Teorías monetarias – resumen

Clases magistrales – primer parcial

- Tipos de bonos en los que invierten los bancos comerciales:
  - BANGUAT
  - Ministerio de Finanzas (Estado)
- **Operaciones de mercado abierto (OMA's)**: título que el Banco de Guatemala otorga, principalmente a otros bancos o empresas grandes, para poder demandar ese dinero de un período determinado a una tasa de interés (son negociables). Se usan para contrarrestar o intervenir en cambios muy altos en el tipo de cambio; es la compra y venta de bonos del tesoro por parte del gobierno.
- **Reporto**: operación de compraventa con acuerdo de venta-compra; son las operaciones mayormente realizadas en el Banco de Guatemala; mecanismo privilegiado para dar créditos entre bancos (generalmente a muy corto plazo).
- **Corralito**: restricción de la libre disposición de dinero en efectivo de plazos fijos, cuentas corrientes y cajas de ahorro impuesta en Argentina → la gente no podía sacar su dinero de los bancos
- **Productos financieros**: intereses recibidos o cobrados por el dinero que tiene colocado el banco, mayormente en créditos
- **Calificadora de riesgo:** ver los elementos importantes para saber si la persona tiene la capacidad de pagar el crédito: estabilidad laboral por un año, fuente de ingresos, cantidad de ingresos, límite de endeudamiento = 30% del sueldo para intereses y capital, historial crediticio, estado patrimonial (activos versus capital y pasivos)
- **Multiplicador bancario:** cuántas veces cada dinero que emite el banco central y sale a circulación se multiplica en el sistema financiero
- **Estructura bancaria líquida:** donde mis activos y pasivos están calzados en tiempo → si mis activos están a un plazo de un año, mis pasivos deberían estar en el mismo plazo
- Es más líquido un banco que se dedica a dar préstamos a corto plazo de capital social
- Puede existir un banco insolvente y líquido y funcionar por mucho tiempo, pero un banco solvente líquido puede quebrar (insolvente es que tiene deudas pero que tiene liquidez para colocar dinero)
- Los fondos de inversión, en teoría, son a largo plazo, pero pueden ser redimidos cuando se desee

The Industrial Organization of Banking – chapters 1 & 2

- **Industrial organization of banking:** the study of the structure of individual banks, banking markets, and their interactions

The Bank Balance Sheet

- **Bank asset:** represents a legal obligation by another party to repay principal plus any contracted interest to the bank within a specified period
    - **Loans:** they are the predominant category of assets held by commercial banks. Four important loan classifications:
        - **Commercial and Industrial Loans:** loans that banks extend to business enterprises to meet the day-to-day cash need or to finance purchases of plants and equipment. A borrower typically must secure C&I loans with assets pledged as collateral to ensure repayment of the principal and interest on a loan.
        - **Consumer Loans:** finance purchases of automobiles, mobile homes, durable consumer goods through installment credit agreements, under which individual borrowers agree to repay principal and interest in equal periodic payments scheduled over a one to to five-year interval *(highest interest rates).*
        - **Real Estate Loans:** loans that banks extend to finance purchases of real property, buildings, and fixtures (items permanently attached to real estate).
        - **Interbank Loans:** banks lend funds to each other directly in markets for interbank loans, such as the U.S. federal funds market in which banks borrow from and lend to each other deposits that they hold at Federal Reserve banks *(lowest interest rates).*
    - **Securities:** treasury bills, notes, and bonds (20% of total assets).
    - **Cash assets:** the most liquid bank assets that function as media of exchange; a key component is vault cash, which is currency that commercial banks hold at their offices to meet depositors' cash requirements for withdrawals on a day-to-day basis. The second type is reserves held with the central bank.

- **Bank Liabilities and Equity Capital**: a liability of a bank is the value of a legal claim on its assets
    - **Transactions deposits**: accounts from which owners may draw funds via checks or debit cards.
    - **Large-denomination time deposits:** certificates of deposit that typically fund a significant portion of banks' short-term lending operations (denominations exceeding $100,000)
    - **Savings deposits and small-denomination time deposits:** passbook and statement savings accounts with no set maturities and money market deposit accounts usually held in somewhat larger denominations
    - **Purchased funds and subordinated noted and debentures:** purchased funds include interbank borrowings, central bank borrowings, Eurocurrency liabilities, and repurchase agreements. Subordinated notes and debentures are bank debt instruments with maturities in excess of one year; those who hold these, in the event of bankruptcy, would receive no payments from a bank until all depositors at the bank have received the funds from their accounts.

    - **Bank capital:** a commercial bank's equity capital is its net worth, or the amount by which its assets exceed its liabilities

<u>The Bank Income Statement</u>

- **Interest Income:** it is derived from loan interest income
- **Noninterest Income:** obtained from sources other than interest income, such as trading profits and customer service charges
- **Interest Expenses:** banks apply funds raised from issuing deposits and other liabilities to acquisition of income-generating assets; to attract funds, banks must pay interest on these liabilities, and these interest expenses constitute a significant component of bank costs
- **Expenses for Loan Loss Provisions:** banks earmark part of their cash assets as loan loss reserves; this portion of cash assets is held as available liquidity that banks recognize as depleted in the event that loan defaults actually occur.
- **Real Resource Expenses:** the bank must pay wages and salaries to its employees, purchase or lease capital goods, and pay rental fees for the use of land on which its offices are situated
- **Bank Profitability Measures:** for purposes of comparison between banks, researchers use three profitability measures:
    - **Return on assets:** a bank's accounting profit as a percentage of the value of its assets → how capable a bank has been in transforming assets into net earnings
    - **Return on equity:** a bank's accounting profit as a percentage of the value of its equity capital → indicates the rate of return flowing to shareholders
    - **Net interest margin:** difference between a depository institution's interest income and interest expenses as a percentage of total assets → useful indicator of current and future bank performance

<u>Asymmetric Information and Risks in Banking</u>

- **Adverse selection:** the potential that those who desire funds for undeserving projects are most likely to seek credit
- **Moral hazard:** the possibility that a borrower may behave in a way that increases risk after a loan has been made or a debt instrument has been purchased

<u>Risks on the Balance Sheet</u>

- **Credit risk:** the probability that a portion of the institution's assets (loans in particular) will decrease in value
- **Market risks:** one form of market risk is exposure to price risk, or the potential for a sudden drop in securities prices. Another form is interest rate risk, which arises mainly through the potential for interest rates on liabilities to rise more rapidly than increases in interest rates on assets

- **Liquidity risk:** probability of having insufficient cash and borrowing capability to satisfy desired depositor withdrawals, to be able to extend loans to creditworthy borrowers, or to meet other cash requirements
- **Systemic risk:** because payment flows among banks are interdependent, however, risks confronted by individual institutions have the potential to spill over onto others.

<u>Risks Off of Bank Balance Sheets</u>

- **Loan commitments:** a promise by a bank to extend credit up to some prespecified limit under a contracted interest rate and within a given interval
- **Securitization:** it permits a bank to remove loans from a balance sheet; it entails pooling loans with similar risk characteristics and selling this loan pool in the form of a negotiable financial instrument
- **Derivative securities:** securitization addresses a portion of a bank's credit and market risks by moving part of its loan portfolio off its balance sheet; for a number of banks, trading derivatives also has proved to be a significant source of revenues.

Liquitidy – Melchior Palyi

- **Liquidity:** the capacity to fulfill financial obligations
- In reality, the long-term trend of reduced cash holdings is not due to the improved liquidity of earning assets, but rather to market developments permitting the sale (shifting) of assets on a large scale
- **Shiftability theory:** an approach to keep banks liquid by supporting the shifting of assets. When a bank is short of ready money, it is able to sell or repo its assets to a more liquid bank (traditional theory)
- **Liquidity theory:** assets and liabilities should be in the same time frame and banks should only offer short-term loans (Palyi's theory)
- Inversion banks should be the ones to finance long-term assets; commercial banks should only finance short-term assets

The Federal Reserve and the Financial Crisis – Lecture 1

Central banks

- A central bank is a government agency that stands at the center of a country's monetary and financial system
- **Two broad aspects** of what central banks do:
    - To try to achieve macroeconomic stability → achieving stable growth in the economy, avoiding big swings (recessions) and keeping inflation low and stable
    - To maintain financial stability → central banks try to keep the financial system working normally and they try to either prevent or mitigate financial panics or crises
- The **three tools** that central banks use to achieve these objectives are:
    - *Monetary policy:* in normal times, the Fed can raise or lower short-term interest rates by buying and selling securities in the open market. If the economy is growing too slowly or inflation is falling too low, the Fed stimulates the economy by lowering interest rates, which encourages spending on the acquisition of homes, construction, investment by firms, etc.
    - *Provision of liquidity:* in order to address financial stability concerns, central banks can make short-term loans to financial institutions → this can help calm the market, stabilize those institutions, and help mitigate or end a financial crisis **(lender of last resort)**
    - *Financial regulation and supervision:* central banks usually play a role in supervising the banking system, assessing the extent of risk in their portfolios, making sure their practices are sound and, in that way, trying to keep the financial system healthy **(secondary tool)**
- The Bank of England was founded in 1695, and was for many decades the most important and influential central bank in the world

Financial panics

- A **financial panic** is sparked by a loss of confidence in an institution
- No bank holds cash equal to all its deposits; it puts that cash into loans, so the only way the bank can pay off the depositors, is to sell or otherwise dispose of its loans (it is very hard)
- A financial panic can occur anytime you have an institution that has longer-term illiquid assets (illiquid in the sense that it takes time and effort to sell those loans) and is financed by short-term liabilities, such as deposits
- By providing short-term loans and taking collateral (the illiquid assets of the institution), central banks can put money into the system, pay off depositors and short-term lenders, calm the situation, and end the panic
- **Walter Bagehot** → a key person in the intellectual development of banking:

  - He said that during a panic central banks should lend freely to whoever comes to their door; as long as they have collateral, give them money
  - Central banks also need to charge a penalty interest rate so that people do not take advantage of the situation; they signal that they really need the money by being willing to pay a slightly higher interest rate

<u>Clearing houses</u>

- Before the Fed existed, there was the **New York Clearing House:** it was a private institution (a club of ordinary commercial banks) that served as a place where banks could come at the end of each day to clear checks against one another. Over time, if one bank came under a lot of pressure, the other banks might come together in the clearing house and lend money to that bank so it could pay its depositors.
- Sometimes, the clearing houses would agree to shut down the banking system for a week in order to look at the bank that was in trouble, evaluate its balance sheet, and determine whether it was a sound bank; if it was, it would reopen and things would calm down ← these kinds of private arrangements were not sufficient because they did not have the resources or credibility of an independent central bank

<u>Gold standard</u>

- **Gold standard:** a monetary system in which the value of the currency is fixed in terms of gold → it is far from a perfect monetary system because all this gold is being dug up and then put back into another hole *(Milton Friedmann)*
- Under a gold standard, typically the money supply goes up and interest rates go down in periods of strong economic activity, which is the reverse of what a central bank would normally do today; there is no flexibility for the central bank to lower interest rates in a recession of vice versa
- Volatility in output variability and year-to-year movements in inflation were much greater under the gold standard
- One of the things a gold standard does is to create a system of fixed exchange rates between the currencies of countries that are on the gold standard → there is no variability
- Fixed exchange rates between countries tend to transmit both good and bad policies between those countries and take away the independence that individual countries have to manage their own monetary policy (example: China and USA)
- Another problem: speculative attack (running out of gold because speculators lost confidence that its currency would maintain its gold convertibility)
- One of the strengths that people cite for the gold standard is that it creates a stable value for the currency, it creates a stable inflation → this is true over very long periods

<u>Great Depression</u>

- The U.S. stock market crashed on October 29th, 1929, and the financial crisis of the Great Depression was not just a U.S. phenomenon, it was global
- The most damaging financial collapse was of the large Austrian bank called the Credit-Anstalt in 1931, which brought down many other banks in Europe
- The Depression lasted from 1929 to 1941, when the U.S. entered the was following the attack on Pearl Harbor
- The economy contracted and unemployment soared (there was an enormous contraction of GDP and the economy was experiencing deflation)
- **What caused the Great Depression?**
    - Repercussions of World War I
    - Problems with the international gold standard
    - The bubble in stock prices in the late 1920s
    - The financial panic that spread throughout the world
- In the 1930s, there was a lot of support for a way of thinking about the economy called the **liquidationist theory**: the 1920s had been too good a time; the economy had expanded too fast, there had been too much growth, too much credit had been extended, stock prices had gone too high → what you need when you've had a period of excess is a period of deflation
- There were **two things that Franklin Roosevelt did** that did a lot to offset the problems the Fed created:
    - *The establishment of deposit insurance:* if you were an ordinary depositor and the bank failed, you still got your money back and therefore there was no incentive to run on the banks
    - *He abandoned the gold standard:* he allowed monetary policy to be released and allowed expansion of the money supply, which ended the deflation and let to a powerful short-term rebound in 1933 and 1934
- The Federal Reserve failed to use monetary policy aggressively to prevent deflation and the collapse in the economy, so it failed in its economic stability function; and it did not adequately perform its function of lender of last resort, allowing many bank failures
- Asset price bubbles are dangerous, and we want to address them if possible, but when you can address them through financial regulatory approaches, that is usually a more pinpoint approach than just raising interest rates for everything