



DE-RISKING THE FUTURE OF EUROPE

REFORMING THE MACROFINANCIAL ARCHITECTURE

Institutional supercycles and green
macrofinance in the Euroarea

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9 AM - 6 PM

London School of Economics
Old Building - Houghton Street, London

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Laggards in the financial globalisation supercycle
leaders in the green supercycle?



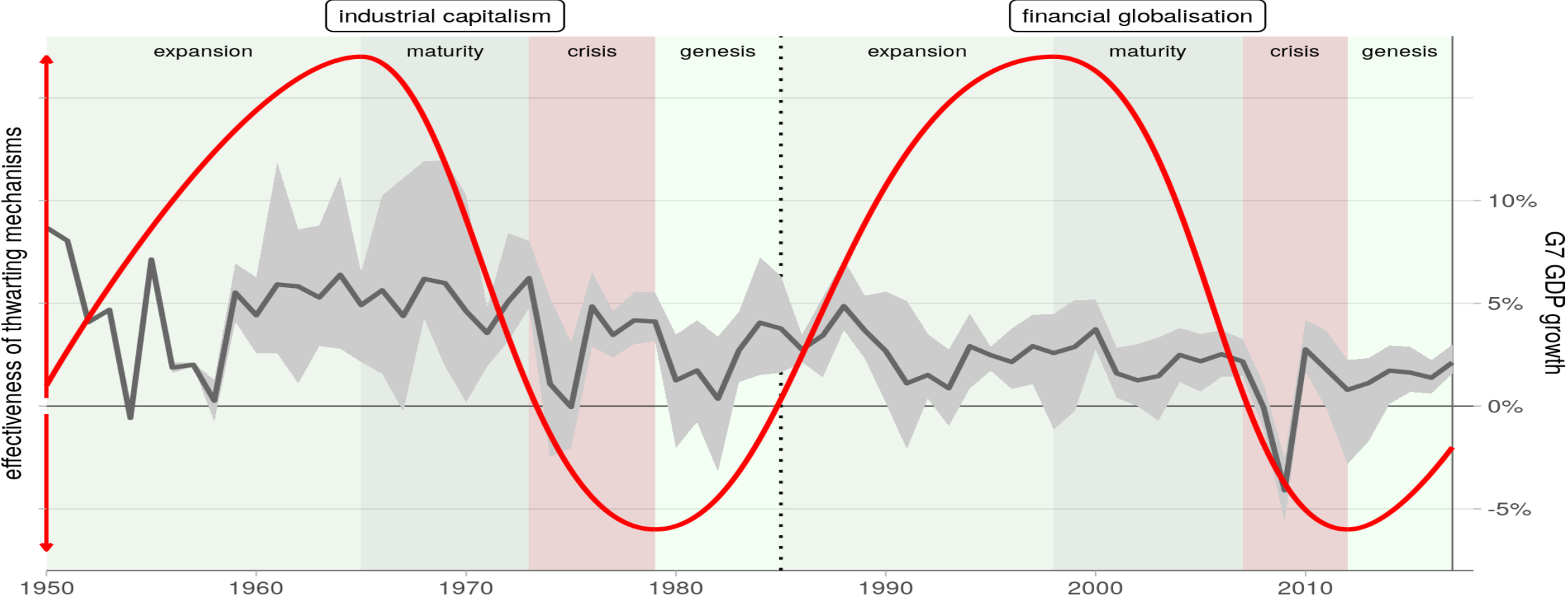
1. Institutional supercycles

- institutional change and macrofinancial developments are dynamically interlinked (Ferri and Minsky, 1992; Minsky, 1995; Palley, 2011) - **institutional supercycles**.
- long-run cycles with distinctive distribution of power, institutional macro-financial architecture and hegemonic economic ideas.
- longer duration than business and financial cycles (Borio et al., 2014; Filardo et al., 2019) and affect these cycles.

Institutional supercycles

- long-run cycles with distinctive distribution of power, institutional macro-financial architecture and hegemonic economic ideas.
- **thwarting mechanisms:** customs, institutions and policy interventions that reduce the amplitude of cycles and contain instability by putting ceilings and floors on dynamic paths of economic systems.
- eroded by : private innovation and long-run instability

Institutional supercycles



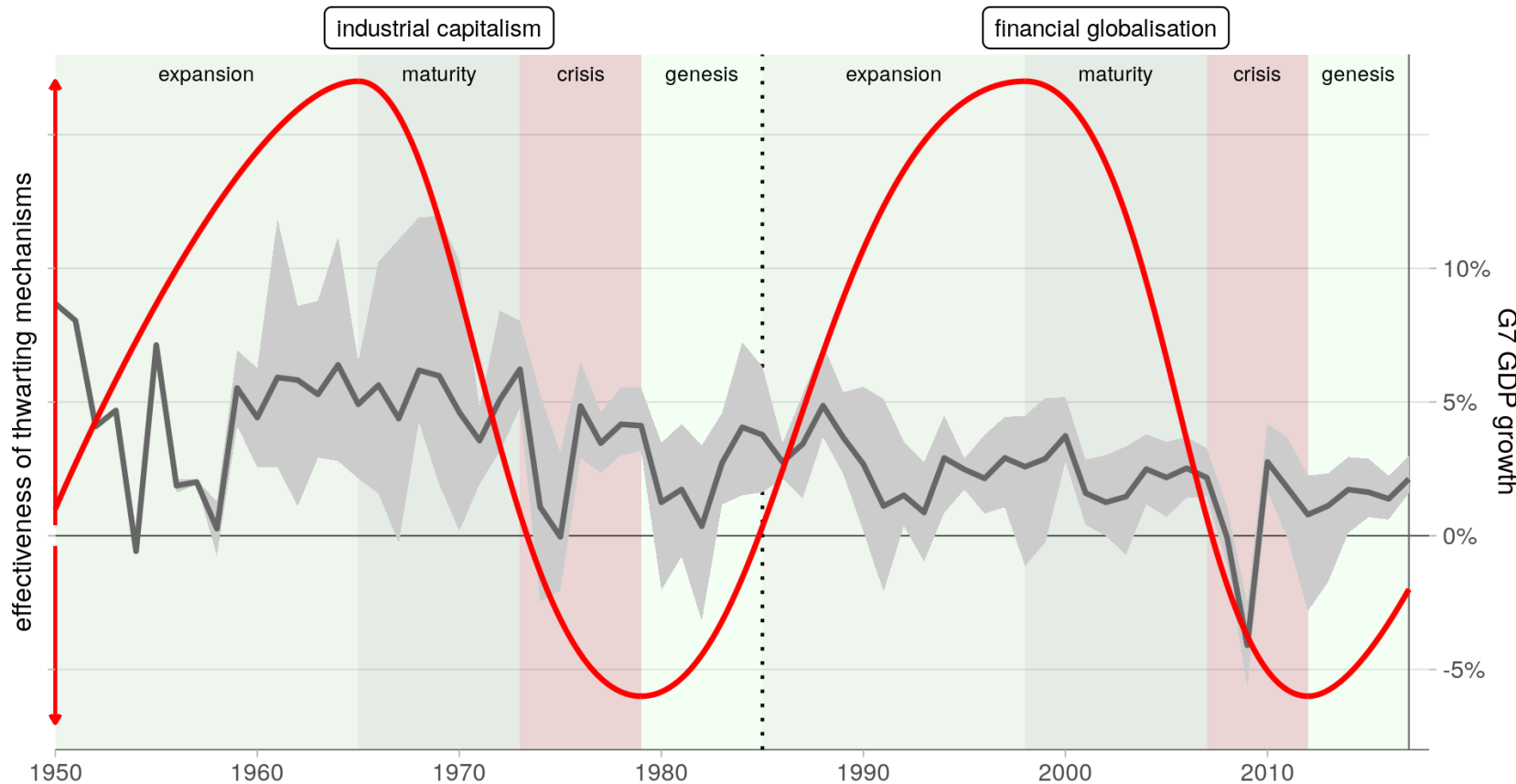
The financial globalisation supercycle

- redistribution of power towards global finance: new class within the financial system, whose power has steadily increased during the financial globalisation supercycle.
- **neo-rentiers**: financial institutions whose activities are geared towards the *production* of new asset classes via shadow banking /market-based finance
- profitability = daily changes in asset prices via *mark-to-market* balance sheet effects (Lindo, 2013; Orian Peer 2016; Gabor 2018a; Gabor and Vestergaard; 2016, 2018).

The financial globalisation supercycle

		Industrial capitalism (IC) supercycle	Financial globalisation (FG) supercycle
Key feature		Financing expensive capital assets	Production and preservation of tradable financial assets
Basic cycle drivers		Fragile corporate balance sheets Cyclical functional distribution	Neo-rentier driven fragile financial balance sheets Cyclical functional distribution
Thwarting mechanisms	<i>Ceilings</i>	Glass-Steagall Act Bretton Woods	Basel II Monetarism/Inflation targeting
	<i>Floors</i>	Wage and fiscal policy Industrial policy Welfare state Accommodative banking /LOLR	Export-led growth Debt-led growth LOLR
Causes of erosion	<i>Innovations</i>	Eurodollar markets	Shadow banking Collateral-based liquidity provision
	<i>Long-run processes</i>	Wage/price spiral Oligopoly structures	Excess accumulation of private debt Global financial cycle

2. Euroarea – laggards of the financial globalisation supercycle



Expansion: Debt expansion becomes a key source of growth; shadow banking grows as IC thwarting mechanisms erode.

Maturity: shadow banking erodes public collateral-based liquidity provision (BIS, 1999; Gabor, 2016) in global financial cycle (Rey, 2015; Rey and Agrippino 2016; Bruno and Shin, 2014, 2015);

Crisis: LOLR does not work; introduction of MMLR

Genesis: green supercycle

Euroarea in the FG maturity phase: accommodate neorentier practices in macrofinancial architecture

*Monetary policy implementation via repos (Gabor and Ban 2016)

*Repo/sovereign bonds: export neorentier model for government bond markets outside US– global financial cycle

Table 2: Collateral Practices, Central Banks, Before and Since the Euro.

<i>Margining practices</i>	<i>Belgium</i>	<i>France</i>	<i>Germany</i>	<i>Italy</i>	<i>Holland</i>	<i>ECB</i>	<i>UK</i>	<i>US</i>
Mark to market	No	No	No	No	Weekly	Daily	Daily	Daily
Margin call	No	No	No	No	Rare	Yes	Yes	Yes
Initial haircut	Yes	Yes	No	No	Yes	Yes	Yes	Yes

Source: compiled from BIS (1999) and central bank websites.

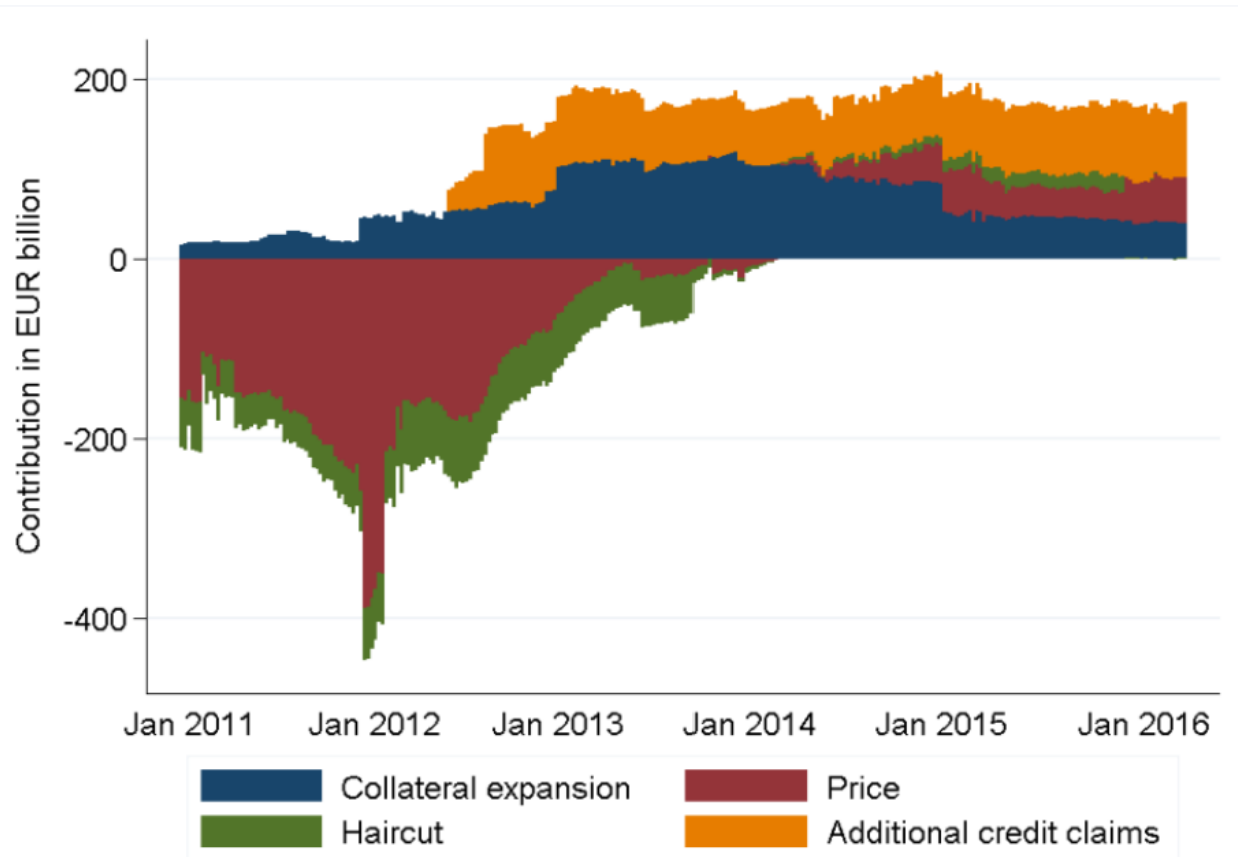
Note: Data for eurozone countries is for June 1998, for the others June 2015.

One of the fundamental features of market liquidity is the self-fulfilling process whereby liquid markets become more liquid. Participants are more willing to transact and take positions in markets where they expect liquidity to continue at a high level for the foreseeable future, while this willingness to transact in turn contributes to enhanced liquidity. Given this, it may be most productive to identify a financial market whose ample liquidity would benefit financial markets as a whole. Such a market is defined here as a core financial market.

In most cases, a government securities market is the most natural candidate for such a market. This is because, being virtually free from credit risk, the yield curve for government securities serves as a benchmark in pricing other financial assets. As a result, government securities are often used by dealers as a major hedging tool for interest rate risk, and as underlying assets and collateral for related markets, such as the repo, futures and options markets.

Euroarea in the FG supercycle crisis phase

Figure: Shocks on the outstanding amount of collateral (Euro area)



Note: price and haircut contributions are compared to their average values between January and June 2014

Source: Barthelemy et al. (2018)

Political obstacles to new thwarting mechanisms:

- no MMLR until Draghi's 'whatever it takes'
- no single safe asset (bund exorbitant privilege reinforced by ECB LOLR framework, see Gabor and Vestergaard 2018)
- austerity and political instability

Crisis phase: destroy national safe assets, prevent single safe asset

Second, safe assets act as a *means of exchange*, especially for the non-bank financial system which cannot settle claims with central bank money.^[16] Market-based finance is, by and large, organised around collateralised lending, which creates high demand for safe and therefore low-price-volatility (or information insensitive) collateral. In this context safe sovereign bonds play a special role. And such “transaction demand” for safe assets is also structurally increasing as financial intermediation shifts from the bank to the non-bank sector.^[17]

For these reasons, if the net supply of safe sovereign bonds suddenly contracts, as we saw in the euro area, it is extremely disruptive for the financial system – analogous to expansions and contractions in the supply of cash. And such disruptions are obviously something that public policymakers have to be sensitive to.

Sovereign debt in the Euro area – too safe or too risky?
Benoit Cœuré (2016)

3. Euroarea – leading the genesis of a green supercycle?

- high economic activity and employment without undermining ecological sustainability.
- UK Green Finance Strategy: all carrot, no stick and no thwarting mechanisms

private ESG taxonomies
(rating environmental, social
and governance practices)
used by neorentiers

voluntary disclosure of TCFD
risks (Bank of England)

green (washing) financial
globalisation

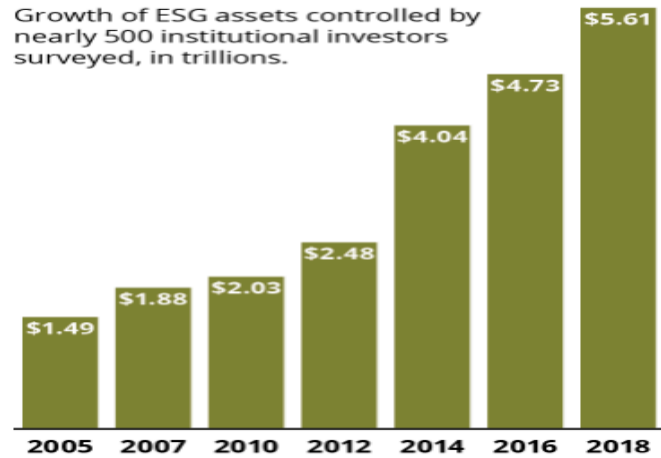


carrots for greening
mortgage market

climate crisis as strategic
opportunity for City
competitiveness in green
finance market

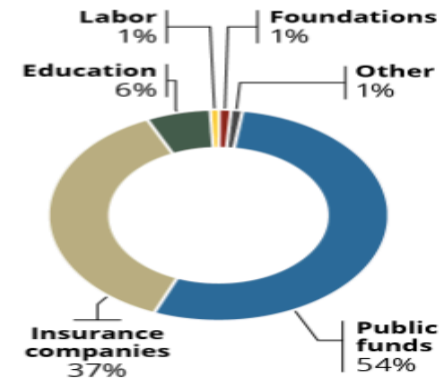
Institutions embrace ESG investing

Growth of ESG assets controlled by nearly 500 institutional investors surveyed, in trillions.



Source: US SIF Foundation

Institutional investment in ESG assets by investor type as of 2018.



Fuel, Energy, and Auto Execs From Facing Accountability on Climate Change



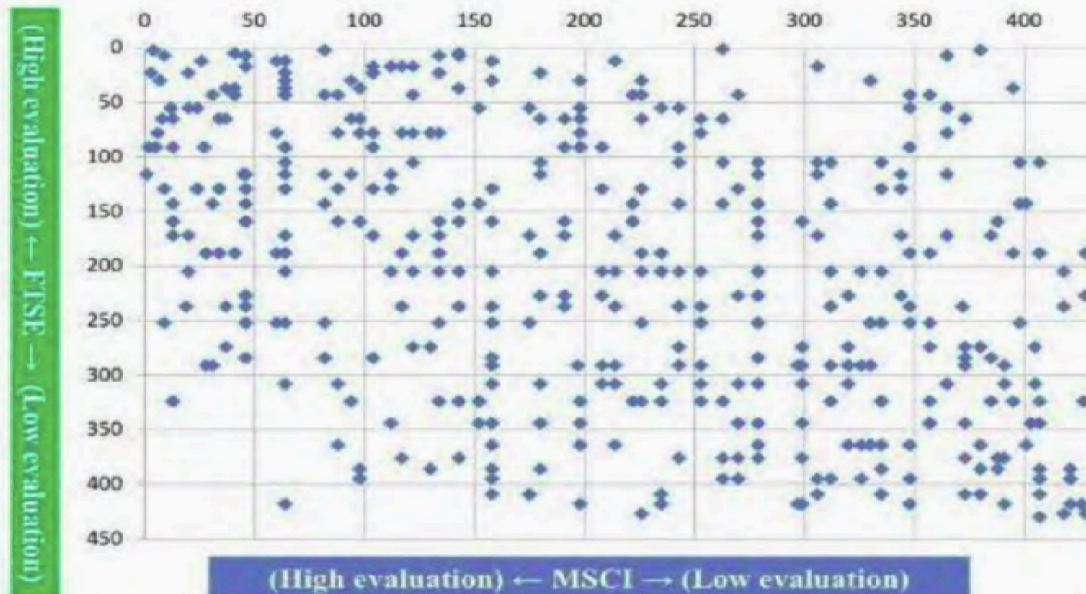
Eli Kasargod-Staub [Follow](#)
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SEC Disclosures Reveal That Top Asset Managers Voted Against Key Climate Resolutions at ExxonMobil, Duke Energy, Ford, General Motors, and Dominion Energy — several of which were backed by the Climate Action 100+, the \$34 Trillion Global Investor Coalition



Today BlackRock and Vanguard's disclosures of their 2018–2019 shareholder votes were released to the SEC, revealing that **both asset managers wielded their**

Comparison of ESG scores from FTSE and MSCI



3. Euroarea – leading the genesis of a green supercycle?

- high economic activity and employment without undermining ecological sustainability.
- UK Green Finance Strategy: all carrot, no stick, no thwarting mechanisms
- new euroarea thwarting mechanisms that could initiate a green supercycle.
 - Green (unconventional) monetary policy framework - green collateral
 - Minimize greenwashing: EU sustainable finance taxonomy - mandatory disclosure;
 - Use taxonomy for green macropru and ECB balance sheet for mitigating transition risks
 - Green FTT and Green single safe asset for European Green New Deal

Can EU institutions initiate a new supercycle?

- **Clear** transition path for greening the central bank balance sheet, financial system and economy
- **Just** transition path: re-shaping the macro-financial architecture for Green New Deal(s) –where burden of decarbonization does not fall excessively on workers, sharpen inequality or create deflation

Managing Supercycles: Globalisation and Institutional Change

Principal Investigator:

Professor Daniela Gabor



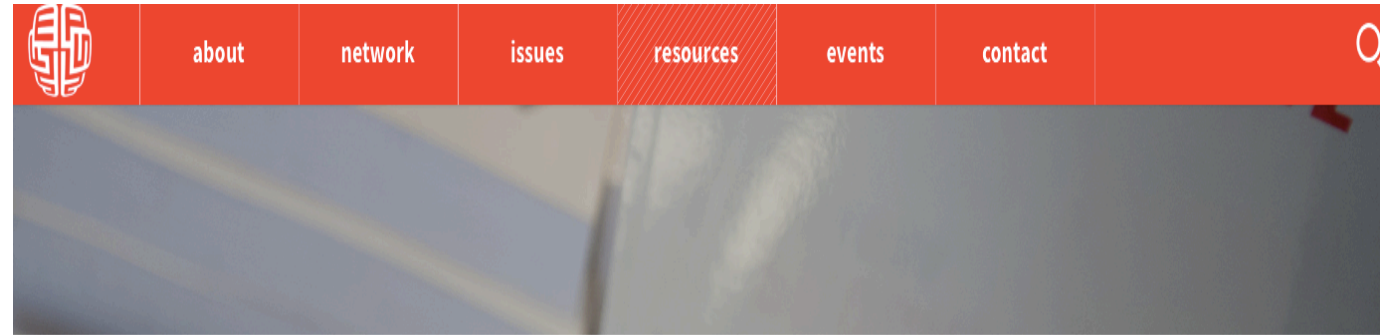
Daniela Gabor is Professor in Economics and Macro-Finance at the University of the West of England (UWE), and obtained a PhD in Banking and Finance in 2009 from the University of Stirling.

Her research develops three related themes under the umbrella of critical macro finance. First, shadow banking activities, in particular repo markets, and the implications for monetary theory, central banking, sovereign bond markets and regulatory activity. Second, my research develops the theme

of transnational banks' involvement in policy deliberations around capital controls and crisis management in both global settings and in emerging markets. Finally, I research the IMF's conditionality and advice on capital controls.

Co-Investigators: Yannis Dafermos (UWE Bristol) and Jo Michell (UWE Bristol)

<https://www.rebuildingmacroeconomics.ac.uk/projects/managing-supercycles-globalisation-and-institutional-change/>



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The single safe asset: A Progressive view for a "first best EMU"

Publication

Author: Daniela Gabor

May 24, 2018

ECONOMIC AND MONETARY UNION | GROWTH

The Single Safe Asset is an important if underappreciated element of the on-going debates on the EMU architecture. This Brief first describes the 'Northern' and 'technocratic' view of safe assets and then proposes three pillars of a progressive standpoint to frame the debate:

- (1) Single and national safe assets;
- (2) Public not private single safe asset;
- (3) ECB, not ESM/EMF, backstop for EMU safe assets.