Comments on "Responding to a Shadow Banking Crisis: the Lessons of 1763"

Conference to Honor Warren Weber
February 18. 2012

Ellis Tallman
Oberlin College and Federal Reserve Bank of Cleveland

Overview of the paper

- A relevant liquidity crisis to investigate
- A rich data set
- Central question –
  - How did Bank of Amsterdam avert "contagion" failures?

What a data set!

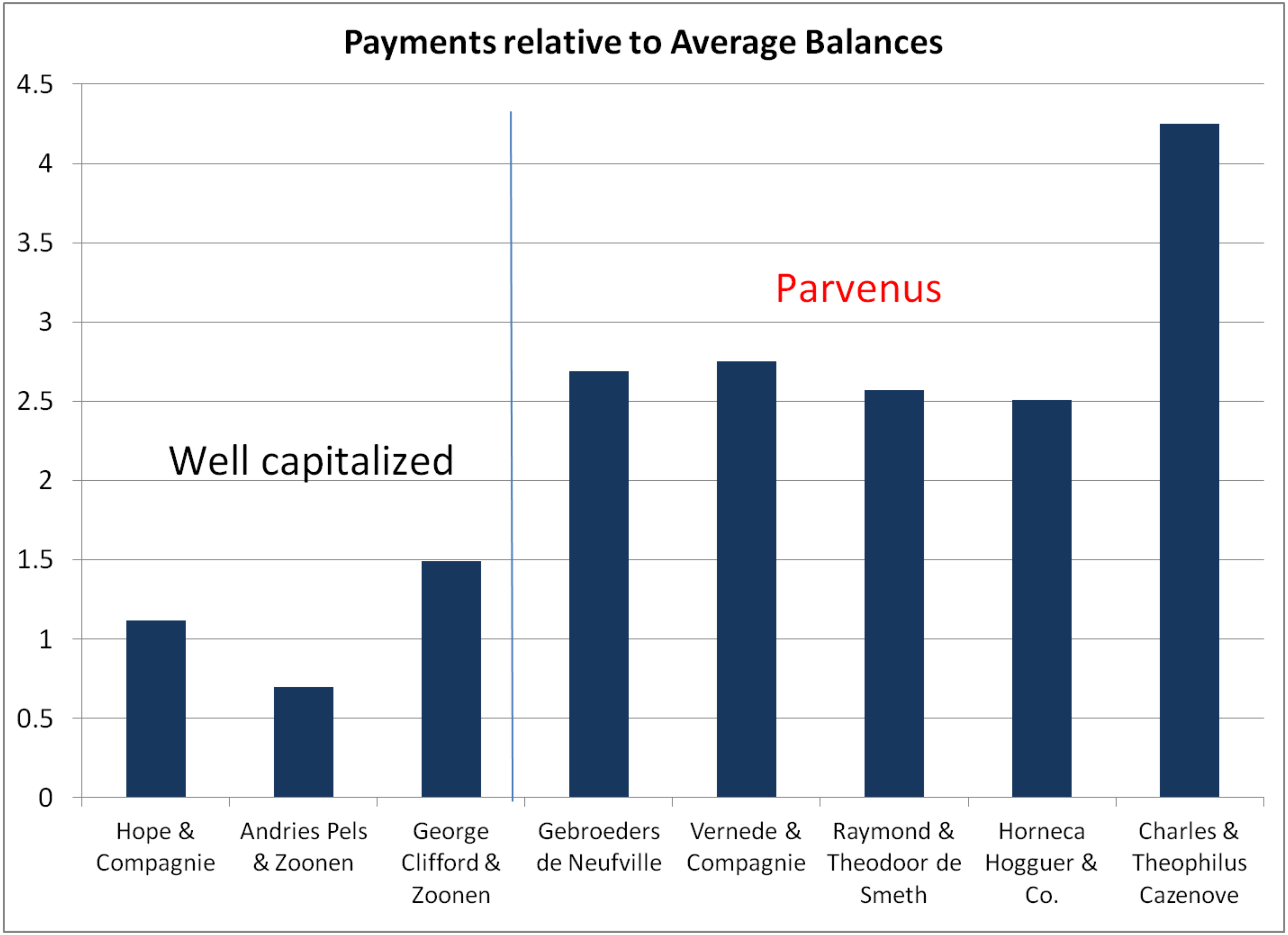
- Cross-bank payments data
  - $X_{ik\ t}$
  - X represents a transfer (amount)
  - i is bank receiving the transfer
  - k is the bank sending the transfer
- Many uses for this data – main one here
  - Analyze the contagion effects of a big failure

Use of data

- Illustrate the liquidity needs of *banquiers*
  - Volume of payments relative to average balances
  - Reliance of the "parvenus" on new credit lines
- Seems like an "excess reliance" on refunding
  - *Sounds familiar –*
  - *Certainly* 2007-2009
  - But also 1873 and 1907

Case of 1763

- How does the fringe intermediary earn profit?
  - Low per transaction return
  - High turnover – high leverage
- Interconnections – they have them in data
  - A parvenu failure can have large knock on effects
  - And “running out of balances” at the Bank of Amsterdam would be all that is necessary



Payments relative to Average Balances
4.5
4
3.5
3
2.5
2
1.5
1
0.5
0
Well capitalized
Parvenus
Hope & Compagnie
Andries Pels & Zoonen
George Clifford & Zoonen
Gebroeders de Neufville
Vernede & Compagnie
Raymond & Theodoor de Smeth
Horneca Hogguer & Co.
Charles & Theophilus Cazenove

Institutional knowledge shared

- Intensive analysis of existing contract design
- Comparison to modern securitized loans
- Question: How much is necessary to examine the issue of liquidity the provision of which may have prevented contagion?

Provocative statement

- Bullion window lending as key to solution
  - Small channel => disproportionately large effects
- Simulation exercise and graphics display it
- The “why” of disproportionate effects
  - Accounts at the Bank of Amsterdam could never run out of bank money (no overdrafts)

Run and Response

Weekly position of Cazenove

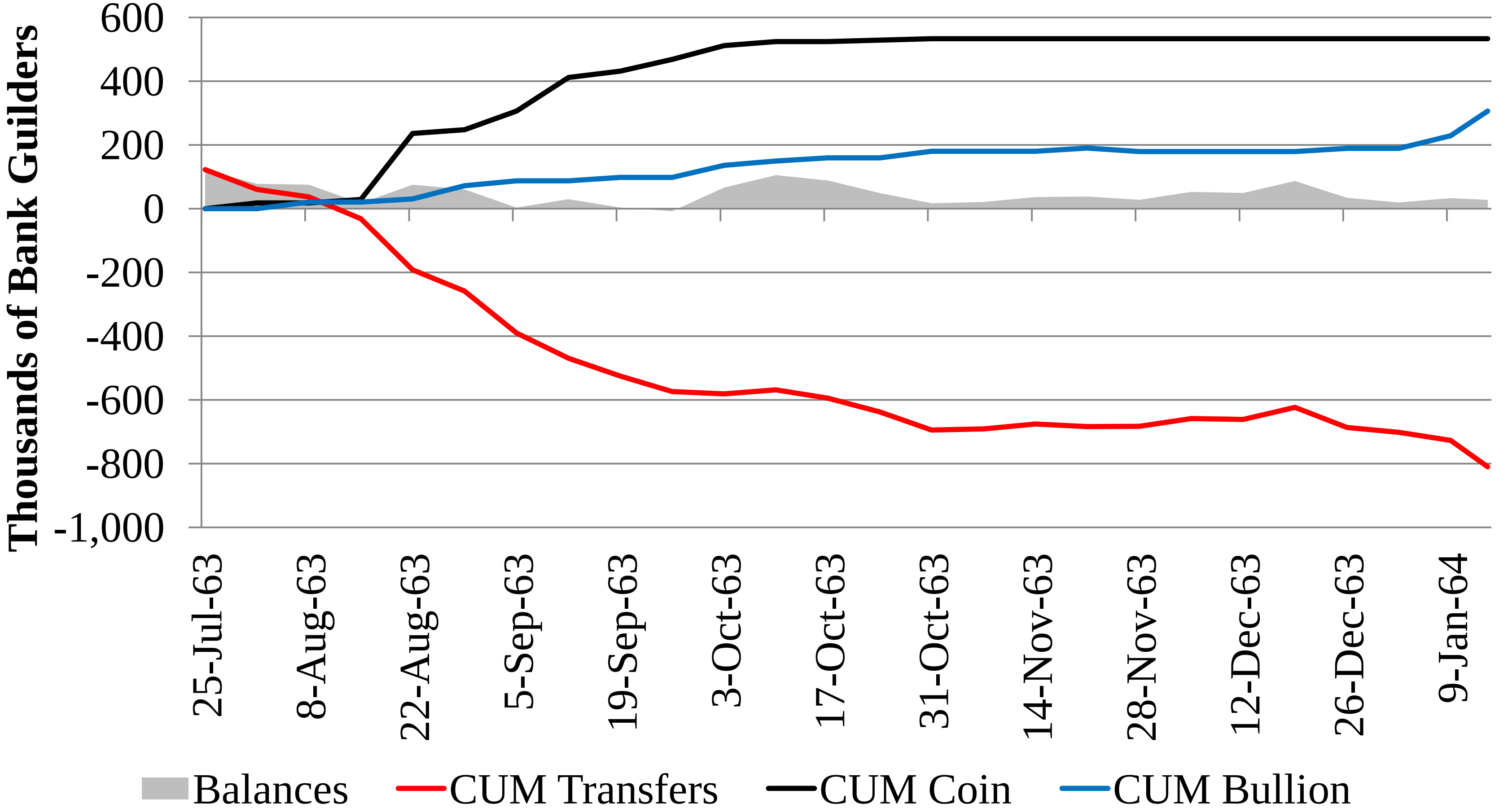
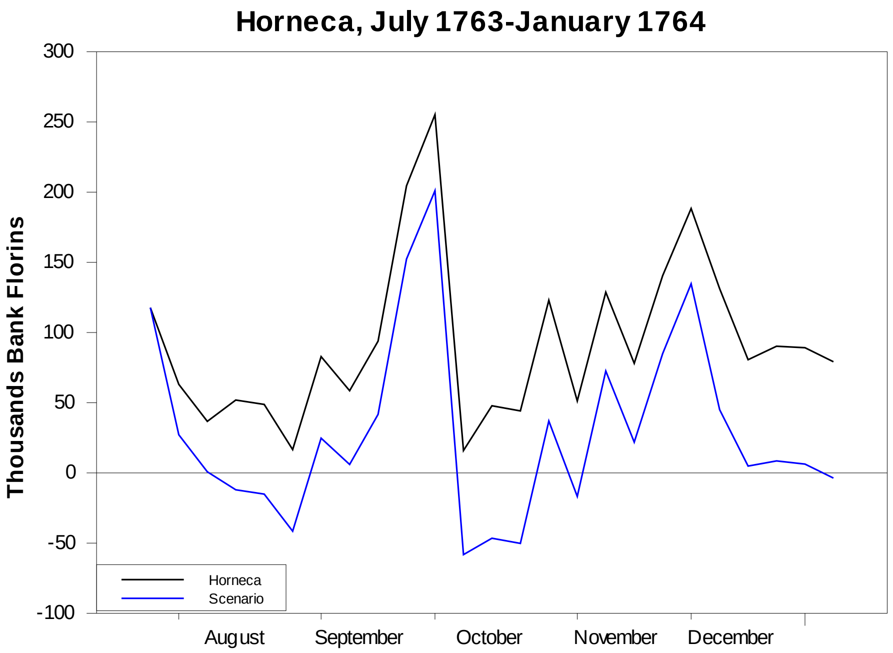
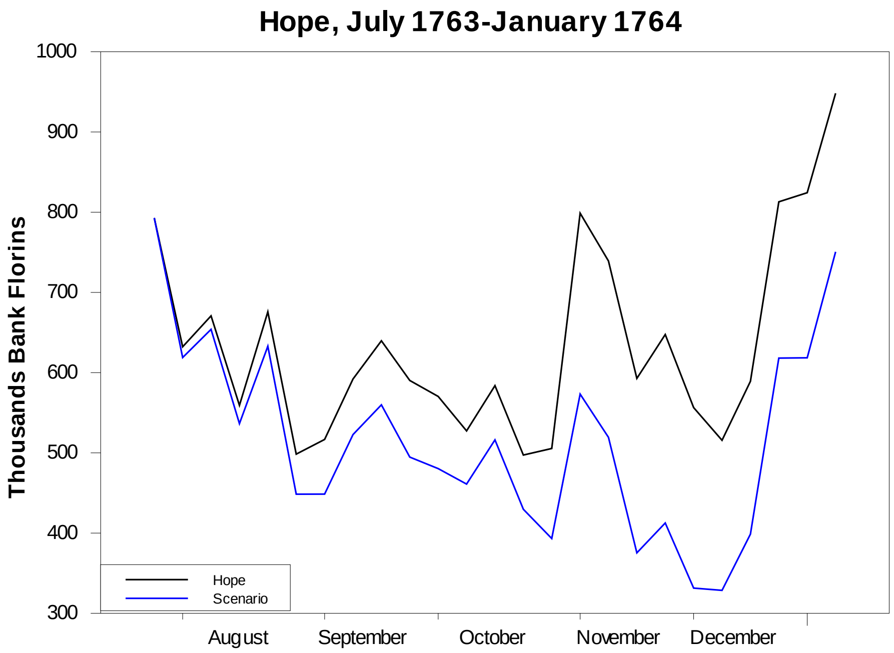


Figure 10: Simulated balances with no bullion window + 2 failures





The value of liquidity

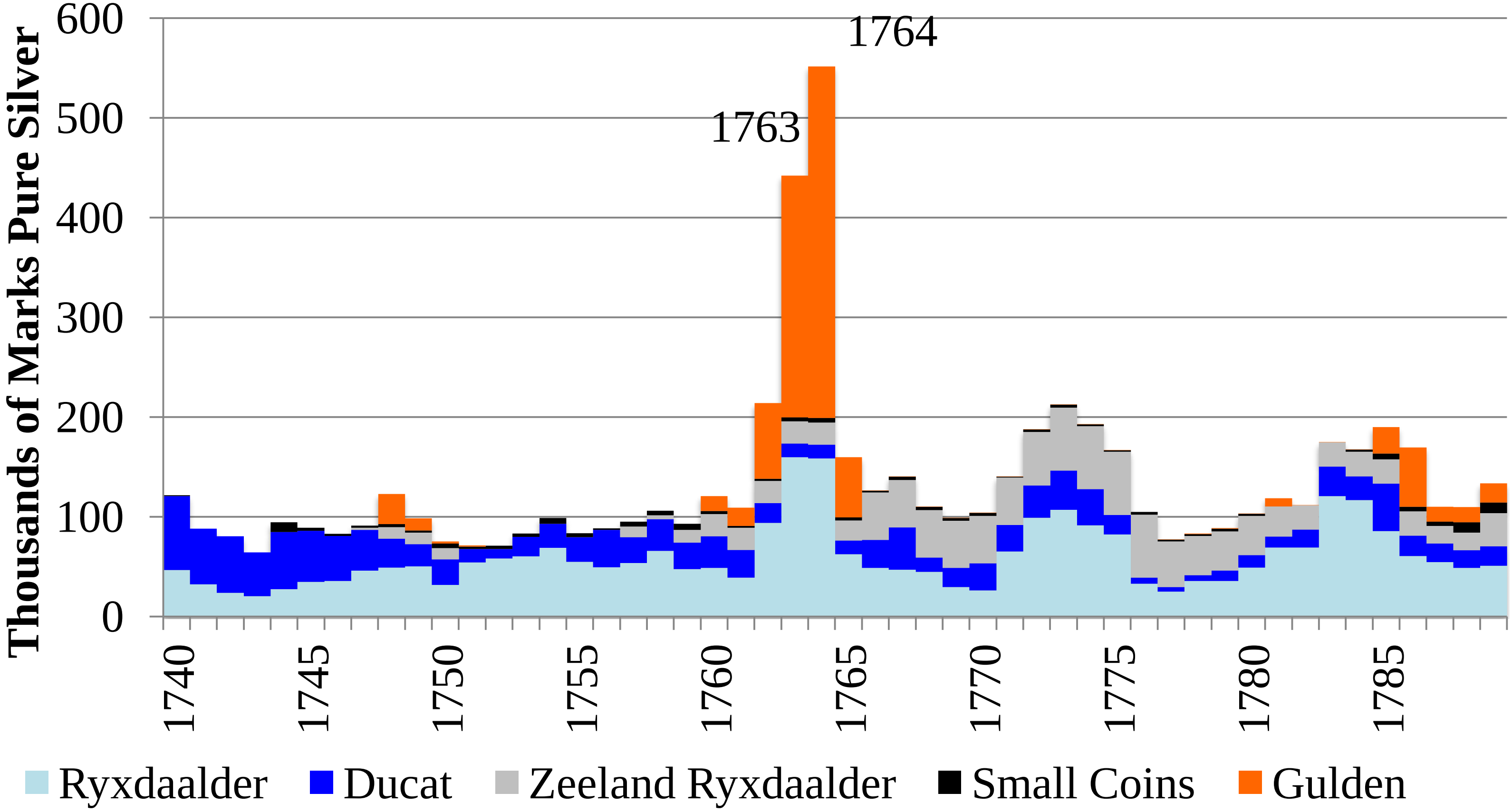
- That last unit of account that would have prevented a negative balance
  - Important in these circumstances

- Relaxation of collateral standards
  - Crucial for increasing the supply of liquidity
  - May seem small –
  - But without it bad things could happen

Transactions outside

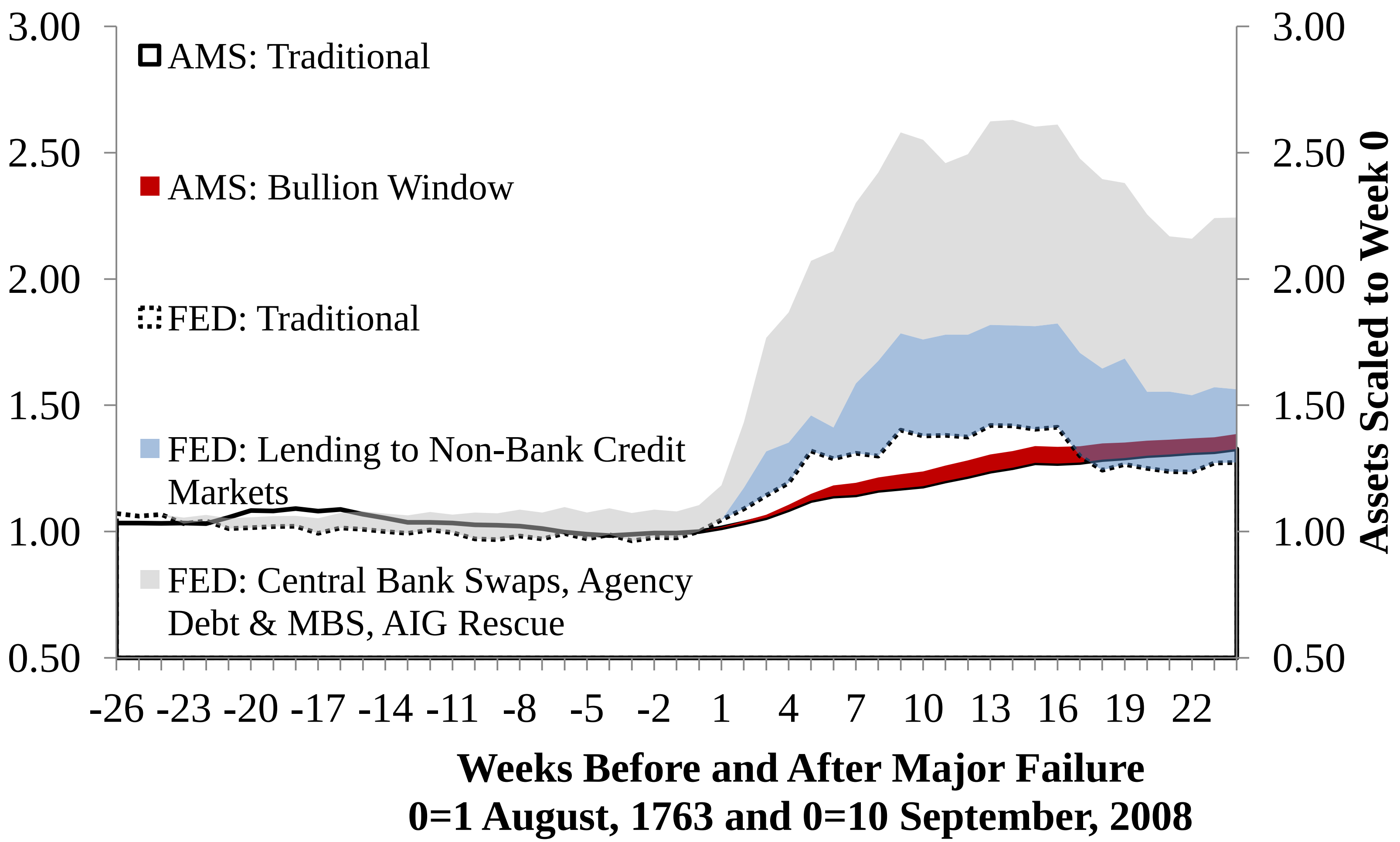
- Runs on banks of deposit
- Extreme demand for coinage (not just for BoA collateral, but for day to day purchases)
- Description of the balance between bullion value as collateral vs bullion for minting
  - Fiscal and monetary policy coordination?

Mint production of silver coins, 1740 to 1789



Analogues in the National Banking Era

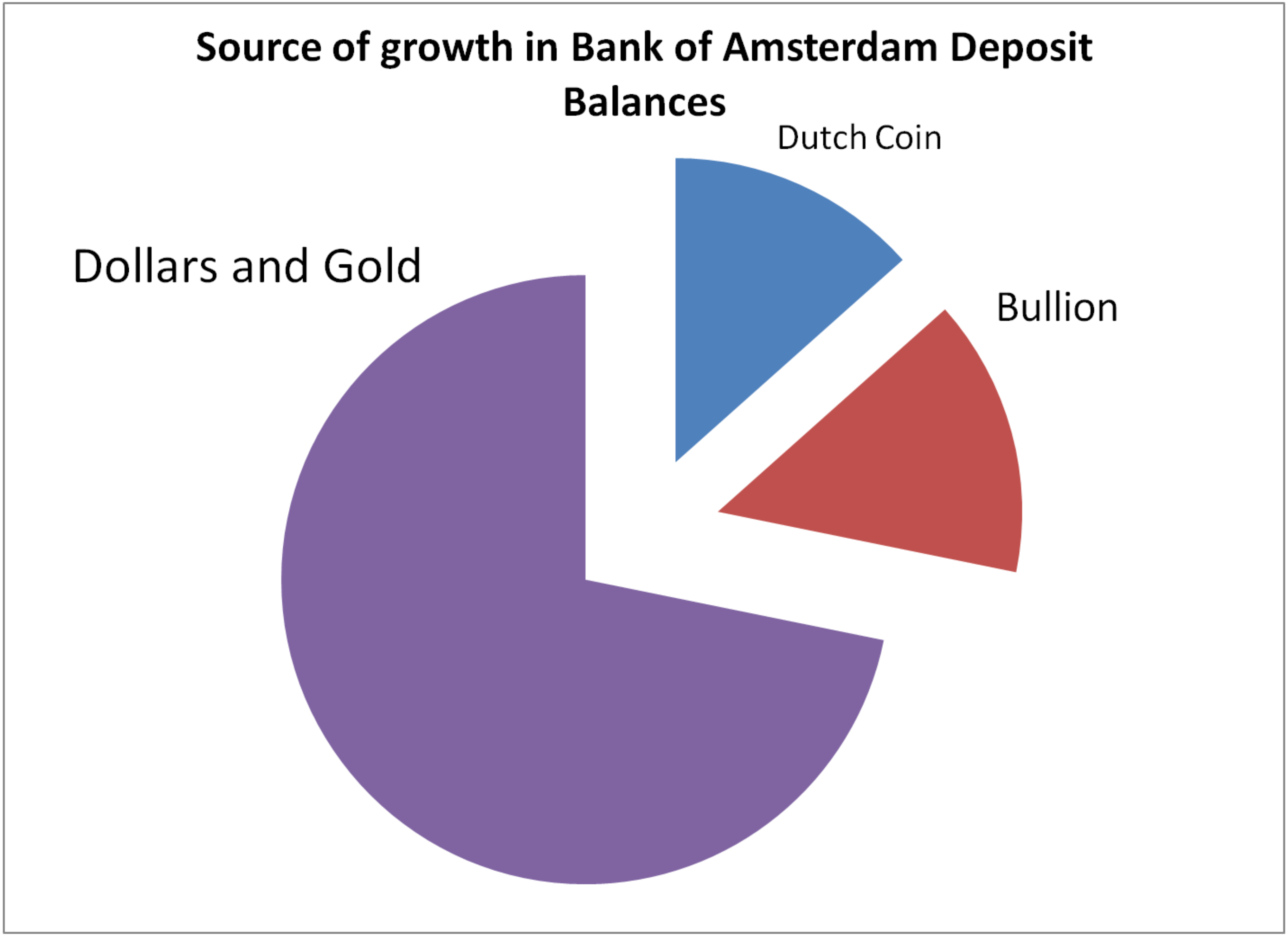
- Collateral requirements in panics
  - Issuance of clearing house loan certificates
  - 75 percent of “market” value of collateral
    - “Temporary” liquidity – exchanged at par at the clearing house (6 percent interest paid by borrower to the bearer of the loan certificate)
- What was used as collateral?
  - Assets that normally were not liquid



3.00
2.50
2.00
1.50
1.00
0.50
AMS: Traditional
AMS: Bullion Window
FED: Traditional
FED: Lending to Non-Bank Credit Markets
FED: Central Bank Swaps, Agency Debt & MBS, AIG Rescue
Assets Scaled to Week 0
-26 -23 -20 -17 -14 -11 -8 -5 -2 1 4 7 10 13 16 19 22
Weeks Before and After Major Failure
0=1 August, 1763 and 0=10 September, 2008

Much liquidity added

- Bank of Amsterdam increased liquidity more through the normal discount of coin
  - In 1763 production of Bank discountable coin increased by about 45 percent (my guess)
- But the marginal addition of bank money by bullion collateral was still crucial
- This issue should be central to the revision


Source of growth in Bank of Amsterdam Deposit Balances
Dutch Coin
Dollars and Gold
Bullion

Final Comments

- Fight the urge to do more –
  - Try to maintain aim at contagion issue
- There is material to address many questions
  - Other papers can take on those question
- Great feat of economic history reconnaissance
  - My hat is off to y'all