



The Bond Vigilantes

BLOG TEAM



FEATURING!
LOW INFLATION
(THEORETICALLY)

HEALTHY, STABLE
ECONOMIES
(SOMETIMES)

INDEPENDENT
(FOR NOW)

RAMPANT POST-COVID INFLATION HAS RENEWED DEBATE AROUND THE **ROLE OF CENTRAL BANKS**. LET'S DELVE INTO THE HISTORY OF THESE FINANCIAL CORNER-STONES TO SEE WHERE THEIR FUTURE MIGHT LIE.

JIM
THE CIO

THE **BANK OF JAPAN** IS AN OUTLIER AN INNOVATOR, BUT WHERE WOULD THEY GO IN ANOTHER ECONOMIC DOWNTURN?

EVA
FUND MANAGER

CENTRAL BANK DECISIONS HAVE IMPLICATIONS FOR **EMERGING MARKETS**, EVEN A RUMOUR CAN SPELL TROUBLE.

CLAUDIA
EMERGING MARKETS

THE

CENTRAL BANKS

GUARDIANS OF stability?

EDITION 2

IN THE BEGINNING



IT
REALLY IS A
**LICENCE
TO PRINT
MONEY**

SWEDEN'S RIKSBANK, 1668, IS RECOGNISED AS THE FIRST CENTRAL BANK. MANY EARLY INSTITUTIONS CAME FROM A NEED TO SERVICE DEBT ARISING FROM WARS, **THE BANK OF ENGLAND, 1694**, HELPED WILLIAM III BUILD A NAVAL FLEET. FOR A £1.2M LOAN, IT HAD EXCLUSIVE CONTROL OF THE GOVERNMENT'S BALANCES AND THE ISSUE OF BANK NOTES.

MODERN TIMES

SOME 200 YEARS PASSED BEFORE THE MODERN IDEA OF A CENTRAL BANK, WITH A BROADER DOMESTIC REMIT, ARRIVED. **THE US FEDERAL RESERVE, 1913**, WAS CREATED TO PROVIDE A MORE STABLE FINANCIAL SYSTEM.



IT IS MADE UP OF REGIONAL FEDERAL BANKS AND GOVERNORS AND HAS A STATED FOCUS ON EMPLOYMENT AS WELL AS STABILITY. THE FED'S BOARD OF GOVERNORS HAS A DESIGNATED CHAIR, A ROLE THAT HAS COME UNDER INCREASING POLITICAL SCRUTINY.

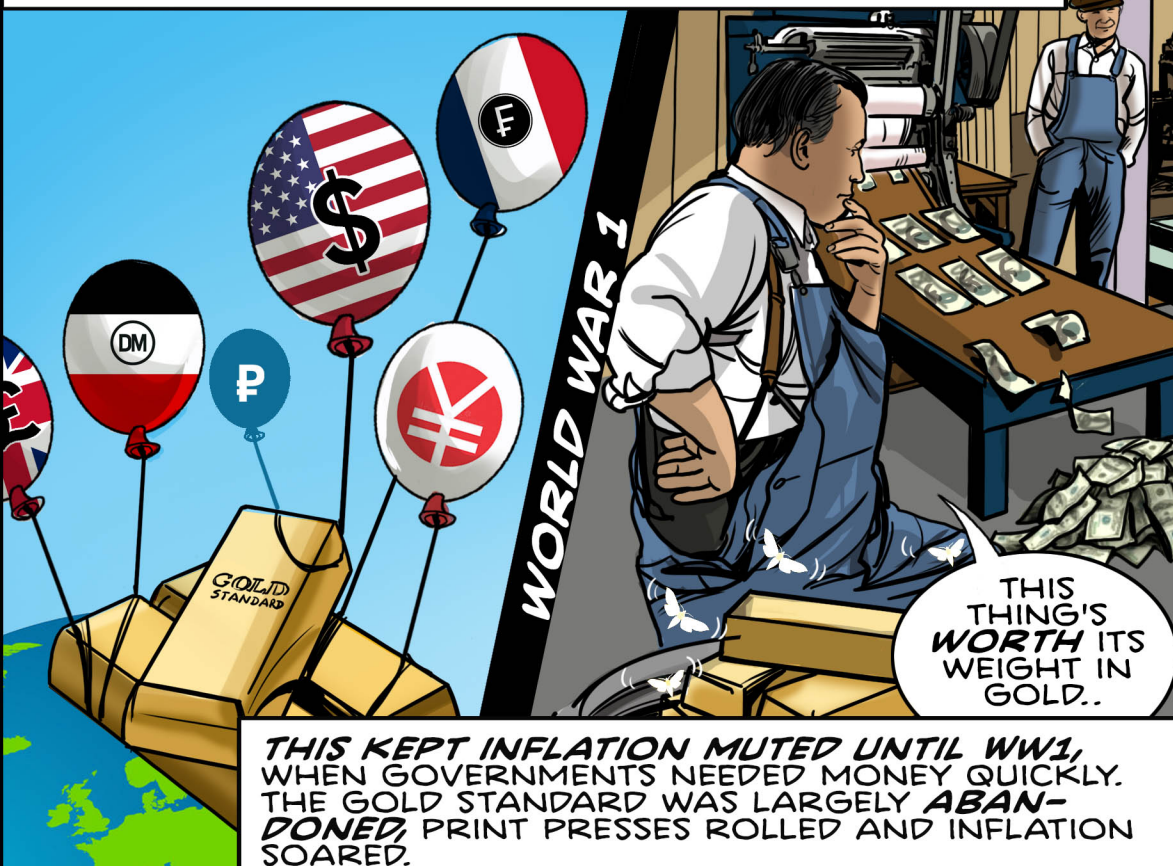
THE LENDER OF LAST RESORT

WILL
OUR HERO
SAVE THE
DAY?

THE MODERN CENTRAL BANK IS FOCUSED ON LONG-TERM DOMESTIC PRICE STABILITY, BUT IT IS ALSO THE '**LENDER OF LAST RESORT**'. THIS HOLLYWOOD NOMENCLATURE BECAME ANYTHING BUT FICTIONAL FOLLOWING THE GFC AND A GLOBAL PANDEMIC WITH INTERVENTIONS TO SUPPORT THE BANKING SYSTEM. **BUT CBs WERE NOT ALWAYS SO READY TO 'STEP IN'.**

THE GOLD STANDARD

BETWEEN 1870 AND 1914, WORLD CURRENCIES WERE PEGGED TO THE **GOLD STANDARD**, WITH CENTRAL BANK MONETARY POLICY AND CURRENCY BASED ON A COUNTRY'S GOLD RESERVES.



THE GREAT DEPRESSION

AFTER **WW1**, AMERICA CAME **ROARING** BACK, FUELLED BY EXCITING NEW INDUSTRIES.

I'VE
BEEN
KICKED
IN THE
GATSBYS!

WANTED
A DECENT
JOB
Will
work
for
Gin
Rickey

BUT IN
1928, THE
GOOD TIMES
WERE OVER.
**SOARING INFLATION
LED TO RATE HIKES...**

IN 1933, PRESIDENT ROOSEVELT FINALLY TOOK THE US OFF THE GOLD STANDARD, WITH PEOPLE REQUIRED TO EXCHANGE GOLD FOR CASH. THE PRICE OF GOLD ROSE, AS DID THE MONEY SUPPLY. IN RECENT TIMES THE FED HAS NOTED THAT ITS DECISIONS AT THE TIME INCREASED THE SEVERITY OF THE DEPRESSION.

IT HAD FAILED TO ACT AS THE LENDER OF LAST RESORT.

70S & STAGFLATION

THE **POST-WW2** US ECONOMY WAS UNPARALLELED, BUT IN THE EARLY 70S IT BEGAN TO SLOW, CAUSED BY INCREASED INTERNATIONAL COMPETITION, THE COST OF THE VIETNAM WAR AND THE DECLINE OF MANUFACTURING JOBS. UNEMPLOYMENT AND PRICES ROSE, **WAGES STAGNATED** = **STAGFLATION**. US INTEREST RATES PEAKED NEAR 20%.

DEPARTMENT OF EMPLOYMENT
Unemployment Benefit Office

IT'S A GOOD JOB THE LOVE IS FREE

THE STATE OF INDEPENDENCE

EARLY CBS WERE **RARELY INDEPENDENT**. OVER TIME, THOUGH, THERE WAS A CLEAR TREND TOWARDS **SEPARATING MONETARY POLICY FROM POLITICAL INFLUENCE**. THE BOE BECAME PUBLIC IN 1946, WHILE THE **EUROPEAN CENTRAL BANK** WAS SET UP SPECIFICALLY AS AN INDEPENDENT INSTITUTION.

THAT'S ALL I NEED RIGHT NOW!

GOVERNMENT REVIEW

INDEPENDENCE HAS PROVEN STABILIZING BUT A DECADE AFTER THE GFC, CBS ARE **STRUGGLING** WITH THEIR CORE MANDATES - WITH POLITICAL PRESSURE CALLING FOR MORE ACCOUNTABILITY AND LESS INDEPENDENCE.

GLOBAL FINANCIAL CRISIS

CENTRAL BANKS

COLLECTIVE ACTION

0%

QUANTITATIVE EASING

LAST RESORT

COLLABORATIVE ACTION

IF THE CRASH OF THE 30S AND STAGFLATION OF THE 70S LED TO **CRITICISM OF THE CENTRAL BANKS**, THEY CERTAINLY STEPPED UP IN THE GFC, WITH COLLECTIVE ACTION AVERTING A GLOBAL DEPRESSION. INTEREST RATES WERE **LOWERED** TO NEAR 0%, ALLOWING LARGE AMOUNTS OF MONEY TO BE LENT TO BANKS AND ASSET RICH INSTITUTIONS, AND CENTRAL BANKS BOUGHT UP FINANCIAL SECURITIES. THE MOVE TOWARDS 0% ADDED A NEW WEAPON TO THE CB ARMOURY. THIS WAS THE TIME OF **QUANTITATIVE EASING**.

QUANTITATIVE MECHANICS

THE WORLD BECAME AWARE OF QUANTITATIVE EASING IN 2008 (EVEN IF THE BANK OF JAPAN HAD USED THIS TOOL SINCE 2001) AND MARKETS QUICKLY BECAME **QE-RELIANT**. INCREASING THE SUPPLY OF MONEY INTO THE ECONOMY TO **STIMULATE GROWTH** LARGELY INVOLVED BUYING GOVERNMENT AND CORPORATE BONDS, SO IT'S EASY TO SEE WHY THE MARKETS LIKED IT.

STOCK MARKET

BUT THEN CAME **QUANTITATIVE TIGHTENING**, SLOWING THE ECONOMY AND THE SUPPLY OF MONEY, SELLING ASSETS BOUGHT UP DURING QE, TO COMBAT INFLATION. **DAMPENING MARKETS** WAS ALWAYS GOING TO BE MET WITH NERVOUSNESS. **WHAT OCCURRED WAS A LITTLE MORE EXPLOSIVE.**

EMERGING MARKETS & THE TAPER TANTRUM

THE TAPER TANTRUM

COINED BY THE MEDIA, THE 2013 **TAPER TANTRUM** CAME WITH RUMOURS THAT THE FED WAS THINKING ABOUT TAPERING ITS QE POLICY. THE EFFECTS, THOUGH, WERE **VERY REAL**, ESPECIALLY FOR **EMERGING MARKETS**.

INVESTORS WITHDREW CAPITAL FROM EMs, SEEKING OUT HIGHER YIELDS AMID RISING U.S. INTEREST RATES. INVESTOR FLIGHT LED TO **EM CURRENCY DEPRECIATION** AGAINST THE DOLLAR AND **HIGHER INFLATION**, MAKING IT HARDER STILL TO SERVICE DEBT

THE TAPER TANTRUM

THE BANK OF JAPAN IS AN UNDISPUTED OUTLIER AMONG CBS: FACED BY PERSISTENTLY LOW INFLATION, IT WAS THE FIRST TO EMPLOY QE AND ONE OF THE LAST TO KEEP IT. A FAN OF ACRONYMS, IT HAS ALSO PURSUED YCC (YIELD CURVE CONTROL), NIRP (NEGATIVE INTEREST RATE POLICY), AND ANOTHER FORM OF QE (THIS TIME QUALITATIVE). IS THIS THE YEAR WHEN YCC IS GRADUALLY PHASED OUT?

BUT WHAT HAPPENS IN ANOTHER CRASH?

APPARENTLY IT'S *TBC*

FOR THE BOJ, IT IS ALL ABOUT **RETAINING SUSTAINABLE INFLATION** AND IT REMAINS RELAXED AND FLEXIBLE ON HOW TO ACHIEVE THIS.

AN INDEPENDENT EUROPE

THE ECB IS A MODERN INSTITUTION, UNIQUE IN ITS **FREE CAPITAL MOVEMENT ORIGINS** AND ROLE AS THE CENTRAL BANK TO SOME 20 SOVEREIGN EUROZONE NATIONS WITH A SINGLE MANDATE TO KEEP A HOLD ON INFLATION.

THE COMBINATION OF SCOPE AND MANDATE MADE THE ECB **HUGELY IMPORTANT** DURING THE GFC WITH SOME HIGHLY UNORTHODOX POLICIES INCLUDING NEGATIVE INTEREST RATES AND A HEADLINE €3TN QE PLAN. IT HAS ITS DETRACTORS, BUT LOOKS TO BE STRENGTHENING ITS POSITION WITH NEW POWERS OF SUPERVISION.

APPARENTLY IT'S INDEPENDENT AND HAS FREE MOVEMENT?

UK CHALLENGES TO CB INDEPENDENCE ARE NOT NEW BUT HAVE GROWN WITH RECENT INCREASES TO INFLATION AND INTEREST RATES. **THE HOUSE OF LORDS** HAS REVIEWED THE BOE'S MANDATE UNDER THE SPOTLIGHT OF THE GFC AND RECENT INFLATIONARY PRESSURE. TERMS INCLUDING '**PRUNE**' (IT'S REMIT) AND '**STREAMLINE**' (MANAGEMENT) WERE A FEATURE, WITH A SUGGESTED FIVE-YEAR PARLIAMENTARY REVIEW. IT FEELS A LONG WAY FROM OLD HEADLINES THAT DECLARED '**THE OLD LADY SET FREE!**'

Review

Streamline

THIS LADY IS NOT FOR PRUNING

IF OUR **CENTRAL BANK ROAD TRIP** HAS PROVED ANYTHING, IT IS THAT **INFLATION AND INTEREST RATES** HAVE CHALLENGED FINANCIAL INSTITUTIONS REGARDLESS OF HOW **INDEPENDENT** THEY ARE OR WHAT TOOLS THEY CAN EMPLOY.

HISTORICALLY, WHEN RATES RISE SUBSTANTIALLY (AND OFTEN QUICKLY), IT'S BECAUSE SOMETHING HAS **BROKEN** OUTSIDE OF CENTRAL BANK CONTROL. AND WHEN THIS HAPPENS, **COUNTERMEASURES** NEED TIME TO TAKE EFFECT, OFTEN **CLASHING** WITH THE SHORT-TERMISM OF POLITICS

SO WHAT LIES AHEAD? MARKETS SEEM TO BELIEVE THAT 2024 WILL BE THE YEAR OF FED RATE CUTS, BUT HOW FAR AND DEEP WILL THEY GO? WITH **UNPREDICTABILITY** SEEMINGLY THE ONLY CERTAINTY, MAYBE WE SHOULD BE LOOKING AT **DIFFERENT METRICS?**

THE TEAM THAT WRITES ABOUT THE BOND MARKETS, FIND US AT **BONDVIGILANTES.COM**