



Global Markets and the Center for Financial Stability

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President and Founder

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

The Economist

SEPTEMBER 20TH - 26TH 2008 www.economist.com

What next?

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

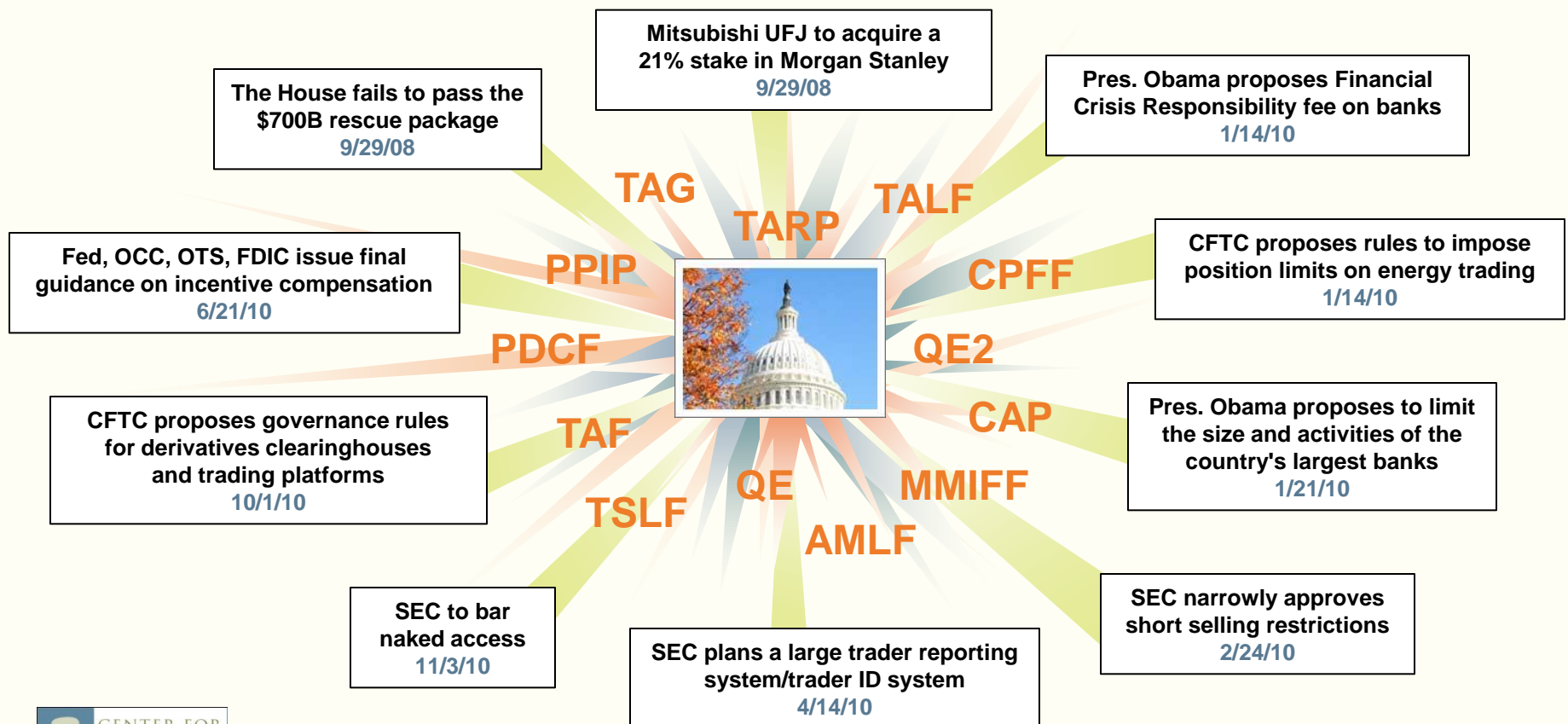
US\$5.99 • C\$7.50

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Algeria	17.81	Canada	137.50	Indonesia	155.10	Sweden & Finland	125.51
Argentina	35.19	Chile	138.90	Israel	168.10	Switzerland	13.50
Australia	54.51	Colombia	1452.00	Japan	131.09	Taiwan	13.50
Brazil	55.19	Croatia	13.90	South Korea	11.00	UK	13.50
China	17.81	Czechia	13.90	Sri Lanka	13.50	USA	13.50
Denmark	13.50	Egypt	13.50	Turkey	13.50	Value added	20.01
France	13.50	Greece	13.50	Ukraine	13.50		
Germany	13.50	Hong Kong	13.50				
India	13.50	Italy	13.50				
Indonesia	13.50	Japan	13.50				
Israel	13.50	Korea	13.50				
Italy	13.50	Latvia	13.50				
Japan	13.50	Lithuania	13.50				
Korea	13.50	Malaysia	13.50				
Latvia	13.50	Mexico	13.50				
Lithuania	13.50	Netherlands	13.50				
Malaysia	13.50	New Zealand	13.50				
Mexico	13.50	Norway	13.50				
Netherlands	13.50	Poland	13.50				
New Zealand	13.50	Portugal	13.50				
Norway	13.50	Romania	13.50				
Poland	13.50	Slovakia	13.50				
Portugal	13.50	Slovenia	13.50				
Romania	13.50	Spain	13.50				
Slovakia	13.50	Sweden	13.50				
Slovenia	13.50	Switzerland	13.50				
Spain	13.50	Taiwan	13.50				
Sweden	13.50	Thailand	13.50				
Switzerland	13.50	Turkey	13.50				
Taiwan	13.50	Ukraine	13.50				
Thailand	13.50	USA	13.50				
Turkey	13.50	UK	13.50				
Ukraine	13.50	Value added	20.01				
USA	13.50						
UK	13.50						
Value added	20.01						



The U.S. Response





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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



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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.

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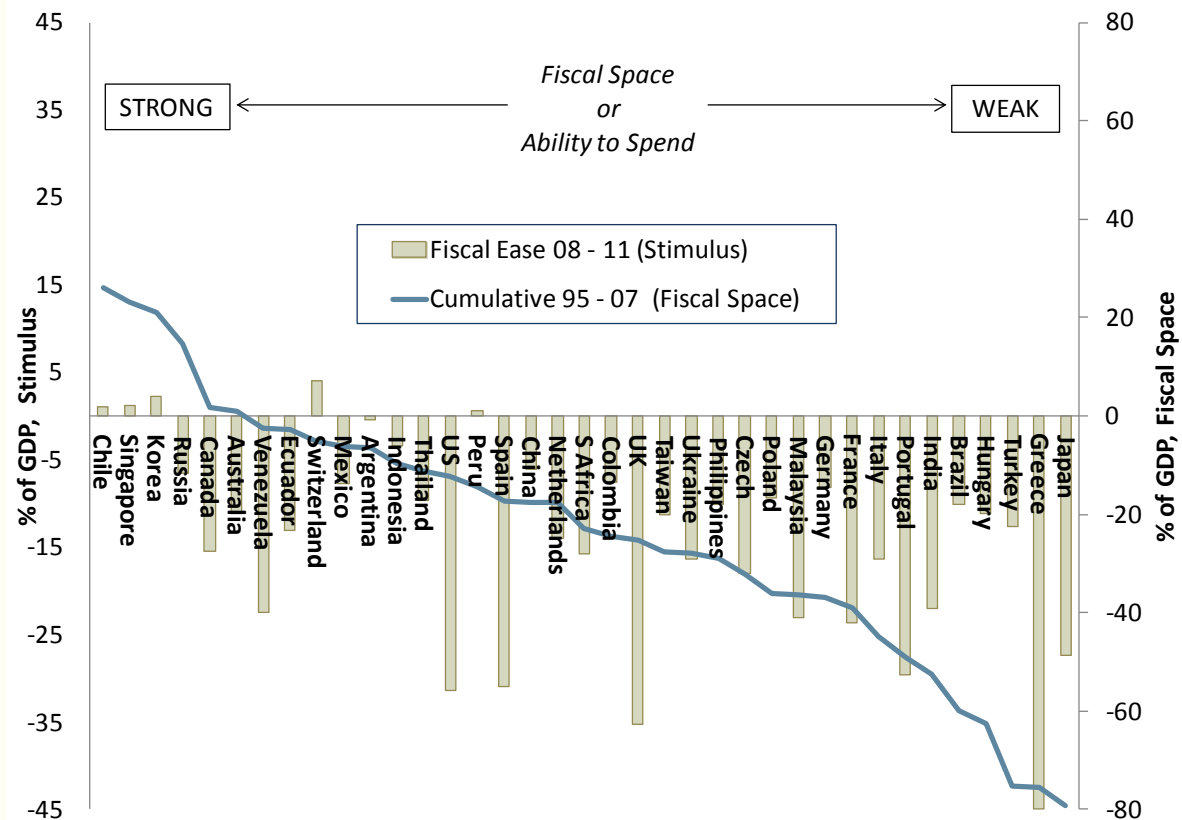


Governments

- 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.



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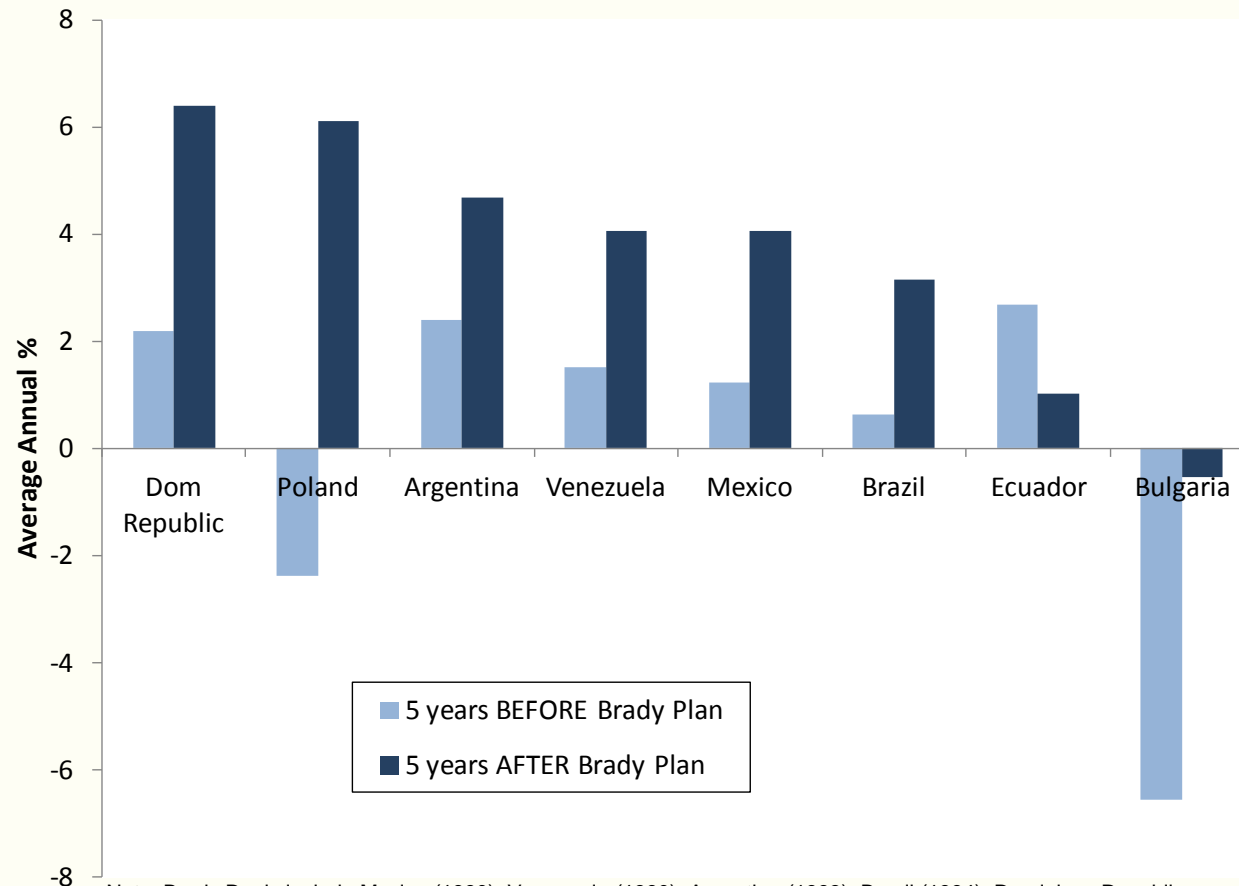
Debt Restructuring: The Way Forward

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.



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Economic Growth Improvement Post Debt Reduction



Note: Brady Deals include Mexico (1990), Venezuela (1990), Argentina (1993), Brazil (1994), Dominican Republic (1994), Bulgaria (1994), Poland (1994), and Ecuador (1995).

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



New Strategy: Financial Program

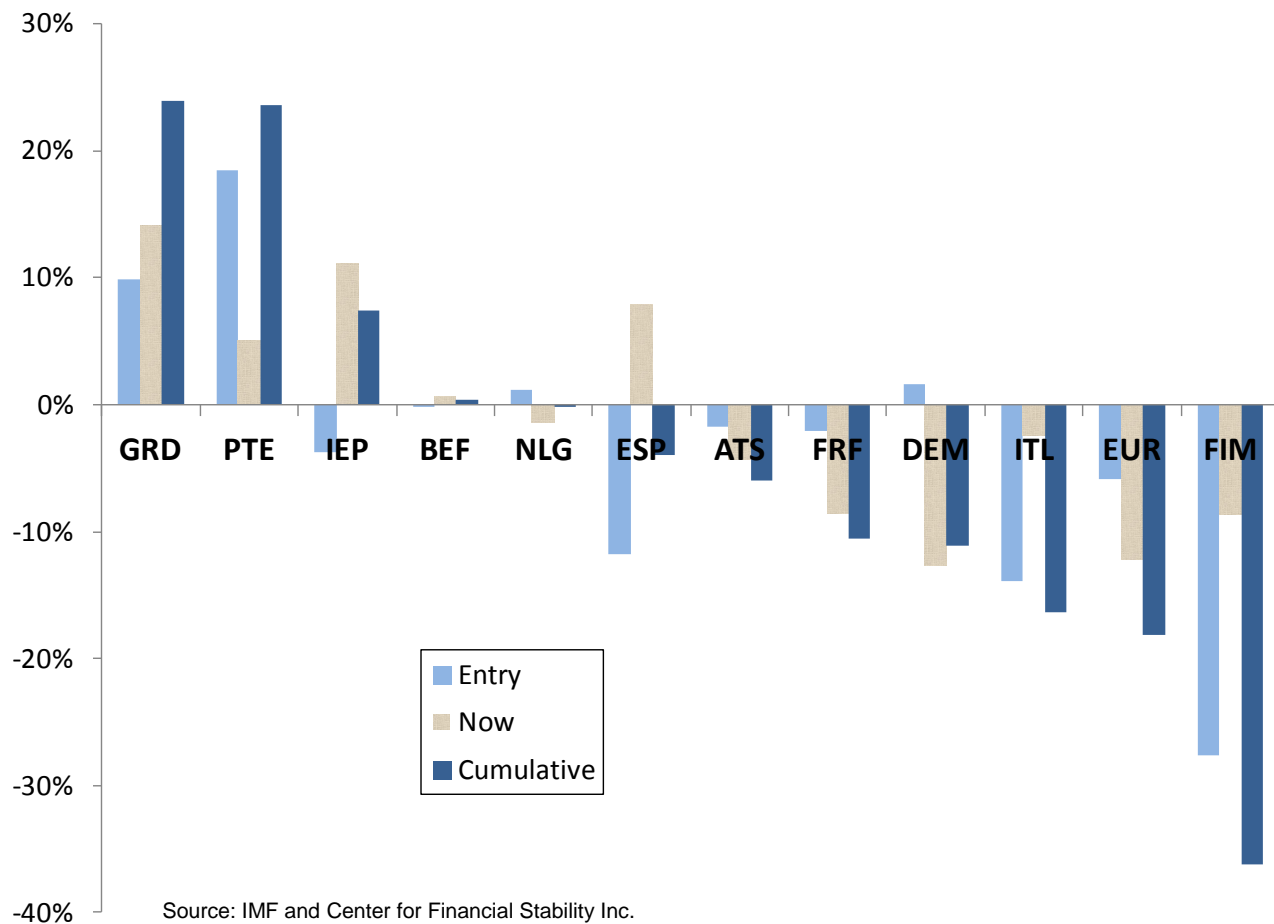
Substitute Math for Rhetoric

- **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.



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Component Currency Strains in the Euro

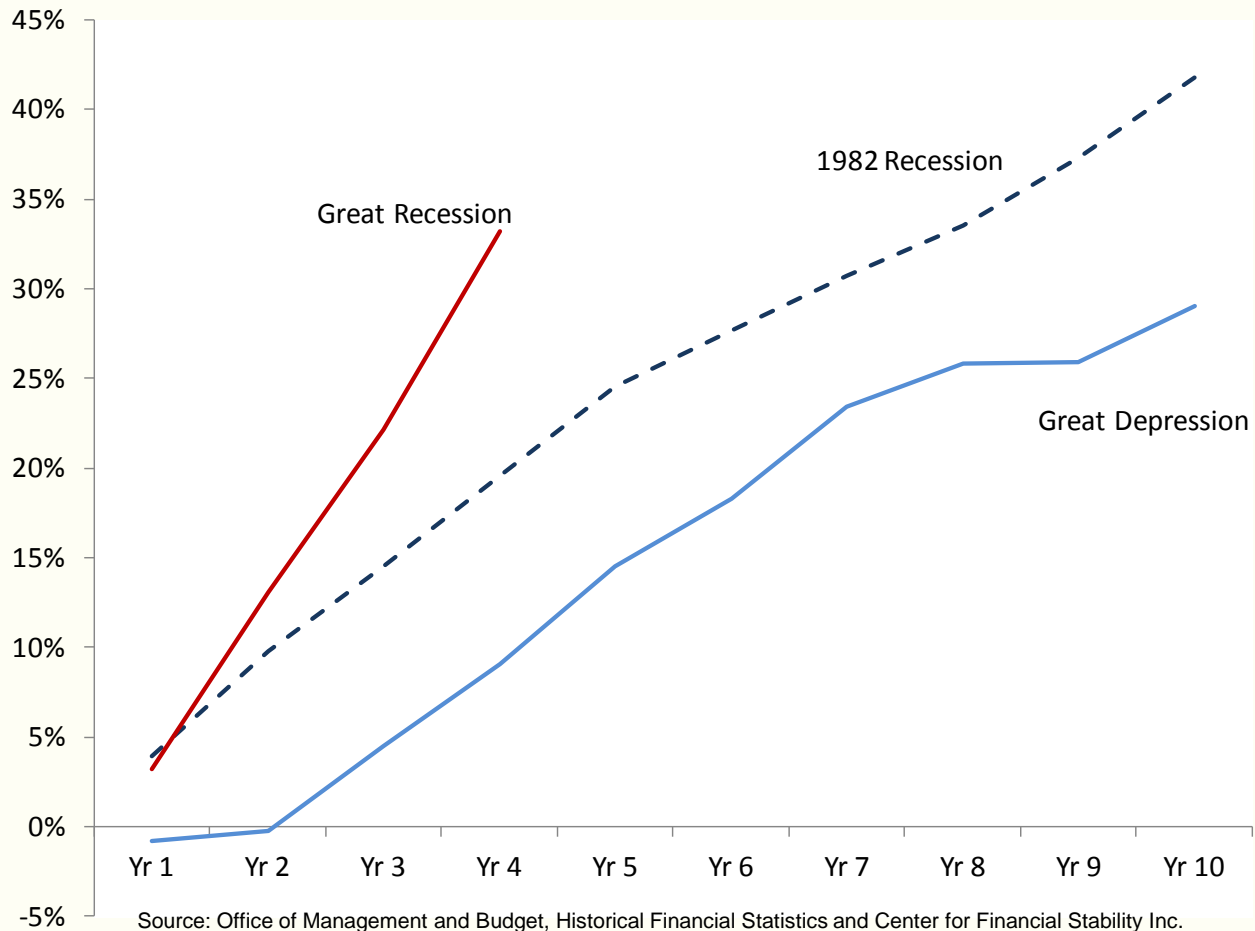


Source: IMF and Center for Financial Stability Inc.



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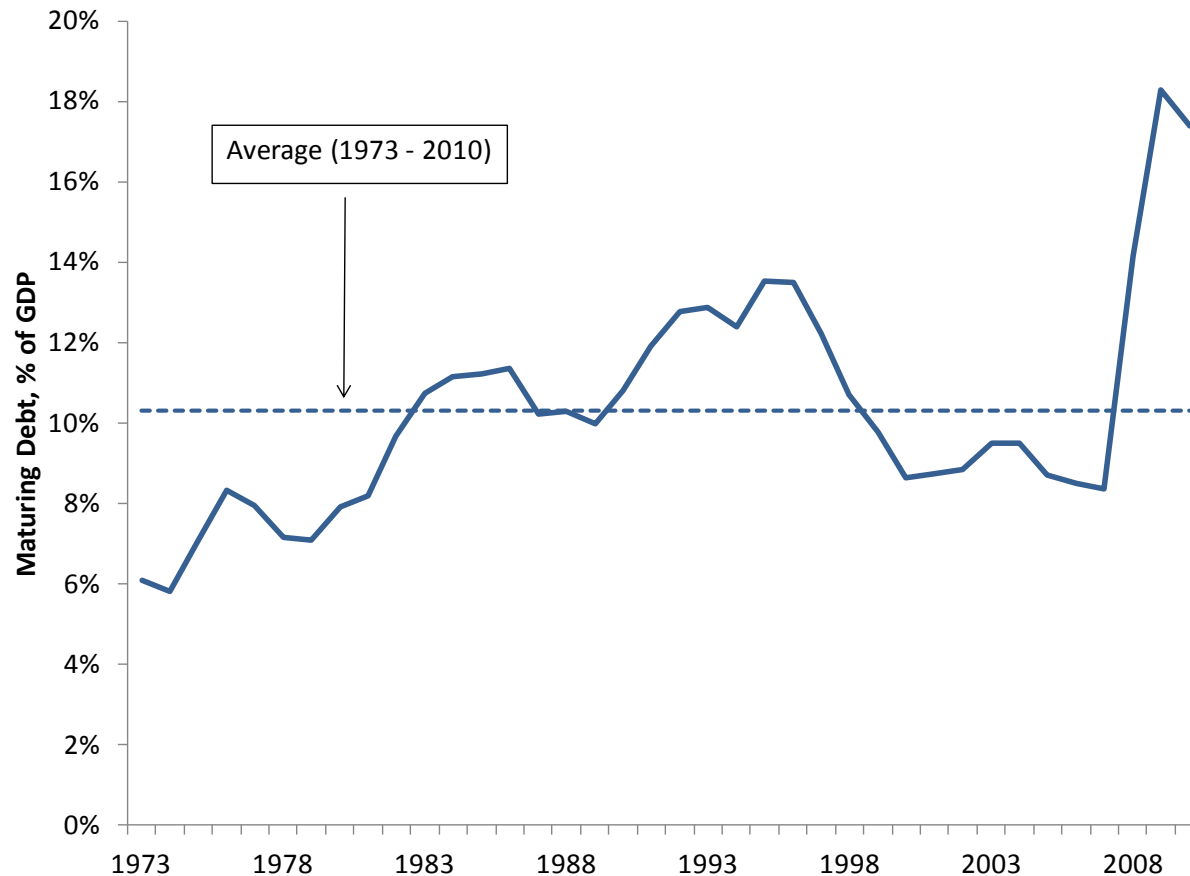
Cumulative Deficits in Deep Downturns, % of GDP





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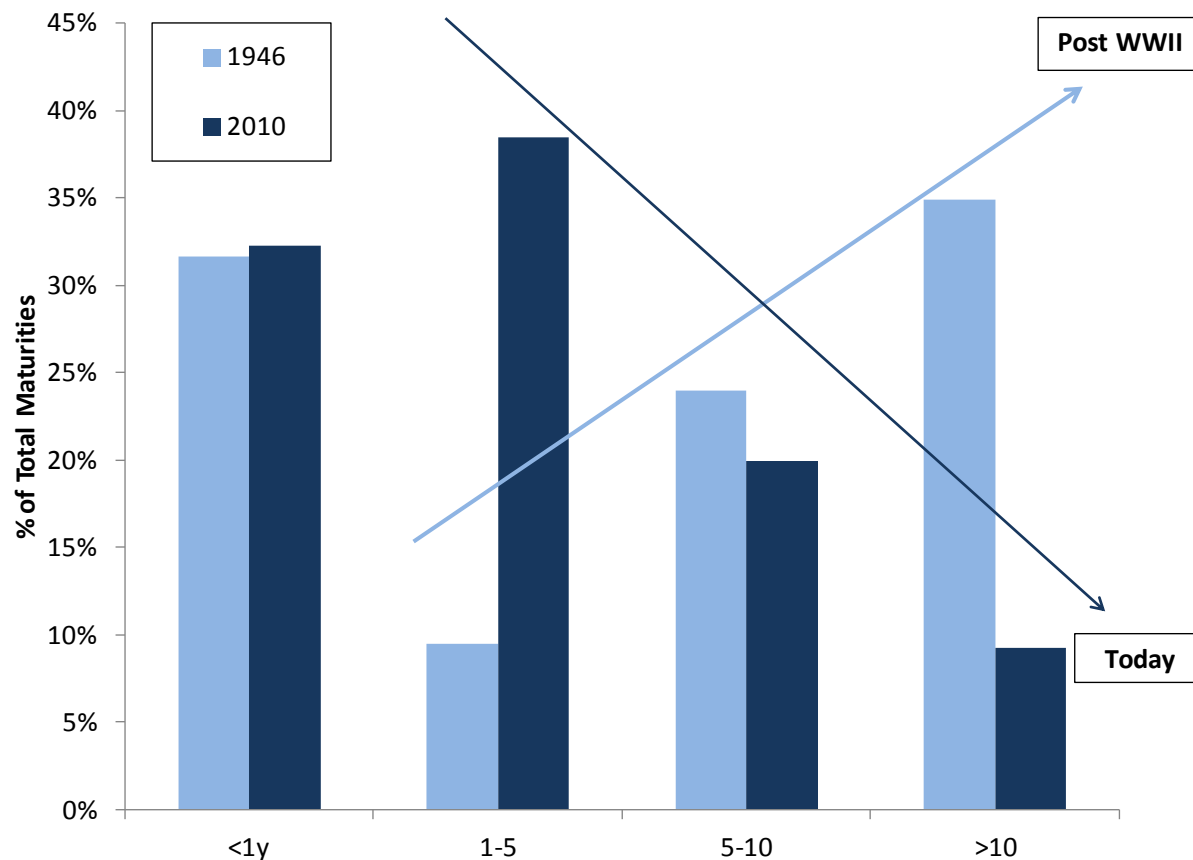
USG Debt Maturities Spike in Coming Year



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



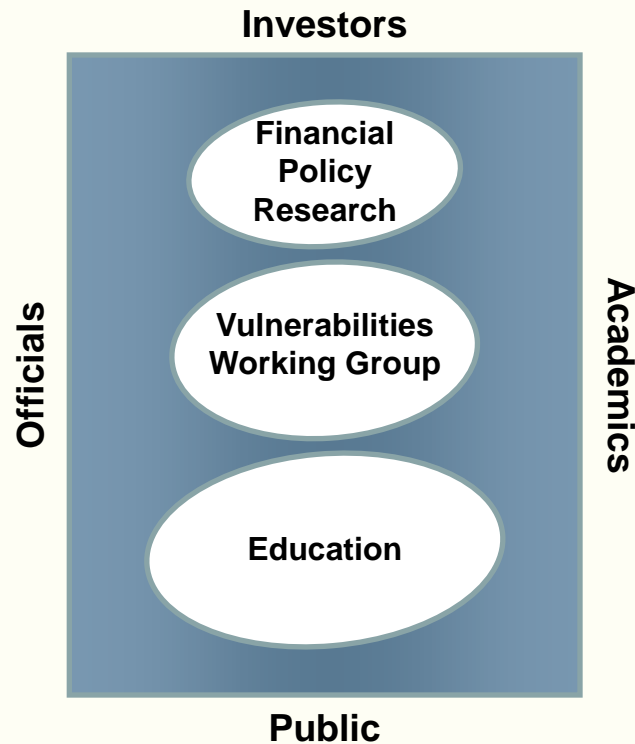
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Note: Interest bearing public debt held by private investors.
Source: US Treasury and Center for Financial Stability Inc.



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.



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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
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- **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.



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Getting It Wrong

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

WILLIAM A. BARNETT

Blame for the recent financial crisis 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-sum monetary aggregation formulas used by central banks, including the US Federal Reserve, became obsolete. Instead, a major increase in public availability of best-practice data was needed. Households, firms, and governments, lacking the requisite information, incorrectly assessed systemic risk and significantly increased their leverage and risk-taking activities. Better financial data, Barnett argues, could have signaled the misperceptions and prevented the erroneous systemic-risk assessments.

When extensive, best-practice information is not available from the central bank, increased regulation can constrain the adverse consequences of ill-informed decisions. Instead, there was deregulation. The result, Barnett argues, was a worst-case toxic mix: increasing complexity of financial instruments, inadequate and poor-quality data, and declining regulation.

Following his accessible narrative of the deep causes of the crisis and the long history of private and public errors, Barnett provides technical appendixes, containing the mathematical analysis supporting his arguments.

WILLIAM A. BARNETT is Oswald Distinguished Professor of Macroeconomics at the University of Kansas, Director at the Center for Financial Stability in New York City, and Senior Fellow at the IC² Institute at the University of Texas at Austin. He is Editor of the eminent journal *Macroeconomic Dynamics* and coauthor 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 1982.

"Leading up to the financial crisis, investors displayed an incorrect assessment of systemic risk and significantly increased their leverage and risk-taking activities. Barnett documents that better Federal Reserve data could have signaled the error in that view. 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 the world's foremost authority in the study of monetary and financial aggregation 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 rocket scientist, shows clearly how important it is that economists pay attention to details and teaches economists how to do far better. Until economists absorb these lessons, the policy makers they advise will be flying blind." Kenneth L. Judd, Hoover Institution, Stanford University

"*Getting It Wrong* is a gripping combination of colorful mini-biographies, memoir from a close witness to our financial troubles, and well-argued case for better monetary statistics. This book first makes you care about monetary aggregation and then masterfully shows you how it should be done." Julio J. Rotemberg, William Ziegler Professor of Business Administration, Harvard Business School

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BARNETT

Getting It Wrong

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

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