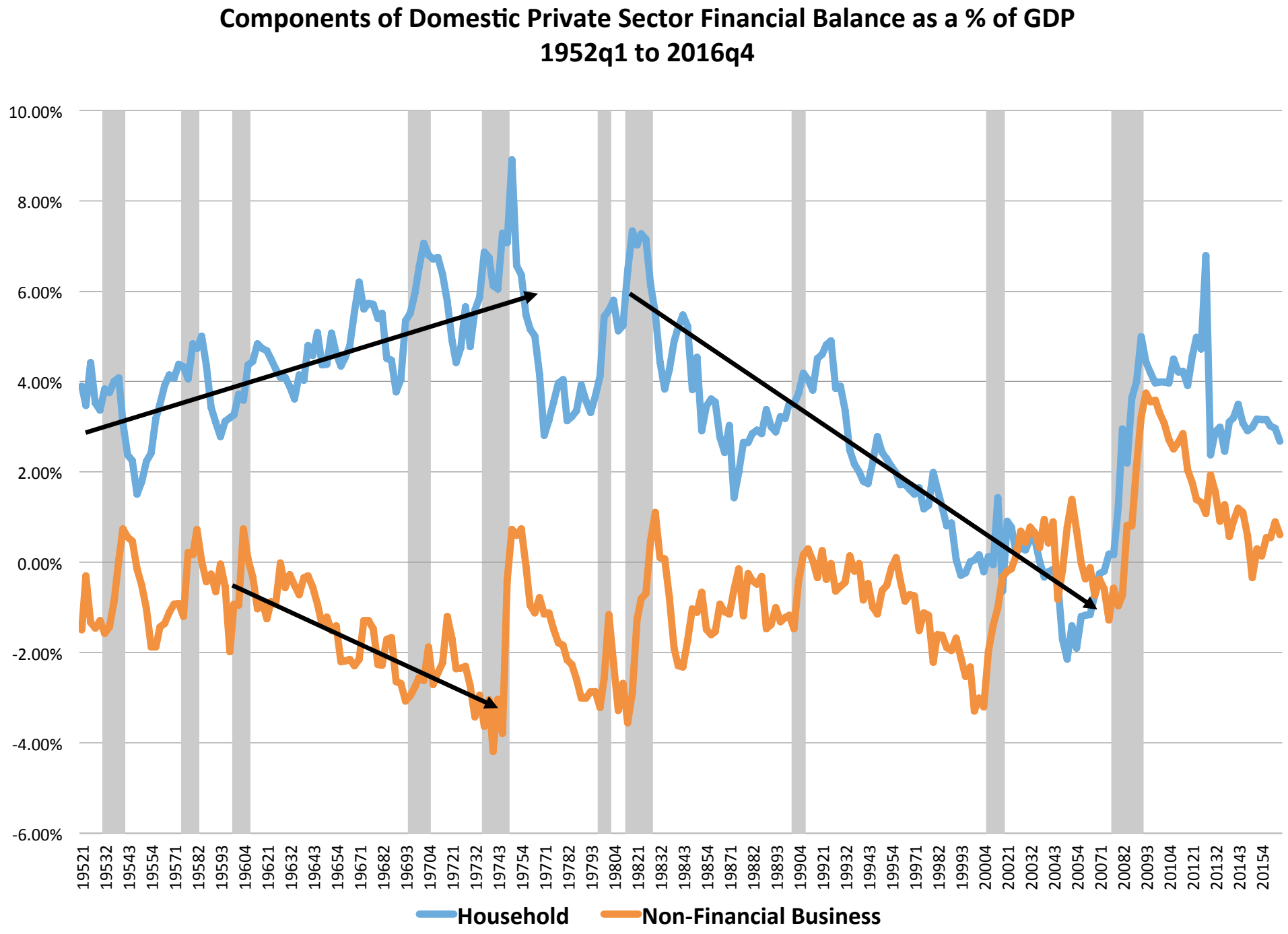
Banks

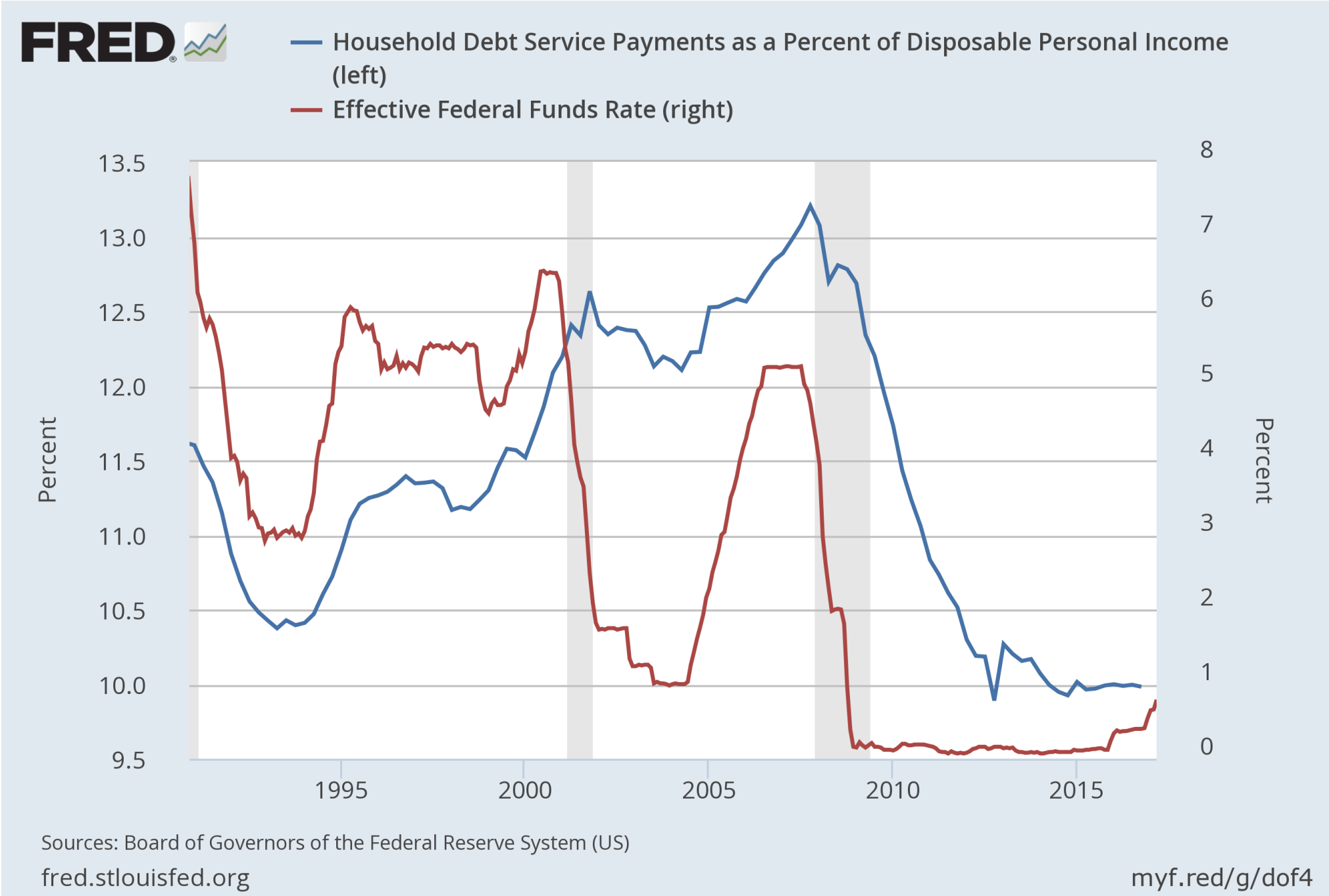
Assets	Liabs/Equity
Liquidity	
Vault Cash	Core Deposits
Reserve Balances	Time Deposits
Liquid Securities	Short-Term Borrowing
Other Securities	Discount Window Borrowing
Business Loans	Long-Term Borrowing
Household Loans	Preferred Stock
	Common Stock
	Retained Earnings
	Capital

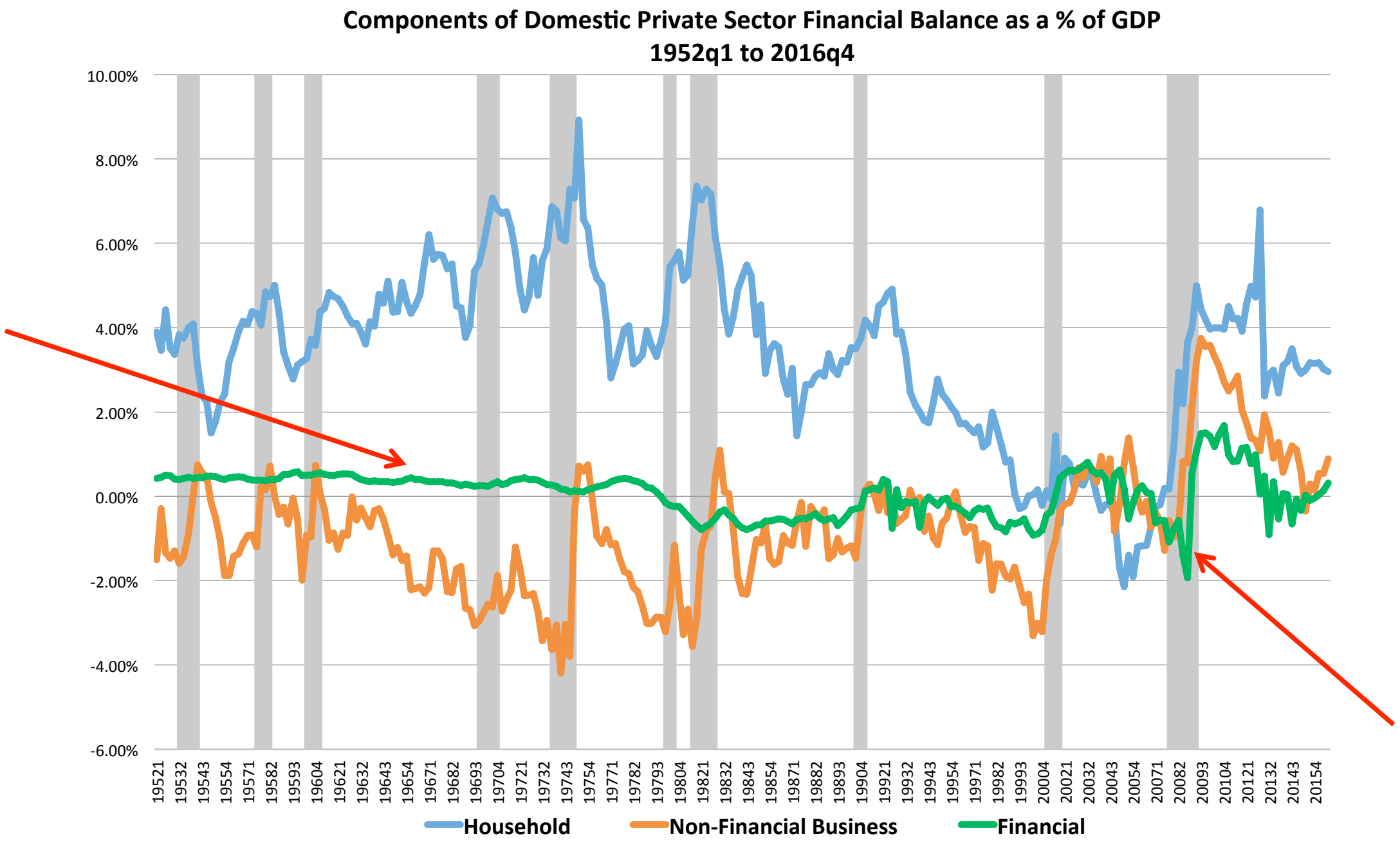
Banks

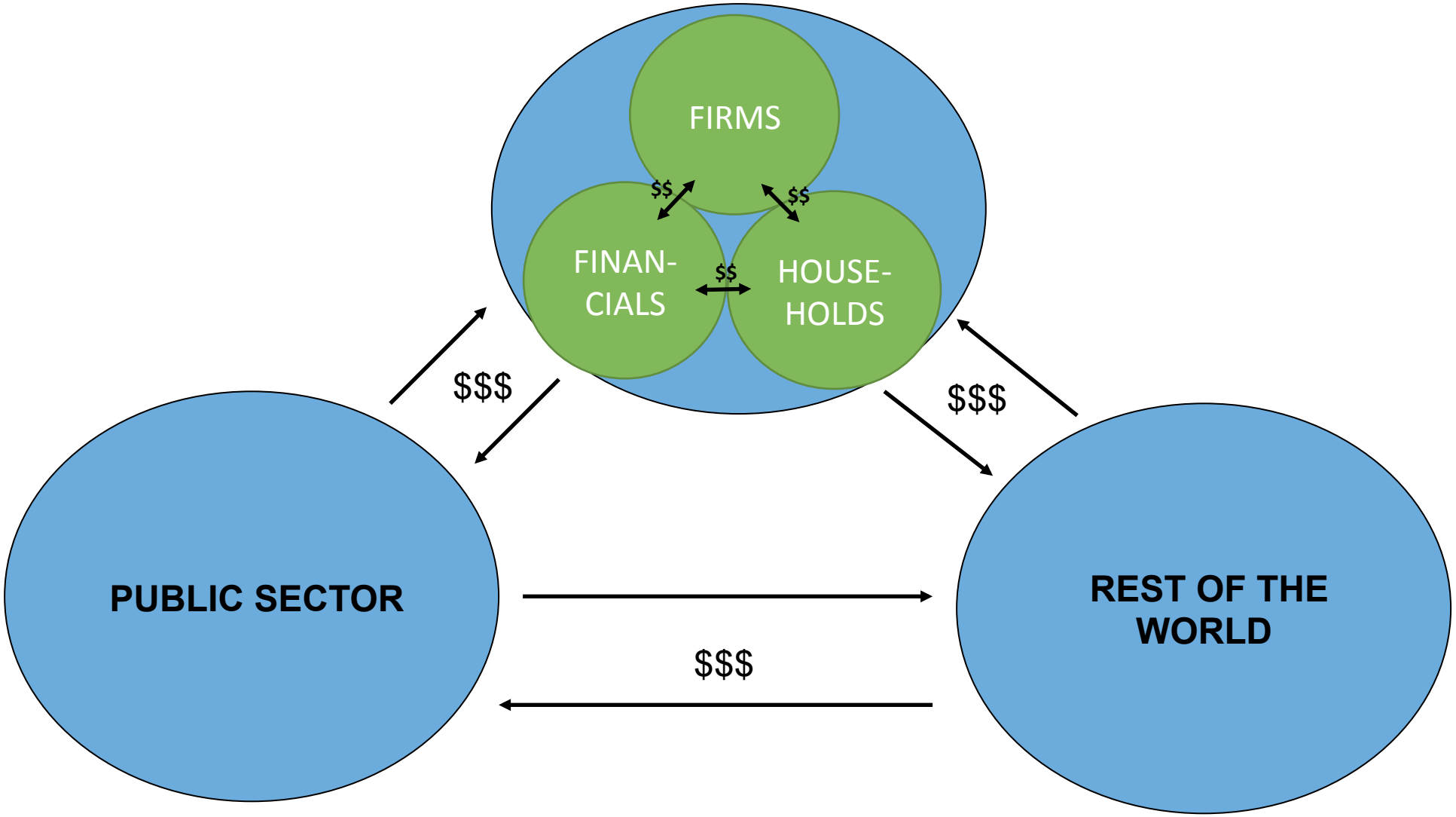

SPVs
Assets
Liabs/Eq
Loans
Securities
Shadow Banks
Assets
Liabs/Eq
Securities
MMMFs
Banks
Assets
Liabs/Eq
Loans
Deposits

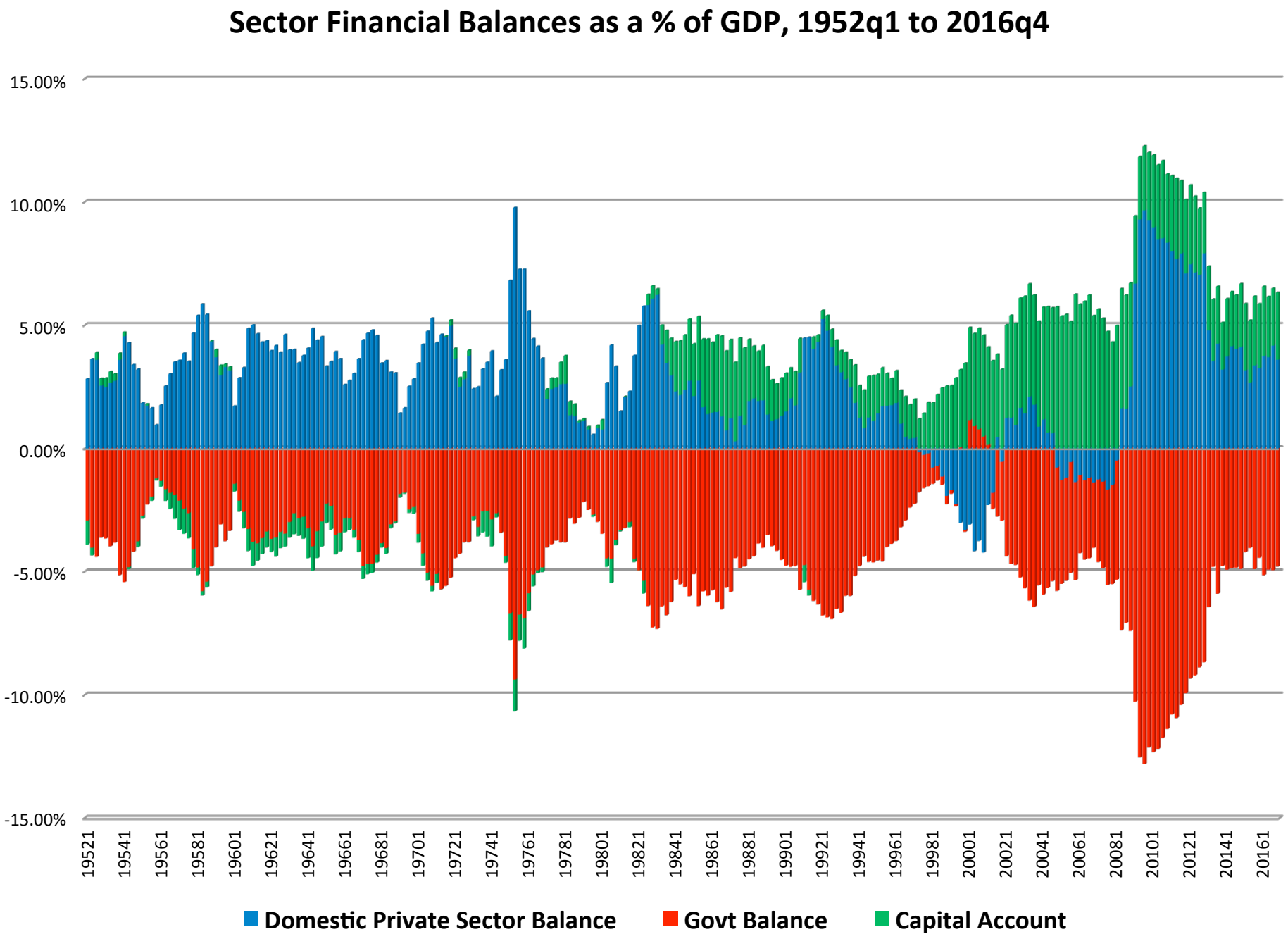

Components of Domestic Private Sector Financial Balance as a % of GDP
1952q1 to 2016q4
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
-2.00%
-4.00%
-6.00%
19521
19532
19543
19554
19571
19582
19593
19604
19621
19632
19643
19654
19671
19682
19693
19704
19721
19732
19743
19754
19771
19782
19793
19804
19821
19832
19843
19854
19871
19882
19893
19904
19921
19932
19943
19954
19971
19982
19993
20004
20021
20032
20043
20054
20071
20082
20093
20104
20121
20132
20143
20154
Household
Non-Financial Business


Components of Domestic Private Sector Financial Balance as a % of GDP
1952q1 to 2016q4
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
-2.00%
-4.00%
-6.00%
19521
19532
19543
19554
19571
19582
19593
19604
19621
19632
19643
19654
19671
19682
19693
19704
19721
19732
19743
19754
19771
19782
19793
19804
19821
19832
19843
19854
19871
19882
19893
19904
19921
19932
19943
19954
19971
19982
19993
20004
20021
20032
20043
20054
20071
20082
20093
20104
20121
20132
20143
20154
Household
Non-Financial Business

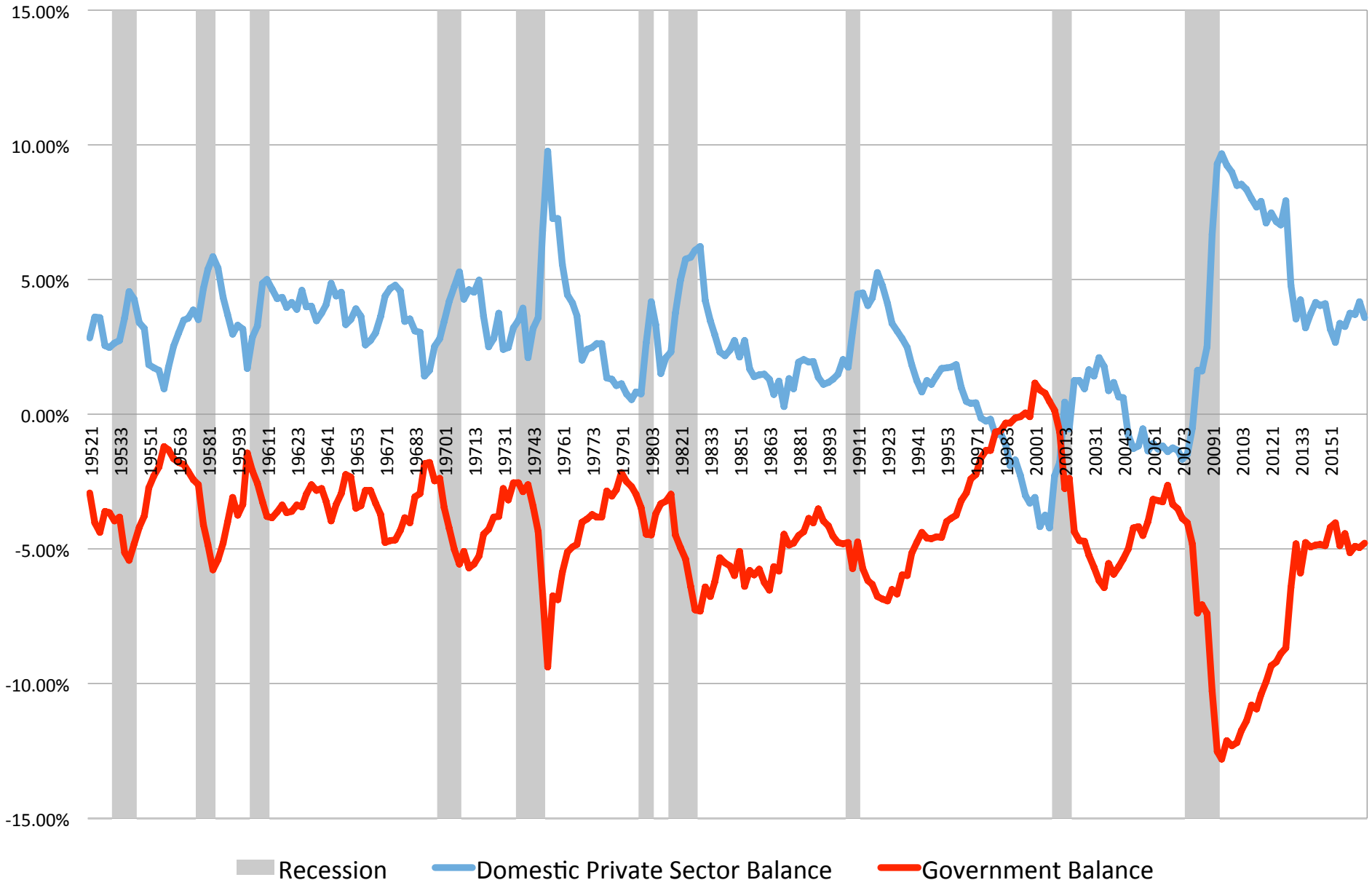

FRED
Household Debt Service Payments as a Percent of Disposable Personal Income (left)
Effective Federal Funds Rate (right)
Percent
13.5
13.0
12.5
12.0
11.5
11.0
10.5
10.0
9.5
8
7
6
5
4
3
2
1
0
Percent
1995
2000
2005
2010
2015
Sources: Board of Governors of the Federal Reserve System (US)
fred.stlouisfed.org
myf.red/g/dof4


Components of Domestic Private Sector Financial Balance as a % of GDP
1952q1 to 2016q4
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
-2.00%
-4.00%
-6.00%
19521
19532
19543
19554
19571
19582
19593
19604
19621
19632
19643
19654
19671
19682
19693
19704
19721
19732
19743
19754
19771
19782
19793
19804
19821
19832
19843
19854
19871
19882
19893
19904
19921
19932
19943
19954
19971
19982
19993
20004
20021
20032
20043
20054
20071
20082
20093
20104
20121
20132
20143
20154
Household
Non-Financial Business
Financial


FIRMS
$$
$$
FINAN-
CIALS
$$
HOUSE-
HOLDS
$$$
$$$
PUBLIC SECTOR
REST OF THE
WORLD
$$$


Sector Financial Balances as a % of GDP, 1952q1 to 2016q4
15.00%
10.00%
5.00%
0.00%
-5.00%
-10.00%
-15.00%
19521
19541
19561
19581
19601
19621
19641
19661
19681
19701
19721
19741
19761
19781
19801
19821
19841
19861
19881
19901
19921
19941
19961
19981
20001
20021
20041
20061
20081
20101
20121
20141
20161
Domestic Private Sector Balance
Govt Balance
Capital Account

Pvt and Govt Sector Financial Balances as a % of GDP, 1952q1 to 2016q4



During a protracted expansion dominated by household and business deficits the ratio of household and business financial commitments to income rises, whereas in an expansion dominated by government deficits the ratio of private commitments to income decreases.

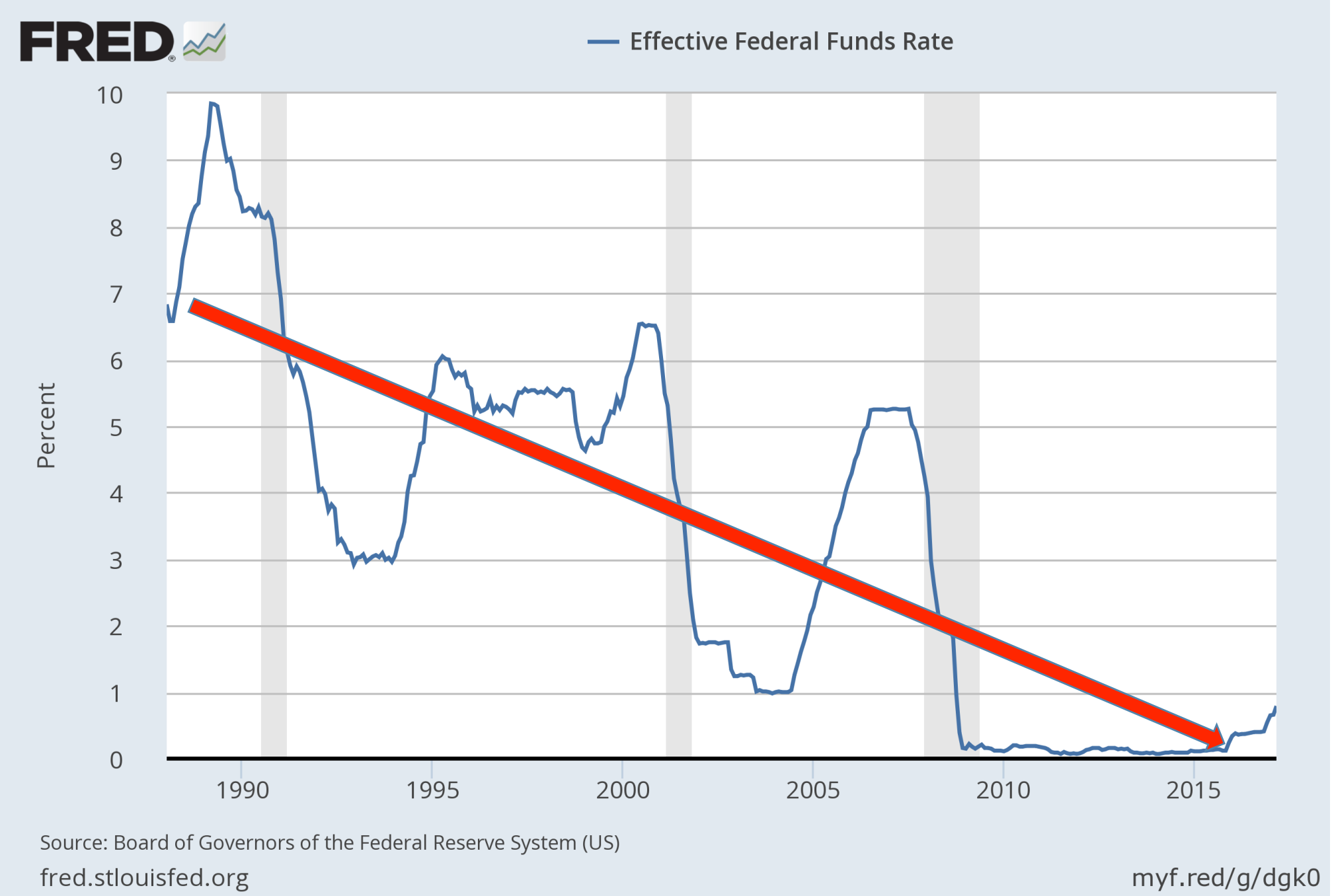
HP Minsky 1963, p. 412

We thus have the fundamental point of difference between the two approaches:

Is monetary policy (the Big Bank) to be assigned to control goods prices (monetarist) or aid fiscal policy to control quantities (neoclassical Keynesian);

or should it . . . be directed to stabilize capital asset prices [and the stability of the financial system in general]?

JA Kregel
1992, p. 88


FRED
Effective Federal Funds Rate
Percent
10
9
8
7
6
5
4
3
2
1
0
1990
1995
2000
2005
2010
2015
Source: Board of Governors of the Federal Reserve System (US)
fred.stlouisfed.org
myf.red/g/dgk0

5

Conclusion:
The Return of Flat Ocean Theory?
(Did It Ever Actually Leave?)

The Monetary Policy Committee of the Bank of England ... contained ... a strong representation of academic economists and other professional economists with serious technical training and backgrounds. This turned out to be a severe handicap when the central bank had to ... change from being an inflation-targeting central bank under conditions of orderly financial markets to a financial stability-oriented central bank under conditions of widespread market illiquidity and funding illiquidity.

Willem Buiter, 2009

- "Natural" or "Neutral" Rate of Interest?
- "New" View of Fiscal Policy?
- Evolution of Private Sector Financial Positions in FOMC Minutes or BoG/FRB Speeches? Threats from Rising Interest Rates?
- Discussion of Underwriting Quality and Margins of Safety? Related Financial Innovations, and Appropriate Regulatory/Supervisory Responses?

Soft Landing?

Or
Something Else
Entirely?