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Anil Kashyap on Rising Interest Rates and Financial Cracks

October 13, 2022

Unedited Webinar Transcript as provided by Zoom

Transcript:

Markus Brunnermeier: So thanks everybody for coming and welcome back to another Webinar organized by Princeton for everyone that they happy to have um annual cash up with us today. I am you good to see you. Bye.

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00:04:40.020 --> 00:04:49.209

Markus Brunnermeier: Anil is a professor at Chicago Booth University of Chicago, and also was for several years now members of the Bank of England Financial

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00:04:49.910 --> 00:05:01.309

Markus Brunnermeier: Policy Committee, so he has firsthand knowledge what's going on in the UK at the moment, and in general is an expert on financial stability, banking and financial crisis.

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Markus Brunnermeier: You also has a lot of experience with Japan as well. So we will touch on many topics.

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00:05:06.750 --> 00:05:18.910

Markus Brunnermeier: So let me just uh use one opening slide, and then also tell you what the the poll questions were. You thankfully agree to answer. So at the moment what we really see is uh

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00:05:18.920 --> 00:05:36.570

Markus Brunnermeier: a three-sided game of chicken. It's been fiscal, monetary and financial dominance. So we have, on the one hand, you know the UK: traditionally thinking about. You know you One of their tax cuts the monetary authorities, the Bank of England. And then there's also financial dominance where the monitor authorities is actually

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00:05:36.580 --> 00:06:04.980

Markus Brunnermeier: uh limited. What they can do in terms of of interest rate tightening what typing in general, because it might actually create some couples in the financial sector. So you have this monetary dominance which would actually ask for typing to get the inflation under control. But then a financial dominance with Uk pension funds and Ldi, and all this which will actually ask for some loosening, or at least some financial stability considerations which would ask for, uh, doing it less strangely

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00:06:04.990 --> 00:06:22.410

Markus Brunnermeier: so in this context we will have a discussion today, and he will give us his insights. But let's start with the poll questions. So the first question was the spike in the Uk yields, or the Uk into that is due to financial fractions,

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00:06:22.420 --> 00:06:40.889

Markus Brunnermeier: or is it due to solvent to fears or the loss of center bank credibility or other uh reasons. And the answer was essentially forty-four percent of you to financial fractions forty-three percent to solvent. If you's thirty-seven percent loss of ccentral, bank credibility, or others. Twenty-two percent.

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00:06:41.100 --> 00:06:45.299

Markus Brunnermeier: Of course it doesn't add up to one hundred percent because you could answer more than one question.

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00:06:45.840 --> 00:06:49.000

Markus Brunnermeier: The second question was, Um.

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00:06:49.310 --> 00:06:57.640

Markus Brunnermeier: The increase in the interest rates in the Us. Or hike will likely reveal tax in the original banks,

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00:06:57.770 --> 00:07:07.519

Markus Brunnermeier: in the shadow banks, or other intermediaries, or in equip to assets and the answers. For here eighteen percent additional banks, sixty one percent in in shadow banks

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00:07:07.590 --> 00:07:15.489

Markus Brunnermeier: uh forty-nine percent in other intermediaries, pension funds, insurance companies, and thirty-five percent thought in crypto assets.

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00:07:16.210 --> 00:07:19.560

Markus Brunnermeier: Uh the next question was

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00:07:20.240 --> 00:07:36.989

Markus Brunnermeier: the increase in interest rates in the Us. Will bring inflation back to the target, because the fed will tolerate a recession. That's what sixty-six percent thought so the majority thinks inflation is coming back and fed will tolerate a hard landing or recession sixty-six percent

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00:07:37.210 --> 00:07:51.180

Markus Brunnermeier: uh The second answer was only twenty-six percent bring back inflation, but it will lead to slower growth. But no recession. So no recession. Soft landing is only twenty-six percent, and the fed will actually

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00:07:51.190 --> 00:07:57.320

Markus Brunnermeier: not going back inflation because it will stop of hiking. That's what's thirteen percent thought that pick

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00:07:57.440 --> 00:08:00.630

Markus Brunnermeier: majority is actually for hard, hard landing.

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00:08:00.810 --> 00:08:04.130

Markus Brunnermeier: The fourth question is the normalization of Monty Pulse lead to

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00:08:04.250 --> 00:08:15.350

Markus Brunnermeier: normalization of Copper Pont default. So you copy of one defaults will go up to sixty-nine percent thought this way, and there will be excessive copied on the phone at thirty-two percent of this way.

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00:08:15.460 --> 00:08:31.310

Markus Brunnermeier: And finally, uh, we will have a question on Japan. Is Japan spared from high inflation, yes or no. And actually sixty-three percent thoughts Japan is spared from inflation. They have three. Now they will not have high inflation, and uh thirty-nine percent

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00:08:31.820 --> 00:08:35.230

Markus Brunnermeier: uh sold uh, they actually the

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00:08:35.720 --> 00:08:41.830

Markus Brunnermeier: they're not spared. So there was one or two or one person, probably, who clicked on both.

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00:08:42.610 --> 00:09:02.570

Markus Brunnermeier: Okay, thanks a lot. So let's start with this background from you, giving us some feedback. How you're thinking is, And now we go to a Neil. He will start with a little background. View. What happened in the UK. What happened with the interstates the bit, asks France, so I will share my slides, and until you will

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00:09:02.580 --> 00:09:06.240

Markus Brunnermeier: take over for a few minutes, and then we have our discussion

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00:09:06.310 --> 00:09:12.339

Markus Brunnermeier: on this very exciting topic, but also scary. And the fact that what's going on.

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00:09:12.590 --> 00:09:27.939

Anil Kashyap: Okay? Well, thanks, Marcus. It's treat to be here. I've enjoyed these webinars is fun to actually be uh be participating, and I should start by saying my term on the Financial Policy Committee is over. So i'm not speaking for the Bank of England. There's a policymaker anymore.

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00:09:27.950 --> 00:09:43.199

Anil Kashyap: Um, But this is obviously something i'd continue to follow closely. And here here you you can see what was going on um for people that are interested. There's a letter that John Cunliff, who's the Deputy Governor Financial Stability at the Bank of England, wrote to the

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00:09:43.210 --> 00:09:55.100

Anil Kashyap: Parliament to the Treasury Select Committee that outlined the rationale for a lot of this. And so, if you want the details, I for you to go there. John had a version of this chart. This is updated through yesterday.

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00:09:55.110 --> 00:10:17.470

Anil Kashyap: Um, and you you can see that um the the so-called fiscal event where the the mini budget um was unveiled a few weeks ago, seems to have precipitated the the sharp rise in in interest rates that we've seen there. Um! It's noteworthy that the day before the fiscal event there had been a monetary policy committee meeting,

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00:10:17.480 --> 00:10:35.350

Anil Kashyap: and you know the bank kind of unveiled a much more hockey stick, So that that was out there in public, and you could see that there wasn't much movement there. It really does seem to have been that people saw this this news around the fiscal event. And um! What? What? That

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00:10:35.390 --> 00:10:49.639

Anil Kashyap: unleashed was, you know a a very rapid change in interest rates that cause trouble for um pension funds in the Uk. Uk still has many defined benefit pension funds,

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00:10:49.650 --> 00:11:09.179

Anil Kashyap: and so, when interest rates move, the liabilities of those those pension promises fluctuate in value. For years and years and years interest rates have been falling, and that had meant those liabilities were going up. One of the things that the Pension regulator had had pushed for was for the banks to try to hedge some of that exposure,

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00:11:09.190 --> 00:11:09.990

Anil Kashyap: and

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00:11:10.070 --> 00:11:28.279

Anil Kashyap: that brought them to this so-called liability-driven uh investment strategy whereby they would go ahead and hold long-term government and it's. It's important to realize the uk has a a big market in thirty and fifty year Long-term debt.

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00:11:28.290 --> 00:11:37.579

Anil Kashyap: Both inflation are linked and um conventional, and so a lot of that's been issued, and it was owned by the pension funds. And so,

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00:11:37.700 --> 00:11:54.240

Anil Kashyap: when interest rates went shooting up. That was good for the overall pension scheme, but it meant that their hedges started to to kick in, and the the volatility and interest rates meant that anything that was heads through derivatives required margin calls,

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00:11:54.250 --> 00:12:07.510

Anil Kashyap: and those margin calls were very, very uh abrupt, so much so that the the pension funds found that the the vehicles that they had set up to do the hedging were running out of capital

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00:12:07.550 --> 00:12:22.299

Anil Kashyap: now overall for the pension funds. This wasn't a problem. They had the assets and other parts of their pension. Um, but they they weren't able to transfer capital immediately, and so the bank stepped in,

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00:12:22.310 --> 00:12:41.700

Anil Kashyap: and there's been a lot of controversy about why it's stepped in and said, We only going to be here for two weeks, and the answer quite clearly is this is not. This is not an attempt to try to cap interest rates to suppress um, you know, to suppress interest rates. It was a monetary policy action. It was to try to make sure that there was a buyer there,

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00:12:41.710 --> 00:13:01.209

Anil Kashyap: as these guys were instructed to try to raise capital and and then de leverage, and if they were going to do leverage they needed to sell. And so this um period that we're going to end uh tomorrow was supposed to be a time when they would recapitalize, and that's going on.

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00:13:01.220 --> 00:13:14.149

Anil Kashyap: And if you want to watch one thing to figure out, if if this uh is going to subside is to see how much um capital has been put into these vehicles at the Pension Fund zone,

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00:13:14.160 --> 00:13:33.870

Anil Kashyap: and that's not easily disclosed. It's not like there's regular reporting, or you go to a Bloomberg screen and download the so, though it won't surprise me if Bloomberg starts tracking this uh just like they did with write downs and losses during the financial crisis. It would be helpful and a a public good to disclose all of that. So

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00:13:33.880 --> 00:13:49.040

Anil Kashyap: um! The idea was they'd recapitalize once they do, then the hedges could remain in place, and and you know they could carry on. If they can't raise the capital. Then what they're going to have to do is sell, and that's where the the bank has been buying

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00:13:49.050 --> 00:14:01.390

Anil Kashyap: for the first week. There was a very few sales. Um, The last two days there's been more like four billion. But uh today I think there was about just over four billion, most of it inflation linked.

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00:14:01.400 --> 00:14:11.489

Anil Kashyap: And so, you know, as Andrew Bailey said couple of days ago, there's one more day to go. These guys need to be risk and and raise their capital. And then we're going to see what's going to happen

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00:14:11.610 --> 00:14:22.719

Markus Brunnermeier: between the linkers and the the inflation linked pounds and the non-inflation linked pounds is this going hand in hand, or is there some?

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00:14:22.730 --> 00:14:41.060

Anil Kashyap: They disproportionately own the inflation linked bonds. There's usually people arbitraging the difference between these using Uh futures markets. But if if there's no natural buyers, there's there's not another's class of natural buyers for this very long dated inflation protected bonds,

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00:14:41.070 --> 00:14:55.770

Anil Kashyap: So these these are usually the buyers, and if they're not there, it it can cause disruption. If you want to go to the next slide. Um, let me just ask one quick question, because Paul Taco last week was really drawing on this quick, even inflation. Indicator:

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00:15:04.180 --> 00:15:20.589

Anil Kashyap: Okay, It's because lots of people don't trade linkers to to trade inflation protected bonds. You have to have coded into your software all the intricacies of the way that this, the the linking works. And you have to be able to model this Cpi.

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00:15:20.600 --> 00:15:33.740

Anil Kashyap: In fact, in the Uk, the the index is actually the retail uh price index rpi, which was the prominent price index that was used in the early two thousand when these securities were first introduced.

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00:15:33.750 --> 00:15:46.270

Anil Kashyap: The Uk, like everybody else now in Europe, is on the Uh cpi, the harmonized, the consumer price index. So the thing that the Bank of England's target is is no longer our pi.

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00:15:46.290 --> 00:16:01.899

Anil Kashyap: There's um a standing gap because of formula issues between the Rpi and the Cpi. But you know I I think people do look at these things to try to try to gauge what's going on. Um, if if you you could see here

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00:16:01.910 --> 00:16:21.189

Anil Kashyap: that, uh, in the next slide. These are uh the bit aspirin for thirty and fifty year um bonds, conventional bonds. And if you look back to March of two thousand and twenty, it it looks like a pimple compared to what we're seeing now. So remember how disruptive the dash for cash was back then,

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00:16:21.200 --> 00:16:40.099

Anil Kashyap: when you know central be banks everywhere intervene to massively support markets. Look at how disrupted we we've been now for the last few weeks where the bit esper's, or you know, factor, three three times larger. So the the market was pretty broken until the the the bank

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00:16:40.110 --> 00:16:57.940

Anil Kashyap: stepped in, and you could see that the markets still not super active. But at least there is a buyer, and people are selling, and and hopefully uh they'll be, you know, an orderly end to this on a Friday, and then relatively soon, the bank will try to step out.

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00:16:57.990 --> 00:17:00.270

Anil Kashyap: Um. I wanted to say one more thing.

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00:17:00.920 --> 00:17:09.319

Anil Kashyap: It is important if you're going to call this a financial stability operation that you don't, just get in there and indefinitely support the market.

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00:17:09.369 --> 00:17:26.710

Anil Kashyap: They, If interest rates need to go up, they go up. You don't you don't stop that. You just try to make sure that there's not these abrupt moves that swing and interest rates. If you go back to the last slide was unprecedented. If you you know, in in fifty years of data you've never seen anything like that.

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00:17:26.720 --> 00:17:40.619

Anil Kashyap: So the move in three days was something like equivalent to the biggest move in twenty-nine out of the last thirty-three years over the year. That's how much volatility there was in this. So the

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00:17:40.630 --> 00:17:47.270

Anil Kashyap: the pension funds had done stress tests against interest rate movements, but nothing like what we saw.

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00:17:47.290 --> 00:17:50.409

Anil Kashyap: And so that's that's what caught them by surprise.

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00:17:51.270 --> 00:17:53.849

Anil Kashyap: So there was one thing. Um

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00:17:53.870 --> 00:17:56.700

Anil Kashyap: it. It is important to realize

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00:17:56.810 --> 00:18:13.590

Anil Kashyap: part of the complications here. These things are not domiciled in the Uk. They're not supervised by the Bank of England. Um! And And so the direct window into what's going on there? The ability to influence. What's what's happening is is not something that you know

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00:18:13.600 --> 00:18:17.309

Anil Kashyap: the Central Bank or anybody in the Uk. Can fully control.

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00:18:23.830 --> 00:18:33.349

Markus Brunnermeier: Uh, you know, if you do a lender of last year. So at the bank of thing. You could have also said that, do some repo activity with the pension funds, and take it out instead of our kind purchasing it. Uh,

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00:18:33.470 --> 00:18:55.380

Anil Kashyap: and of course it might be because you want to talk to a bit, Oscar, but they also wanted to putting the rate down so tiff, Can you elaborate a little bit land of losses? So that's what this This was not intended to necessarily reduce rates. It was try to make sure the market function well. But fundamentally the pension funds want to de-risk They want to sell,

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00:18:55.390 --> 00:19:04.360

Anil Kashyap: and so they don't have a funding problem. They they have a a leverage problem because their capital has been exhausted, and they want to get rid of this stuff.

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00:19:04.370 --> 00:19:23.569

Anil Kashyap: And so giving them repo funding wasn't, going to help. They They need somebody to be able to buy it, and it was an open secret in the market. Everybody knew that they were running into these trouble, and so, you know, nobody was going to step in. They want to just let the thing go and and let the fire still commence, and if the safe interest rate

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00:19:23.600 --> 00:19:37.440

Anil Kashyap: gets dislocated and everything else is going to crumble.

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00:19:37.450 --> 00:19:51.650

Anil Kashyap: Yeah, I think I think there was definitely some consideration of that sort, you know why by now. Let them let them twist in the wind, and and so um, and it is it to be fair! There's not a bunch of other um

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00:19:51.660 --> 00:20:09.950

Anil Kashyap: natural buyers that that need fifty year inflation, protection or thirty year inflation protection so. And given that these things require some specialization. Lots of big firms don't bother to trade index debt. So yeah, the people that we're aware of this

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00:20:16.260 --> 00:20:26.689

Markus Brunnermeier: would you say. But Toe essentially took away this long-term bonds and replace it with a short term reserve. So this is still so much long-term bond outstanding long-term debt.

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00:20:26.880 --> 00:20:45.389

Anil Kashyap: Yeah, I mean they they um you know they they've got. They kind of typically buy across the curve, so they did not try to. Uh they. They have not been doing anything like an operation twist or anything like that. They They had to leave the market

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00:20:45.470 --> 00:20:54.590

Anil Kashyap: to deliver price discovery all the way along the yield curve without um kind of concentrating in particular spots.

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00:20:55.120 --> 00:21:10.469

Markus Brunnermeier: Do you think that the Bank of England should, you know, explicitly set up some market make of last? Is what policy framework uh in on top of the L of last is what which is a more temporary nature, just bringing a bit of an orderly market functioning again.

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00:21:10.480 --> 00:21:24.260

Anil Kashyap: I suspect. Once we get back to peacetime, and this is settled down, they're gonna look at what happened, what worked and try to figure out some principles. Um, I think you know

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00:21:24.370 --> 00:21:42.619

Anil Kashyap: they this was not something they had never contemplated, but they didn't think it was going to come. Now. There was an international work stream that um run through the bis that um, you know, had lots of central banks talking about purchase facilities,

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00:21:42.630 --> 00:22:01.609

Anil Kashyap: but they basically had to stand this up. Um, you know, on on a day's notice uh, And so i'm sure There, there'll be refinements to design back, you know, Booth, we're gonna hold a conference about some of this uh next next year. So there, there! There are lots of

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00:22:01.670 --> 00:22:03.420

Anil Kashyap: you know, thirty questions.

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00:22:03.490 --> 00:22:18.669

Anil Kashyap: One thing that's very unusual about the Uk. Is, we actually have a Financial Stability Committee, so that the Fpc. Is in charge of this. So in it most central banks it would be the same people making the decision. In this case. The way it happened was the Fpc.

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00:22:18.760 --> 00:22:32.099

Anil Kashyap: Went to the bank and made a recommendation, saying, Stop this. This is going to threaten financial stability. And then the Npc. Was told about it and said, This is going to happen, and and you know it'll be temporary targeted

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00:22:32.110 --> 00:22:39.830

Anil Kashyap: mit Ctl. And uh, it'll try to be unwound quickly, And the bank's ability to do this again is going to hinge on, making sure that that happens one.

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00:22:39.900 --> 00:22:47.109

Anil Kashyap: I mean if they're still owning this stuff in two years. No one's ever going to believe again that when they say this is a market maker of last resort.

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00:22:47.310 --> 00:23:03.420

Anil Kashyap: So so you think the institution of them up for the Uk. Is superior, because they have Npc. And Fpc. And the fiscal authorities essentially for this, and I, you know I think it's a massive defect to take the United States where we have the silo

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00:23:03.430 --> 00:23:21.759

Anil Kashyap: thing and where you have to coordinate. If you've ever been to an international meeting. Just figuring out who speaks for the United States is a is a complicated thing, because the authority for depending on what you're talking about, at least in the realm of financial stability, rests across many organizations,

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00:23:21.770 --> 00:23:29.799

Anil Kashyap: and so it it doesn't really matter if the Fed thinks one thing. If the sec is opposed, or um, you know the

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00:23:29.870 --> 00:23:34.750

Anil Kashyap: the very, the Treasury could have a different view. So it's. It's much more complicated.

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00:23:35.660 --> 00:23:55.470

Markus Brunnermeier: And up coming back to the big question which was part of the poll question. So, listening to you, it sounds like this is all about financial frictions. It's not about the credibility of the Uk repaying It's that in the long run or well, I I think Bank of England intervention was about the the Ldi problem.

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00:23:55.480 --> 00:24:03.890

Anil Kashyap: I mean. Look at the chart. You don't need fancy econometrics to see that something changed the day that the the the budget was unveiled.

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00:24:03.920 --> 00:24:20.030

Anil Kashyap: Um! I just again. Personally, I think it was super unfortunate that they didn't score the budget and have the office of uh budget responsibility, release something simultaneous with that With that um budget I mean. It's unprecedented in the Uk

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00:24:20.040 --> 00:24:25.399

Anil Kashyap: to to have that big of fiscal impulse come out without somebody looking into it. So

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00:24:25.520 --> 00:24:34.299

Anil Kashyap: it seems pretty clear that that had something to do with the beginning of the the interest rate rises, and then the reinforcing dynamics took over.

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00:24:34.940 --> 00:24:53.190

Markus Brunnermeier: So Charlie Pin has a question he would like to know, you know. So far, you know, the buying volume was not so large. It was actually much bigger budgeted for right. Uh, can you put in perspective how many of this debt is outstanding, and how much is hold by the pension funds, and

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00:24:53.200 --> 00:25:10.639

Anil Kashyap: how big of a faction to be talking. This is very tiny. What the Bank of England is doing, or is it sizable? And well, I I think what happened was um! The capital calls uh went out the day the day the program was announced. I think you can. You can read news reports

98

00:25:10.650 --> 00:25:21.790

Anil Kashyap: uh where some of the pension funds that if this keeps going we're going to have to sell, and we're going to have to, you know, sell in a massive, massive way as soon as the bank intervened

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00:25:21.800 --> 00:25:37.730

Anil Kashyap: an interest rate and announced it was prepared to buy. Rates came right back down. That took off all the immediate pressure to do anything, but you know the supervisors were all over them to get them to try to recapitalize the the hedges still make sense. So if

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00:25:37.740 --> 00:25:55.259

Anil Kashyap: if you know the world was working really well, and there weren't these frictions they would have just recapitalized, kept the hedges in place, and sold nothing, and to the extent that they can raise enough capital. They they really don't want to. They don't want to step out of these things because then they're back to a one-way bet on interest rates. So

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00:25:55.270 --> 00:26:10.659

Anil Kashyap: I think it was good news for a while. Um, if you were on it, get really into the weeds. One problem that remains is that some of these pension funds pool their assets. So Marcus has a small fund, and Neil has a small fund.

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00:26:10.670 --> 00:26:24.989

Anil Kashyap: We we want to hedge our risk, so we each put it into a a a vehicle that an asset manager goes off and gets the interest rate hedge. Okay, collectively, our assets are pulled. There's some losses. We need more capital.

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00:26:25.130 --> 00:26:42.869

Anil Kashyap: Then there's a game of free riding or Marcus as well. I'll wait for Neil to put in the money, Charlie. Wait, you know as well. And if those guys don't recapitalize, then there will be

selling. And I, you know. I'm guessing that some of what's happened in the next. You know the last couple of days. Maybe there's going to be a lot of it tomorrow. Um,

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00:26:42.880 --> 00:27:02.619

Anil Kashyap: because I think if you you're running this as a single firm that's got all your assets segregated. It's pretty clear that you should put the capital in there, and I think that's kind of happening. But you know this is so much like the the Gfc. Where we don't have visibility into these things. We don't have Time series on the you know one

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00:27:02.920 --> 00:27:24.180

Anil Kashyap: what's normal? What So do we have any micro-potential tools to force the pension funds to recapitalize, and who is in charge? Not the Bank of England does some other regulator, and the the Financial Conduct authority has part of it. But it's a real problem just like the money funds in the Uk Sterling. Money funds are almost all in Ireland and Luxembourg,

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00:27:24.190 --> 00:27:39.860

Anil Kashyap: and so um it's a it's a problem that this stuff was set up way back before Brexit, where the Eu was an integrated market, where it was favorable to do this in in certain jurisdictions, and so that that's another layer on top of this?

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00:27:39.870 --> 00:27:53.330

Anil Kashyap: Um: So certainly the F. Pc. Does not have a tool. We could maybe make a recommendation to to these guys. But I mean ultimately they're They're supervised elsewhere. And that's that's part of the problem.

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00:27:53.370 --> 00:28:06.310

Anil Kashyap: Do you have an idea how much capital needs to be raised? So let's suppose I can find out this indicator. You will like to watch. Yeah, I mean, how many Williams do we need, or how many millions or what? Yeah. I mean, there there are guesstimates of

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00:28:06.320 --> 00:28:28.800

Anil Kashyap: how much uh for selling there would have been. Uh, there, there's numbers. I don't know how reliable they are. I mean the firms are obviously talking their book, saying we're going to have to sell everything and so on. But the numbers are in the tens of billions, you know forty, fifty billion. Maybe. Now, if you recapitalize it, it depends a lot on what your interest, rate, volatility, assumption is

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00:28:28.810 --> 00:28:29.480

Anil Kashyap: for,

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00:28:29.510 --> 00:28:30.570

Anil Kashyap: you know,

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00:28:30.610 --> 00:28:41.569

Anil Kashyap: if you, if you have to keep posting margin that's got to come from somewhere. So uh it matters greatly. And you know, if you put, if you look back at that chart we had the interest rates are

113

00:28:41.800 --> 00:28:49.690

Anil Kashyap: close to where they were when we intervened. Um! So you know we the the has not been um

114

00:28:49.860 --> 00:29:09.059

Anil Kashyap: suppressing interest rates. I think that's important to say this is different than monetary policy. It's just trying to buy time, and now they've had the time, and if they haven't um come up with the sustainable arrangement, and it need to be liquidated or wound down. That's just going to have to happen.

115

00:29:09.320 --> 00:29:16.960

Anil Kashyap: And hopefully that can be done in the orderly way. I guess you never know until you see it start, But that's what we'll be watching.

116

00:29:17.630 --> 00:29:28.260

Markus Brunnermeier: So we So I take it that you know all the problems is not in the traditional banking sector. It is actually more in the shadow banking sector, or even in pension funds, insurance companies.

117

00:29:28.490 --> 00:29:46.280

Markus Brunnermeier: And I was wondering in the lightels of the Nobel Prize for Duck, Diamond, and Philippe and Ben Bernanke. What banking is at the cent. Of Of course the mechanism probably applies also applies to sh the banks, but that you can say a little bit about. You know how they runs, and and how is it related to

118

00:29:46.340 --> 00:30:05.749

Anil Kashyap: this is more of a fire sale. But um! You know the thing we saw in March two thousand and twenty, where we we saw this this dash for cash, and we discovered that you know money, market funds, and others literally preferred reserves to treasuries

119

00:30:05.760 --> 00:30:13.140

Anil Kashyap: uh with something never contemplated, and all the liquidity rules that we we put in place. I mean, I I think it's

120

00:30:13.240 --> 00:30:30.600

Anil Kashyap: It's sobering that for ten years we've known that the money funds have an unstable structure or basically banks, with no capital and no deposit insurance. The industry is managed to fight off attempts to make them more um robust and resilient.

121

00:30:30.610 --> 00:30:47.160

Anil Kashyap: But I I think it's it's telling, and it's great that your polls show that very few people think the banks are going to crack. I mean, uh right when the pandemic started. Alex Brazier was one of my colleagues in the Upc. And he got called to testify, and he said, Look, big picture! It's great

122

00:30:47.170 --> 00:30:56.360

Anil Kashyap: news for financial stability that we're having a health crisis, but not a banking crisis, and the banks are making it worse. So I think everywhere we've kind of

123

00:30:56.490 --> 00:31:09.620

Anil Kashyap: topped up the banks that it's not perfect. But the banks are way way way better shape, and, unfortunately, how it's like, you know. You push on the bubble, and and we've moved a lot of the risk out of the banking sector um

124

00:31:09.630 --> 00:31:17.949

Anil Kashyap: into parts where we don't have as many tools. We don't always have as much uh insight into what's going on. I I think that's a problem,

125

00:31:18.060 --> 00:31:29.399

Anil Kashyap: and it's also a problem that so much of this is cross border. So even if you know, even if you know what you want to do in the Uk. If there's still, you know a casino that they can go to

126

00:31:29.410 --> 00:31:38.469

Anil Kashyap: offshore. Um, You're you're gonna have trouble. And so it requires global coordination. They're getting there hopefully. But it's taken a long time.

127

00:31:38.850 --> 00:31:54.730

Markus Brunnermeier: So, coming back to. So I need to missing Jurgis, and would like to know, you know what it mean. A big difference if you pay pension funds could post securities rather than cash for the margin calls, and you know all these year cuts to large on the liquid assets they're holding

128

00:31:55.240 --> 00:32:09.100

Anil Kashyap: the haircuts, The haircuts these are these are haircuts for um guilt, um, and it's tied directly to the volatility. Now, if you see a one in fifty year, move

129

00:32:09.110 --> 00:32:28.350

Anil Kashyap: um. There is a question about what you're supposed to do. But I mean, I think you want You don't want a clearing house to fill if you want to see. You know total nuclear meltdown. It would be watching a clearinghouse sale. So you have to collect the margin. Um, I think it's a question of whether or not you would have um,

130

00:32:28.360 --> 00:32:47.990

Anil Kashyap: I mean, and and given how fast interest rates are moving. Um! Letting them post the the bonds as collateral, would, it would have been complicated. Um, I mean, if this were, if this weren't such a clucky organization, they would have just moved capital from one part of the organization to the other,

131

00:32:48.000 --> 00:33:05.940

Anil Kashyap: and and that's where the the friction is. Um, you know these boards the trustees for these pensions often meet once a month, or even once a quarter, so to call them up Monday night and say, you gotta do this by nine o'clock tomorrow. They look at you like You've got three noses. They don't even know how to do that.

132

00:33:05.950 --> 00:33:13.579

Anil Kashyap: Um. And And so that's why we thought it was reasonable to buy time um, and you know it.

133

00:33:13.730 --> 00:33:26.589

Anil Kashyap: It's uh we're. We're going to see if they take, but you wouldn't go as far. The underlying hedge was a good hedge to take on, Or is it because we had this interview in two thousand and five. The accounting rules that the liabilities are, you know, made

134

00:33:27.200 --> 00:33:33.620

Markus Brunnermeier: made mark to market, or essentially discount. We need to say changes. You discount the liability of the pension funds as well.

135

00:33:34.620 --> 00:33:37.179

Anil Kashyap: Yeah, I mean, I Fundamentally, I

136

00:33:37.250 --> 00:33:48.100

Anil Kashyap: I think one question I've been asking is there must be many other countries that have to find pensions still. And what do they do about hedging the interest rate risk? And you know,

137

00:33:48.910 --> 00:33:54.140

Anil Kashyap: scary question is, you know, where is the next version of this going to erupt?

138

00:33:54.220 --> 00:34:03.279

Anil Kashyap: I would have answered somewhere in the shadow banking system, or maybe other financial intermediaries. I don't think it'll be the banks. But there, there must be other

139

00:34:03.290 --> 00:34:18.500

Anil Kashyap: um countries where this is a problem on the Us. It's not a big deal anymore, because we basically crushed all the defined benefit plans, and we put the risk on the individuals. But um, but there are. There are other places, and i'm you know you. You're not hearing about this.

140

00:34:18.510 --> 00:34:25.400

Anil Kashyap: I don't know whether you know stuff's being suppressed. Uh, and we're gonna see an eruption. But

141

00:34:25.560 --> 00:34:35.659

Anil Kashyap: you know there were a disorderly move and interest rates, and say the euro area, or some of these Asian economies. I I think this would be something you have to watch. For

142

00:34:36.659 --> 00:34:56.579

Markus Brunnermeier: so this is feeling out there, I know, even though pension funds have this long-lasting liabilities they're not run grown, but then ultimately through hedging of interest rates, they'll become an unknown again. So there's a tendency of the financial sector as a whole to get into liquidity, Mismatch, even if they don't need to.

143

00:34:56.800 --> 00:34:58.890

Markus Brunnermeier: And And

144

00:34:58.900 --> 00:35:18.279

Anil Kashyap: do you see it in other areas as well? You know Tfs and hidden leverages there that you see it. Many other problems which might pop up. So where do you have to look now?

145

00:35:18.290 --> 00:35:22.500

Anil Kashyap: And as you just said, there's an intense um

146

00:35:22.740 --> 00:35:40.059

Anil Kashyap: intense profit. Opportunity comes from from harrowing short and lending long in one way or another. So, even if you start out with something that you think you could be matched, you end up going short, then you make a little extra yield, and the fact that um

147

00:35:40.150 --> 00:35:54.170

Anil Kashyap: short term debt is so powerful because you don't really need to monitor. You don't need to know anything. If I lend you overnight, I always figure I can get out faster. And so what you you see, perhaps the sovereign crisis happens everywhere, you see, is the trouble

148

00:35:54.180 --> 00:36:09.500

Anil Kashyap: built. You see maturity shortening, shortening to where it's getting to be overnight, and then one day they don't roll, and then, and the crisis comes. So I I do think. Um, there are many other structures that have the the same kind of

149

00:36:09.510 --> 00:36:25.749

Anil Kashyap: um, you know, short term funding for long term. We had a asset back commercial paper, and in two thousand and eight we've got the money funds still all over the place, and it Won't. Surprise me that we find more of that back going on. If If this continues

150

00:36:25.870 --> 00:36:45.290

Markus Brunnermeier: so, can I come back? So Ellen Blinder is asking a question, and coming back to the market maker of lost the sort. If you look at the it asks that it didn't come down much. Do you have an explanation for that. Uh so if it's really the the aim is to think of it as that down in the market functioning. Yes, the volumes have not recovered,

151

00:36:45.300 --> 00:37:03.569

Anil Kashyap: and it's It's gonna take a while, I think, to to see I I I do think it it's interesting that the bit Aspirates haven't come. But But as uh Charlie noted, there Hasn't been a whole lot of of selling. And so what's going to be interesting is, you know. Let's see tomorrow,

152

00:37:03.580 --> 00:37:19.600

Anil Kashyap: and then let's see next week with the If you know the banks out, what what happens to interest rates, step up again, or do we discover that a bunch of these guys announced. We don't have to sell um, because we've raised the capital and then things normalize, I think, until we know

153

00:37:19.700 --> 00:37:31.980

Anil Kashyap: it, You know. Imagine you were thinking about taking the other side of one of these things. You'd want to know where they are, and so you know There' be a public interest in trying to disclose how much capital they've really raised and

154

00:37:31.990 --> 00:37:40.620

Anil Kashyap: try to. I'm sure there'll be an investigation. There'll be reports written about exactly what they had. We'll try to make this stuff all much more transparent.

155

00:37:40.740 --> 00:37:44.729

Anil Kashyap: But um until I think, until you know,

156

00:37:44.760 --> 00:37:49.369

Anil Kashyap: they've got the capacity to hold the positions. People are not going to want to be on the other side. So

157

00:37:50.350 --> 00:38:07.669

Markus Brunnermeier: so coming back, I mean essentially what you repeating is this this game of chicken going on between the Bank of England and the Pension funds, whether they recapitalize it. And we have another game of chicken going on with the fiscal side. Uh to to you. Okay, Treasury, whether to reverse the Mini budget.

158

00:38:07.770 --> 00:38:21.580

Markus Brunnermeier: How do you see this playing out? It? So is this: The future of central banking will be much more confrontational and playing games of chicken with different players. Uh, do you think that's what the future of central banking will look like, especially in the light of higher inflation.

159

00:38:22.780 --> 00:38:33.749

Anil Kashyap: I mean, I've been worried about this for some time. I mean several banks have crossed a bunch of red lines, and they've started buying assets that they would have never bought. I mean, if you told

160

00:38:33.770 --> 00:38:52.609

Anil Kashyap: if you told Allen, when he was the vice chairman of the fed that the fed would be buying municipal bonds from States and and um local governments, he would have said, I, I'll die on that hill will never do it. Well, now, we've done it. Okay, And and it it went okay the first time. But

161

00:38:52.950 --> 00:39:03.640

Anil Kashyap: but it's a huge temptation for the political process to think. Okay, we've got this balance sheet that can. Essentially, you know, we can lever and do stuff with.

162

00:39:03.750 --> 00:39:18.920

Anil Kashyap: And I, You know, I think the central banks are going to have to fight it. The best way to send that off is get inflation under control. Go back and make sure you're doing your primary job and doing it well, and if you can, that, you know, gives you some cover.

163

00:39:19.070 --> 00:39:19.919

Anil Kashyap: But

164

00:39:19.950 --> 00:39:31.429

Anil Kashyap: you know I think we we didn't have a choice. It was going to be very, very nasty. Uh, if the bank had not inter intervened when when we did a couple of weeks ago. And um!

165

00:39:31.700 --> 00:39:53.300

Markus Brunnermeier: So what this would like to know whether you know this Ldi problem was. You know, there was an Ft. Article in July, and actually, I suppose you talked about it two years ago. Was it well understood, and did it come out of the blue? Or is this one of the biggest reasons uh Richard hosted Richard Nana Pavlova has hosted a conference where he gave a talk

166

00:39:53.310 --> 00:40:08.640

Anil Kashyap: about this mechanism, and one of the staff Kindly push me to put a footnote in pointing to Ldis, is exactly where this could go run, so it's not like this was out of the realm. The The bank staff certainly knew about this. Would

167

00:40:08.650 --> 00:40:23.069

Anil Kashyap: nobody thought to do was test the five Sigma interest rate move, and I don't even know if you should insist on being robust to that kind of um movement. I mean, we've never seen anything like this.

168

00:40:23.240 --> 00:40:26.180

Anil Kashyap: Um, If it's the case that

169

00:40:26.280 --> 00:40:43.980

Anil Kashyap: the bank buys time, they recapitalize and we go back to something more normal. I I think this will go down as a a really good uh market maker of last resort set of precedent show a bunch of possibilities for how this could be done. Well, if it turns out, we step out in the the

170

00:40:43.990 --> 00:40:58.560

Anil Kashyap: not not we anymore. But if the bank steps out has to has to buy uh, come back in at some point or ends up holding this stuff for a very, very long time. The The tool is going to be soiled. So there's there's a lot of pressure to

171

00:40:58.570 --> 00:41:15.899

Anil Kashyap: kind of. Get in. Get out and move on with this. But can you elude a little bit to where the other tax potentially showing up. So Ldi is one. But do we see an Etf's or open in the virtual? I mean, I money funds are obviously still a problem.

172

00:41:15.910 --> 00:41:32.279

Anil Kashyap: I mean, I I worried that the for selling on on like leverage loans um. There's a huge I mean one of the things that seems to be true is lots of high yield debt. Markets are not very vigorous or almost shut right now. Um! And if interest rates keep going up.

173

00:41:32.530 --> 00:41:38.459

Anil Kashyap: If you can get five percent on the Treasury security, what are you going to need for a a high yield bond?

174

00:41:38.680 --> 00:41:51.479

Anil Kashyap: Is Are all those companies that are dependent on that gonna have huge problems rolling their funding. And we've we've already seen some deals. I don't. I don't think there's enough pipeline risk where the

175

00:41:51.490 --> 00:42:04.649

Anil Kashyap: the banks or anybody is holding this stuff trying to, you know. Put it into a a slo or or something like that. But I I worry about that. So I worry about a lot of people not being able to roll that.

176

00:42:04.710 --> 00:42:13.100

Anil Kashyap: Not necessarily um a fast moving crisis, but just a big credit crunch for all these people that

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00:42:13.160 --> 00:42:16.240

Anil Kashyap: got that on terms that now look kind of silly.

178

00:42:16.330 --> 00:42:21.490

Markus Brunnermeier: That's mostly on the corporate side then. Yeah. But countries, too. Yes,

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00:42:24.440 --> 00:42:26.490

Markus Brunnermeier: okay. So

180

00:42:26.660 --> 00:42:39.199

Markus Brunnermeier: let's perhaps move on to them next topic. We have touched it already on default risk, and that's about the rolling things. How much would you? So you follow the Cds and on the corporations and on this organs? Essentially,

181

00:42:39.210 --> 00:42:57.409

Markus Brunnermeier: uh, do you also see a big change on you know, having bonds and stocks have a natural hedge to each other. Do you think this will change? And this will actually also lead to a huge dislocations on the bond market as well, because so far we always thought it was a natural hatches. And we, if you go to stock relation suddenly, these hatches are going away.

182

00:42:57.480 --> 00:43:15.710

Anil Kashyap: Yeah. So the I guess the conventional interpretation is that the um, you know, because inflation expectations are so well anchored, you don't have to worry about bond places uh collapsing when there when there's trouble and you get the flight to safety and everything's gonna work. If

183

00:43:15.780 --> 00:43:22.299

Anil Kashyap: this is why I was saying, Central Banks need to get the inflation under control first and foremost, because if you lose that anchor,

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00:43:22.310 --> 00:43:41.359

Anil Kashyap: you're right. The correlation between bonds and stocks would shift, and that that basically then would cause all kinds of ha chaos, because there's lots and lots of organizations that built their portfolios around the presumption that that negative correlation is structural. They we know from stuff that that John Campbell and co-authors have done

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00:43:41.370 --> 00:43:47.539

Anil Kashyap: that that correlation has varied over time. It really starts about twenty five years ago,

186

00:43:47.830 --> 00:44:06.810

Anil Kashyap: around one thousand nine hundred and ninety-nine, when it flips and becomes negative, that's right around what it looks like the central banks, started to have credibility. So if it gets squandered uh that, that will be certainly a risk. Something. You've written about a lot that this doom loop again between the banks and the sovereigns is

187

00:44:06.820 --> 00:44:20.809

Anil Kashyap: unattended to, so that that's another uh concern. So i'm pretty worried about Italy, and you know how that all plays out. They've got a new government. Maybe they're gonna kind of play by the rules, but

188

00:44:20.930 --> 00:44:22.049

Anil Kashyap: maybe not.

189

00:44:23.280 --> 00:44:37.070

Markus Brunnermeier: And these seals you see spillovers from, because now the markets woke up they all this probably potential dangerous. This is spill over to other parts of the market, to other countries, especially also to emerging economies.

190

00:44:37.270 --> 00:44:45.329

Anil Kashyap: Um, it it. It was surprising to me that even though there was all this pressure at the long end of the guilt market,

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00:44:45.340 --> 00:45:04.349

Anil Kashyap: a lot of the traditional spreads did not blow out two weeks ago. I mean they they They look not great, and the guilt market as a whole. Doesn't look great. I mean, There's There's

pressure all the way through there. Um, but it hasn't shown up um. You haven't seen emerging markets,

192

00:45:04.360 --> 00:45:10.980

Anil Kashyap: you know, completely getting crushed. Um! We we haven't seen um,

193

00:45:11.400 --> 00:45:15.950

Anil Kashyap: we haven't seen it fully spread so far, which is great.

194

00:45:16.470 --> 00:45:19.329

Anil Kashyap: But we know these things happen quickly,

195

00:45:19.370 --> 00:45:33.440

Anil Kashyap: and uh, we also know we don't have good data and good maps of where um where the interconnections lie uh across this it's one of your mentors was who did to ambush? Who had this famous saying

196

00:45:33.450 --> 00:45:40.560

Anil Kashyap: It takes longer than you think, but when it happens very quick, so you afraid this might happen to emerging economies, too.

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00:45:41.040 --> 00:45:58.760

Anil Kashyap: Yeah, I mean the possibility of a sudden stop for the emerging economies is something that you know. I worry about a lot. I mean, we've. There's been so much that issued, and you know the Imf has been warning about this. We still don't have super great restructuring mechanisms, and whether or not

198

00:45:58.860 --> 00:46:13.690

Anil Kashyap: um after the up a pandemic when we couldn't organize global aid to try to make sure we could vaccinate the rest of the world. There's not going to be a lot of sympathy for saying We need to provide support to to,

199

00:46:13.770 --> 00:46:19.979

Anil Kashyap: you know, restructure or support the get that was issued by these countries. There's just no appetite for that.

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00:46:20.010 --> 00:46:39.820

Anil Kashyap: Um, even if it's in our collective interest, try to make sure any restructuring is orderly. Um it. I'm not optimistic. If you were a policymaker on what would you do? I mean, Of course, you run the Fbc. But not anymore. But from a global perspective, an emerging market focus.

201

00:46:39.830 --> 00:46:59.430

Anil Kashyap: I mean, I I think, trying to figure out this, this restructuring and and trying to get some form of bail in into the debt. I mean, what did we learn of the global financial crisis. If you could convert this stuff to equity, It's very good. The problem is as you start to see people getting close to getting bailed in. They step back,

202

00:46:59.440 --> 00:47:07.669

Anil Kashyap: and then you you can't roll the funding. So it would have been great to turn out some of the funding, you, you know there there should have been

203

00:47:07.790 --> 00:47:27.750

Anil Kashyap: stress test in all these countries to figure out who's holding the debt? And if it does blow up, are you going to take out your banking system, and and so on. Um, but it's too late now. I mean there's now we're into the we're starting to get into the tail, and so you can't, you know Best Advice don't start here,

204

00:47:27.870 --> 00:47:38.140

Markus Brunnermeier: but you wouldn't go as far as uh you know. I'll go ahead, and, for example would say the fair to take you to account that when they hike into States also the implications for the emerging economies,

205

00:47:38.390 --> 00:47:48.549

Markus Brunnermeier: So do you think it's just if it has to fight inflation. Now, if it loses the five hundred, and it's even worse for the emerging account for the whole global economy.

206

00:47:48.890 --> 00:48:07.890

Anil Kashyap: I have some sympathy for the basic observation that the world is dollarized and and that creates a special obligation responsibility for the Us. I think the willingness to sanction people using the financial system and weaponizing it. Isn't a free free launch, I mean it

207

00:48:07.900 --> 00:48:21.629

Anil Kashyap: create stress. I mean, if if, as a result of these sanctions. Russia sets up a payment system that's on the side that everybody in the future can run to and get into um. We're not going to be happy with all of that.

208

00:48:21.640 --> 00:48:36.099

Anil Kashyap: So I think the fed really it's number one job is to take care of making sure that inflation in the United States is under control that the US. Economy is not in recession, you know. Hit. Try to hit their dual mandate, do the best they can on that

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00:48:36.200 --> 00:48:42.740

Anil Kashyap: um, but but recognize that it can create trouble for others. I think Janet Yellen said

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00:48:42.830 --> 00:48:47.910

Anil Kashyap: more in this direction yesterday, at least, according to press release, I didn't leave, though

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00:48:48.270 --> 00:48:56.909

Anil Kashyap: whole speech, if there even is one, because it might have been in one of these meetings where it's just reported. But um, I think there's a growing view that

212

00:48:57.130 --> 00:49:00.379

Anil Kashyap: you know there is some responsibility. If you've got the reserve currency,

213

00:49:01.780 --> 00:49:18.329

Markus Brunnermeier: So let me move to Japan, because I know you did a lot of work on Japan early on. So can you comment? You know the reason events and what the high inflation we have on the global scale all over the place. Uh, except the Japan. I mean, it's not so dramatic in Japan.

214

00:49:18.340 --> 00:49:36.060

Markus Brunnermeier: What the Bank of Japan yield to of control is still going on trying to hold down the long-term interest rate there, even in the in the if one exchange markets to stabilize the uh the end, even though it might be a way to get out of this low inflation environment. And perhaps you can also touch on the

215

00:49:36.310 --> 00:49:39.989

Anil Kashyap: covered it to say penalty violations. Okay, So

216

00:49:40.080 --> 00:49:58.929

Anil Kashyap: on on Japan, I mean, I think your former car, leg or Spencer, had that foolproof way of getting out of of a a deflationary trap by just printing and counting on the exchange rate exploding, and Japan had kind of been watching that and letting it go. Um!

217

00:49:58.940 --> 00:50:10.800

Anil Kashyap: Now one of the things that happened to Japan in the last twenty-five years is that their supply chains hollowed out. They moved a lot of stuff outside of Japan into Asia. A lot of it in China,

218

00:50:10.810 --> 00:50:26.879

Anil Kashyap: uh which means that when the Yen weekends like it has, it does cause trouble for the manufacturing sector. So there's lots of parts of Japan that are not saying we're becoming necessarily much much more competitive. We've got this this other

219

00:50:26.890 --> 00:50:42.799

Anil Kashyap: supply chain link. So uh Governor Corrod has been under a lot of pressure, he said. That's not my problem. My problem is to try to hit my inflation objective. I'm going to do everything I can to market will set the exchange rate if wherever it belongs. And

220

00:50:42.810 --> 00:50:56.520

Anil Kashyap: we're we're gonna live with that so far, I mean, you probably saw that the Prime minister a couple of days ago, gave a speech, saying he was still on board with what uh Mr. Krodo is trying to do um. So you know, I I think

221

00:50:56.530 --> 00:51:11.200

Anil Kashyap: they would really like to break the deflationary mindset there and try to get wages rising. Um! So that you know the real income hits aren't so bad. And then, if you could normalize, wage increases

222

00:51:11.210 --> 00:51:30.399

Anil Kashyap: of two, three, and probably inflation would would tag along, and they'd be out of this. I mean the the deflation does create, You know, some imbalances they've got. They've got their pension funds that are trouble. Um! They still don't have a balanced budget. I, you know, have various people. My long term

223

00:51:30.530 --> 00:51:41.159

Anil Kashyap: collaborator to Caho. She's got these calculations of When is the amount of Japanese government debt going to exceed national savings. I think the

224

00:51:41.170 --> 00:52:00.450

Anil Kashyap: tricky thing is that once that happens in the marginal buyer of Japanese debt has to be a foreigner. You could see a pretty radical reprising of Japanese government debt. So it would be good if they could get the fiscal stuff in order, and a little inflation would help get rid of some of this this debt.

225

00:52:00.460 --> 00:52:07.379

Anil Kashyap: Um, but I you know I think they're They're in a tough position, and I hope the BoJ kind of sticks with it.

226

00:52:07.410 --> 00:52:17.109

Markus Brunnermeier: But do you think this unraveling will happen suddenly about Don't Bush dictum anticipating, and hence inflation will creep up slowly?

227

00:52:17.120 --> 00:52:34.359

Anil Kashyap: I don't know I mean you know this trade where you try to bet that the end is going to collapse. It's called the Widow maker I mean it's been on for twenty twenty-five years. Nobody's really gotten rich on it. So I you know. I think if you were of that mindset you would have tried to

228

00:52:34.370 --> 00:52:38.239

Anil Kashyap: express that position in the market years ago would have gotten blown out by.

229

00:52:38.710 --> 00:52:43.909

Anil Kashyap: People are going to be doing these calculations, and it will come the day when

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00:52:43.920 --> 00:53:07.439

Anil Kashyap: um when the that's going to exceed the savings, and then something has to give but it, you know it could be a long time Still, a few years out before that that happens. So they they have some time. So you mentioned that you know the whole outsourcing. We've also, you know, Japan outsourcing to China, Korea, and other nations makes the whole pressure not to have the Vm. To develop.

231

00:53:07.710 --> 00:53:23.950

Anil Kashyap: What's about financial stability is considerations. This is also an issue in Japan, or that if the you know to move rapidly, it will also have some financial stability issues, or the the long term it to say it, or I mean, I I I guess the thing I worry about more is if

232

00:53:23.960 --> 00:53:38.380

Anil Kashyap: interest rates were to move quickly. There, there'd be a lot of lost. I mean there's bonds all over the place, the insurance companies there, something that people been worrying about for a long time, so a a rapid move and interest rates there would, would

233

00:53:38.520 --> 00:53:54.030

Anil Kashyap: surface exposures that people probably Haven't thought about. I mean that the the Japanese do stress test, but I've never really kicked the tires to see exactly what they've done, and how stressful they are, and and and how realistic um

234

00:53:54.040 --> 00:54:10.699

Markus Brunnermeier: they are about all of this. But I, you know that that could. That could be a source of trouble. Just this one question, and and the Q. A. Asking who wrote us to him is up Soon it will change the attitude towards a monetary policy in the Bank of Japan, or it's the

235

00:54:10.710 --> 00:54:26.369

Anil Kashyap: I. I don't know I mean there's rumored to be an insider, and then a former deputy governor that are the names that you one sees. But you never know right this. There's a lot of time between now and then. Um, I. You know there are probably people in the Bank of Japan that are

236

00:54:26.380 --> 00:54:38.320

Anil Kashyap: probably still more sympathetic to Mr. Sheer Cow's view of of how policy should be run rather than Mr. Koda. So I I mean if somebody comes in with that view they could try to reverse

237

00:54:38.330 --> 00:54:56.039

Anil Kashyap: um, and that you know that would be. That'd be pretty jarring, I think, if they were to try to step back quickly, shrink their balance sheet, and all of that. Um, so I don't. I don't know. I think we're gonna have to wait to see who they they point. But you know six months. It's not. He's not up till the end of March. So that's that's what

238

00:54:56.070 --> 00:54:59.679

Anil Kashyap: you know. Six months, basically that's you know

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00:54:59.780 --> 00:55:07.309

Anil Kashyap: that's ancient, you know Long long. That's a very long run in terms of the condition of markets these days,

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00:55:08.940 --> 00:55:19.549

Markus Brunnermeier: so we touched upon the Uk. We trust upon to some extent, Europe and Japan, and we'll talk a little bit about emerging markets, economies, The other part of the world where you would say,

241

00:55:19.680 --> 00:55:22.060

Markus Brunnermeier: I see, for an instability issues

242

00:55:22.130 --> 00:55:29.239

Markus Brunnermeier: to watch out, for in other parts of the world, or is it? I don't know I mean I I I do think

243

00:55:29.260 --> 00:55:34.929

Anil Kashyap: this pension thing is that something that we should be stress testing. I mean it.

244

00:55:35.040 --> 00:55:37.200

Anil Kashyap: It's It's mostly

245

00:55:37.340 --> 00:55:38.470

Anil Kashyap: um.

246

00:55:38.830 --> 00:55:57.020

Anil Kashyap: The The problems will be the same right. The central banks are the people that are most concerned about financial stability. Probably aren't the people that are supervising them, and and so that that creates something. These these are backwaters where people take the view you you express that

247

00:55:57.030 --> 00:56:02.039

Anil Kashyap: they have long term assets. They got long term liabilities. There's no problem here. Um,

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00:56:02.380 --> 00:56:05.489

Anil Kashyap: so it's It's it's tricky. I mean one one thing

249

00:56:05.520 --> 00:56:16.079

Anil Kashyap: it's true is that there's just a lot of political pressure. You may have seen that there's There's been rumors in the Uk. That one of the things that the

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00:56:16.180 --> 00:56:22.950

Anil Kashyap: new government might want to do is change the rules around insurance regulation in the Uk: So

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00:56:23.430 --> 00:56:26.260

Anil Kashyap: again, there's a little bit down in the weeds. But

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00:56:26.340 --> 00:56:40.220

Anil Kashyap: right Now, when an insurance company um has a long-term liability, if it holds a long term asset against it, it can cancel some of that risk, and not have to hold much capital.

253

00:56:40.380 --> 00:56:47.050

Anil Kashyap: There's been pressure in the Uk to try to increase infrastructure investment.

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00:56:47.190 --> 00:57:04.040

Anil Kashyap: The insurance companies kind of talking. Their book said, Well, if you would just let us buy infrastructure bonds and count that as the asset against which our liabilities would be match, we could we could do that. You create a big market for this debt. Of course

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00:57:04.050 --> 00:57:13.069

Anil Kashyap: it's insane to a financial economist to say that if you've got a thirty year infrastructure bond, and you've got a promise against something that's supposed to be safe

256

00:57:13.080 --> 00:57:32.379

Anil Kashyap: that you're going to say. Oh, yeah, we could just net those things and not hold any capital. It's a recipe for disaster. It's exactly the kind of problem that we're living through with the But that's the kind of thing that's in the air. And if if if that were to happen, that would be a disaster right up front you you'd see people starting to worry about the solvents of insurance companies.

257

00:57:32.390 --> 00:57:34.720

Anil Kashyap: And so the fact of something like that

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00:57:34.860 --> 00:57:41.370

Anil Kashyap: can get to the point where it's publicly being discussed shows you the pressure that that's there.

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00:57:42.350 --> 00:57:59.789

Markus Brunnermeier: Let me so fully part. One is also that a refr is his question a little bit. So you know, there's monetary typing. We can type in two ways. We can either do quantitative Qt. Or we can hike interest rates, all the financial stability implications very different, depending which way we will type.

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00:57:59.800 --> 00:58:04.729

Markus Brunnermeier: And if so, which way would you recommend using there some sign negative side effects?

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00:58:05.500 --> 00:58:24.690

Anil Kashyap: Look, I think, if you we kind of understand how interest rate policy works and um, it's just much simpler to communicate, and all the rest to use interest rates. So to the extent you could use the interest rate as your active tool, and let the balance sheet kind of creep down in the background. That would be my my strong preference.

262

00:58:24.930 --> 00:58:36.869

Anil Kashyap: Um, i'd say one of the biggest things we've learned about monetary policy. Transmission over the last ten or fifteen years is a lot of it works by compressing risk premium.

263

00:58:36.880 --> 00:58:56.379

Anil Kashyap: It's it's not just the expected path of interest rates, but it's comp compressing risk from you. Qe. Helps um helps to some extent compressed risk, Premier. But one of the things we also know is that risk, Premier prone to reversals, and you know you get the snap back risk. And so one of the things that I

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00:58:56.390 --> 00:59:08.559

Anil Kashyap: I think is a consideration is. Are we going to have one of these aha moments where the central banks keep pushing up interest rates? And then, all of a sudden you get a big

265

00:59:08.750 --> 00:59:28.140

Anil Kashyap: jump up in risk premium, and then you see some losses that show up with the organizations that then, you know, Don't have the capital, and you get again one of these fire sales, or if if you just get that, the interest rates are very high in the primary market for um, the issuing

266

00:59:28.150 --> 00:59:32.709

Anil Kashyap: certain types of corporate securities. Kind of shuts down. That's a that's a problem.

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00:59:35.160 --> 00:59:53.160

Anil Kashyap: So in general, so you would say you would still go for rather than interested hikes rather than quantitative typing, and you would like to keep the center link balance sheet, then large, or at least we'll run it down. Not to I. I run it down slowly, but I think there are good reasons to have these large balances now.

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00:59:53.170 --> 00:59:55.170

Anil Kashyap: I was not a fan of

269

00:59:55.250 --> 01:00:10.030

Anil Kashyap: how, after the dash for cash. The fed kept buying. I mean what started out as kind of a market making financial stability Intervention somehow worked into Qi, and I think that was unfortunate, that the balance she got as big as it did now

270

01:00:10.040 --> 01:00:28.960

Anil Kashyap: we learned in. Uh, Was it September of two thousand and nineteen? I'm. Losing track of the years. Or we had this, this tan from when the the that tried to bring its um balance sheet back down, maybe below, where people uh expected it to be, and I I I think we're gonna have to live with larger

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01:00:28.970 --> 01:00:47.539

Anil Kashyap: that one, she So I don't know if you had had Ragu on here lately, but I mean he and Viral Charia have this paper that they gave a Jackson hole trying to say, trying to argue that it. Markets get addicted to large uh central bank balance sheets, and then they they go off and and try to lever that up.

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01:00:47.550 --> 01:00:58.110

Anil Kashyap: And so I mean, I think there's we don't know a lot about Q. We uh and and so trying to get out of using that and going back to the interest rates would be my strong preference.

273

01:01:00.360 --> 01:01:12.919

Markus Brunnermeier: And that's also the case. If you think in Europe, you know, the balance sheet contains sovereignty from various different countries. Yeah, you would say rather, you see, interest rates than getting out of so Sol and bonds.

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01:01:13.140 --> 01:01:18.979

Anil Kashyap: Yeah, I didn't as long as i'm talking about risks. I mean, I don't know if this

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01:01:19.210 --> 01:01:28.259

Anil Kashyap: tool that the Ecb is rolled out is is really going to work. I mean, I think it's really difficult to know what's the white

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01:01:28.370 --> 01:01:46.759

Anil Kashyap: market level of of the risk spread between Germany and Italy. It's It's not obvious to me that that you can tell that so if the the Ecb actually has to start intervening there. That could be pretty scary um, and And so

277

01:01:46.770 --> 01:02:04.789

Anil Kashyap: I I don't think that problem is contained. I mean it's it's it's hidden for for now. But I don't know that it's going to work because I think the political push back if they were to step in and begin buying in. Uh in mass there would be huge.

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01:02:06.360 --> 01:02:25.080

Markus Brunnermeier: So I want to come back to two things we touched upon earlier. Uh one is the market maker of lost this. So what aspect And one thing we saw in the Us. Treasury market is actually that the type of market makers who are active they are, has changed dramatically because of regulatory. So away from traditional banks To what hedge funds

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01:02:25.190 --> 01:02:42.659

Markus Brunnermeier: do you see? What's it? The same in the Uk? And do you think that's a a problem? So we should actually invite the banks back to become market makers of in these markets More, And that might not have might have avoided the problems we're facing now or not. I don't think so. I mean, the the problem is,

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01:02:42.870 --> 01:03:02.020

Anil Kashyap: the pension funds naturally want very very long duration assets. Other people don't want to have them there. There there was. There was not a bunch of natural buyers, I mean. Maybe maybe you could intermediate a a little bit better. But um! You know I was in the market make of losses, so it is not the right tool. It's.

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01:03:02.110 --> 01:03:19.410

Anil Kashyap: Well, it's take it off to balance you to control intermediate or right. It's a it's a time buying strategy. So I think if you're going to do market maker of last resort. It's gotta be, you know. It's got to be some budget element to it, so not suppressing interest Rates, I think, is is kind of important

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01:03:19.420 --> 01:03:38.730

Anil Kashyap: buying time. You have to have a story for why, making the market for a while is going to work, We have a very clear one that the Fpc. Had a very clear one in this case, which was, these guys just can't recapitalize fast enough. Let's give them some time, and if they don't they're going to have to eat their own cooking and live with it. But

283

01:03:38.740 --> 01:03:55.080

Anil Kashyap: um, I I don't think you want to be getting in and just suppressing volatility all the time, giving people free options to to take risky positions, knowing that the central bank is going to step in. Um. There's a

284

01:03:55.110 --> 01:04:11.579

Anil Kashyap: active debate. When you get into these discussions about um purchase facilities. You know who your counterparty should be who's going to be eligible Often The the fact that you're doing. It means you want somebody to intermediate, so that this spreads all the way through

285

01:04:11.590 --> 01:04:21.180

Anil Kashyap: uh the yield curve. But it's It's these are kinda open questions, and and I think they'll get much more in attention now that the Uk. Has jumped into the pool

286

01:04:21.600 --> 01:04:22.950

Anil Kashyap: and tried this.

287

01:04:26.450 --> 01:04:45.950

Markus Brunnermeier: So a net is in Jurgis and ask, should the Uk Government refund it, that buying back long and paying with short of that. So in a sense, because you're saying the big problem is a few pension funds buying all this long term that so we can do a an operation Twist, in a sense, by the Uk treasury calls in the Bank of England. So part of this is

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01:04:45.960 --> 01:04:46.910

Anil Kashyap: um

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01:04:47.200 --> 01:04:54.379

Anil Kashyap: trying to distinguish between what the stance of monetary policy and this this financial stability action is The

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01:04:54.530 --> 01:04:57.620

Anil Kashyap: kind of the way I think about it partly is that

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01:04:57.970 --> 01:05:04.080

Anil Kashyap: the Npc. Had the debt structure that it wanted on the Bank of England's balance sheet.

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01:05:04.160 --> 01:05:20.519

Anil Kashyap: If there was going to be an operation twist done by the Bank of England, that would then say that this financial stability consideration is changing. What you would thought was the right stance for monetary policy. I think it muddles the two more now

293

01:05:20.860 --> 01:05:34.570

Anil Kashyap: like you, said the net, proposing that the Treasury buys it back. So it's always the government. Yeah. So the Uk Government can always, you know the debt Management office can always decide if it wanted to do something like that,

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01:05:34.680 --> 01:05:40.339

Anil Kashyap: but that wouldn't have solved the short-term problem. Which is, these guys need to de-risk and deliver,

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01:05:40.380 --> 01:05:56.980

Anil Kashyap: and so they they may conclude um that that This is all a bad idea. I mean, I think they're still going to need some sort of a hedge uh that. That that's there, and the you know the question is, should they? So they just be much more prudent, and run with much much lower leverage.

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01:06:02.770 --> 01:06:03.640

Anil Kashyap: Me

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01:06:03.730 --> 01:06:14.700

Anil Kashyap: the the irony of not having the data once again, and not really knowing the position is is just so frustrating that.

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01:06:14.710 --> 01:06:25.290

Anil Kashyap: And you know you wake up. You have to learn. You know we've been through this once already at the beginning of the war, where you had to learn about how commodities, markets, work, and how the hedging for the energy industries, and the one

299

01:06:25.300 --> 01:06:42.799

Anil Kashyap: the whole physical and financial, uh connection. So people had to do a crash course in this. Learn how that worked. Now we're having a crash course in these liability-driven investment things. And it's just so disappointing that we don't measure that stuff from the beginning.

300

01:06:42.810 --> 01:06:59.590

Markus Brunnermeier: So that's why i'm looking for were the other Cs so open in the market funds on the Of course we didn't talk about math and swing, pricing, and all this. Perhaps you can just give us a three minute cash course. What the cracks could be on that side. Well, so

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01:06:59.670 --> 01:07:01.250

Anil Kashyap: so the reason.

302

01:07:01.380 --> 01:07:20.919

Anil Kashyap: So part of the first mover advantage in money funds is, I know you're gonna. If you If a bunch of us get out, then the price is going to be worse. So I want to get out when when the way you're meeting. My redemption is using cash. But at some point you're going to actually have to sell these securities. Lots of them, especially corporate bond funds,

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01:07:20.930 --> 01:07:22.029

Anil Kashyap: are

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01:07:22.100 --> 01:07:41.429

Anil Kashyap: dealing with fundamentally a liquid uh security. So the average corporate bond fund, the average corporate bond trades once a month. Here you have a vehicle that's proposing to give you daily liquidity against something that you know. If they have to sell it, they're not going to be able to easily sell. Now, the way that that's dealt with in Europe is

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01:07:41.440 --> 01:08:00.909

Anil Kashyap: if you want to get out, then they're gonna trim the price and and say, you're going to get a less good price, and the way they they set that discount is by looking at the total selling pressure and then they have twenty-five years of data. Looking back and saying, Okay, Well, we had to sell this much. How much the prices move. We're going to set your reduction

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01:08:00.920 --> 01:08:05.759

Anil Kashyap: to reflect the selling pressure, and then that kills the first mover badge in the United States.

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01:08:05.800 --> 01:08:21.120

Anil Kashyap: It's hard to do that because a lot of the mutual funds have intermediaries that that make the redemptions for them. So you know Princeton's retirement fund is who you notify when you want a payment

308

01:08:21.130 --> 01:08:38.520

Anil Kashyap: uh to be made, or or you know, if you want to add something, or if you're going to retire and take money out. Um! These things come through Princeton, and Then Princeton goes ahead and contacts vanguard. You know Black Rock, whoever and then they meet the redemption,

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01:08:38.529 --> 01:08:47.350

Anil Kashyap: so they often don't know at the time they have to say, here's the terms for the redemption. What the total selling pressure is going to be in that

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01:08:47.380 --> 01:08:51.059

Anil Kashyap: creates this first mover advantage. Um,

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01:08:51.270 --> 01:09:04.959

Anil Kashyap: you know there are claims. People from Black Rock claim. Well, you don't have to know everybody's order. You just have to know the big ones. You could get eighty of the way by doing something like this. I'd like to see that I was part of a group.

312

01:09:04.970 --> 01:09:21.229

Anil Kashyap: I don't know if you ever had Don Cone or Glenn Hubbard on, talked about this task force and financial stability that that we were part of, and we had a long thing on swing pricing um, trying to propose that we should do more of that, and I think I think that would be pro stability.

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01:09:21.450 --> 01:09:40.809

Anil Kashyap: If you can't do that, then you gotta get them to hold some capital, which, of course, would kill the product for for many of these things. So maybe that's the answer. So you're in favor of swing. Pricing, rather than putting capital in capital would be little. Capital would be good, but swing pricing, and the current system is is designed to fail.

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01:09:40.859 --> 01:09:46.729

Anil Kashyap: Um. And so we need some alternative. Swing pricing works in Europe.

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01:09:46.819 --> 01:09:47.979

Anil Kashyap: Um

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01:09:48.529 --> 01:09:54.689

Anil Kashyap: it, It seems to it's possible in the United States or these, you know, plumbing problems.

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01:09:54.740 --> 01:10:12.380

Anil Kashyap: Um, but we're setting ourselves up for trouble, and it if you were to have a pro pro long fire sale in the corporate bond market, so that basically anybody who wanted to buy a corporate bond to buy a huge discount in the secondary market. Then the primary market shuts down, and nobody can issue.

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01:10:12.390 --> 01:10:19.019

Anil Kashyap: If nobody can issue for a week or two, no big deal. If it goes three, four months, then you start to have the real economy suffering.

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01:10:19.520 --> 01:10:22.670

Markus Brunnermeier: So that's one indicator you're watching out for.

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01:10:23.550 --> 01:10:26.580

Anil Kashyap: Yeah, I mean, I I think if uh

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01:10:26.610 --> 01:10:40.910

Anil Kashyap: these markets are shot at something to to worry about is it is it lingers. I mean it. I mean it. It's more a problem for the real economy. But you know we don't want to see a wave of bankruptcy just because these these markets aren't working.

322

01:10:41.770 --> 01:10:56.760

Markus Brunnermeier: So we always have a condition to end up the high note and a positive note. So you we got a lot of negative aspects there about financial stability and um monetary, fiscal and financial dominance and other aspects

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01:10:56.950 --> 01:11:11.859

Anil Kashyap: say anything, some positive note on this events reason the event. So where you see all, there is something we can learn, and hence but it's most stable or any positive aspect it I think the banks held up so well. I mean, the fact is,

324

01:11:11.980 --> 01:11:26.899

Anil Kashyap: all the reforms that we put into the banking system have served the the banks really, really well, and we're not worried about that. The Uk is a place where the financial system is ten times the size of the economy. The banks are very, very big,

325

01:11:26.910 --> 01:11:37.819

Anil Kashyap: and The fact that they're stable was a really really good first step, but it it means that we need to show the same kind of determination to to get after some of these other problems, you know, and

326

01:11:37.920 --> 01:11:52.570

Anil Kashyap: I think it's great that diamond Divig and Bernanke got the Nobel prize, I mean they They've shined a light on places we need to be looking, and now it's It's up to the the authorities to get after it and say, Okay, look, these structures.

327

01:11:52.600 --> 01:12:02.660

Anil Kashyap: Um are fundamentally not very resilient. What are we going to do about it? And looking the other way, and pretending there's not a problem isn't a very good option.

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01:12:02.740 --> 01:12:09.049

Anil Kashyap: So you know, the banking stuff shows that with determination you can get something done. So let's hope we we see more of that.

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01:12:10.970 --> 01:12:22.910

Markus Brunnermeier: Great thanks a lot, Daniel. It's a fascinating. You show the wealth of your knowledge in this area, and we hope that that stability will prevail, and there will be fewer hiccups, even though

330

01:12:23.350 --> 01:12:25.369

Markus Brunnermeier: times look a little bit scary.

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01:12:26.240 --> 01:12:36.989

Markus Brunnermeier: Thanks again, and we keep in touch, and, thanks to all the viewers for listening and for asking all these interesting questions we could put forward. Sorry I couldn't put all questions forward. But, um,

332

01:12:37.240 --> 01:12:41.860

Anil Kashyap: we covered a lot of count. Yeah, thanks for having me. This is great thanks.

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01:12:41.980 --> 01:12:43.639

Anil Kashyap: Bye, bye,