



# Monetary Policy Paradigm Shifts

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**Remarks at “The Paradigm Shifts in Global Finance”  
Shanghai Development Research Foundation (SDRF)**

Shanghai, China  
November 18, 2019

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## Paradigm shifts in monetary policy: SDRF thoughtful questions

*Many central banks are launching easing policies again, which seems to turn unconventional policies into conventional ones.*

- I. **Modern Monetary Theory (MMT)** has aroused widespread controversy. Views?
- II. What **fundamental changes** are taking place in the **practices** or **theories** of monetary policies?
- III. Why do they happen? How do they **effect the global economy and finance**?
- IV. Conclusions and **Solutions**.

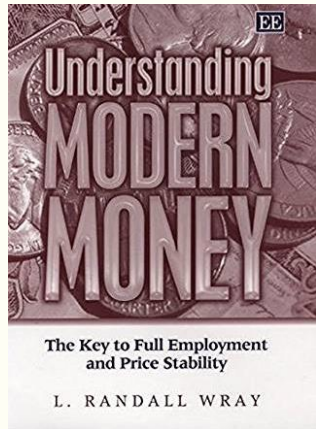


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# I. Modern Monetary Theory

***Modern Monetary Theory (MMT) is:***

- Neither **Modern** ...
- Nor **Monetary** ...
- It is all **Theory**. No models and quants are page numbers.
- Experience ... Latin America and elsewhere.



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## Modern Monetary Theory: Cautionary Tales from Latin America

Sebastian Edwards\*

Economics Working Paper 19106

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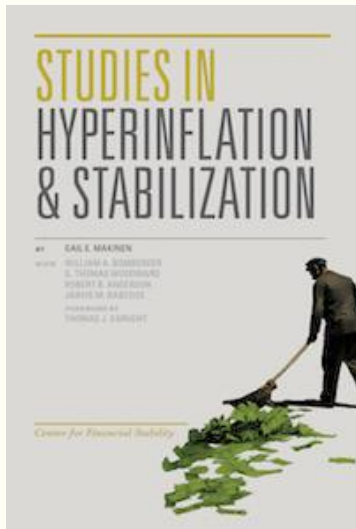
April 25, 2019





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## Studies in Hyperinflation & Stabilization



- *“Wrestling with the government budget constraint and monetary disorders set Gail [Mäkinen] on a **productive lifelong quest to explore and understand monetary and fiscal experiments and disorders on a much broader stage.**”*
- *“By studying mistakes of the past, [we can] shed light on how we can improve things.”*

Thomas J. Sargent

Nobel Memorial Prize in Economics (2011)

Forward comments in

*Studies in Hyperinflation & Stabilization* by Gail Mäkinen (CFS, 2014)



## Studies in Hyperinflation & Stabilization

### *Results and theory from studies and empirical analysis:*

- Hyperinflations ... are also instructive for better understanding **normal-world policies** and **principles**.
- Shouldn't we be scared? **No** (2014). **Maybe** (2019)?
- Very rapid inflations are **rooted in fiscal conditions**.
- Central bank **independence** that **permits the refusal to buy government debt** is essential.

*Studies in Hyperinflation & Stabilization*  
by Gail Makinen (CFS, 2014)

### STUDIES IN HYPERINFLATION & STABILIZATION





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## II. Fundamental changes in Theory and Practice... Triggered by policy miscalculations (\*)

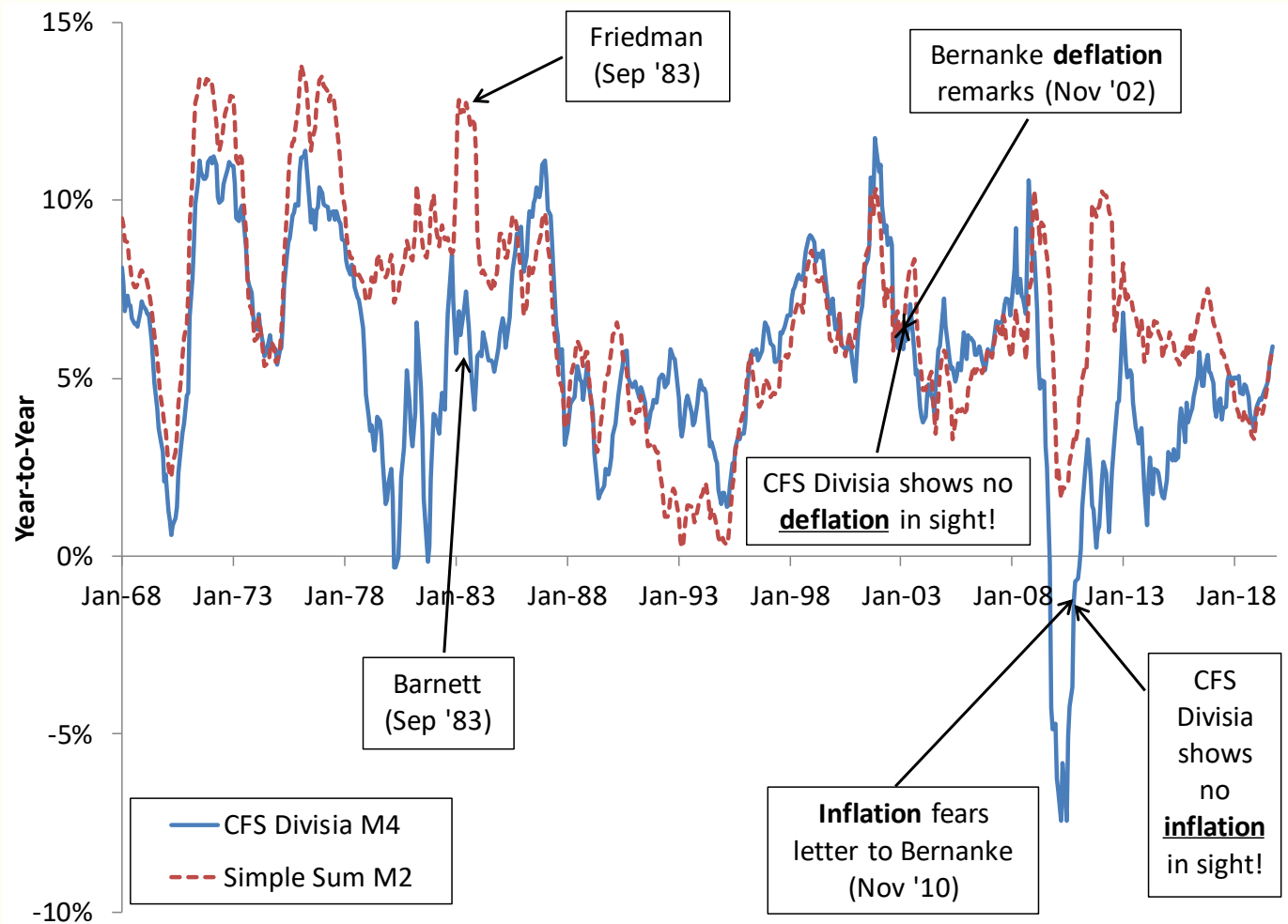
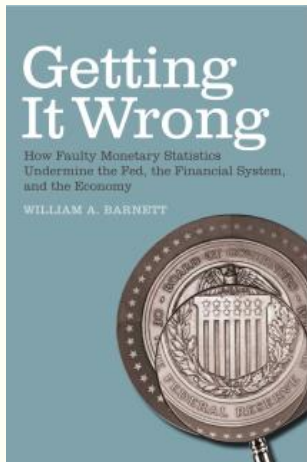
- Deflation and inflation scares in 2002 and 2010, respectively.
- Unclear monetary targets or measurements after 2008.
- Negative interest rates.

(\*) *Focus is largely centered on the U.S. However, relevant shifts have also occurred in Europe, China, and Japan.*





## Monetary and financial measures matter

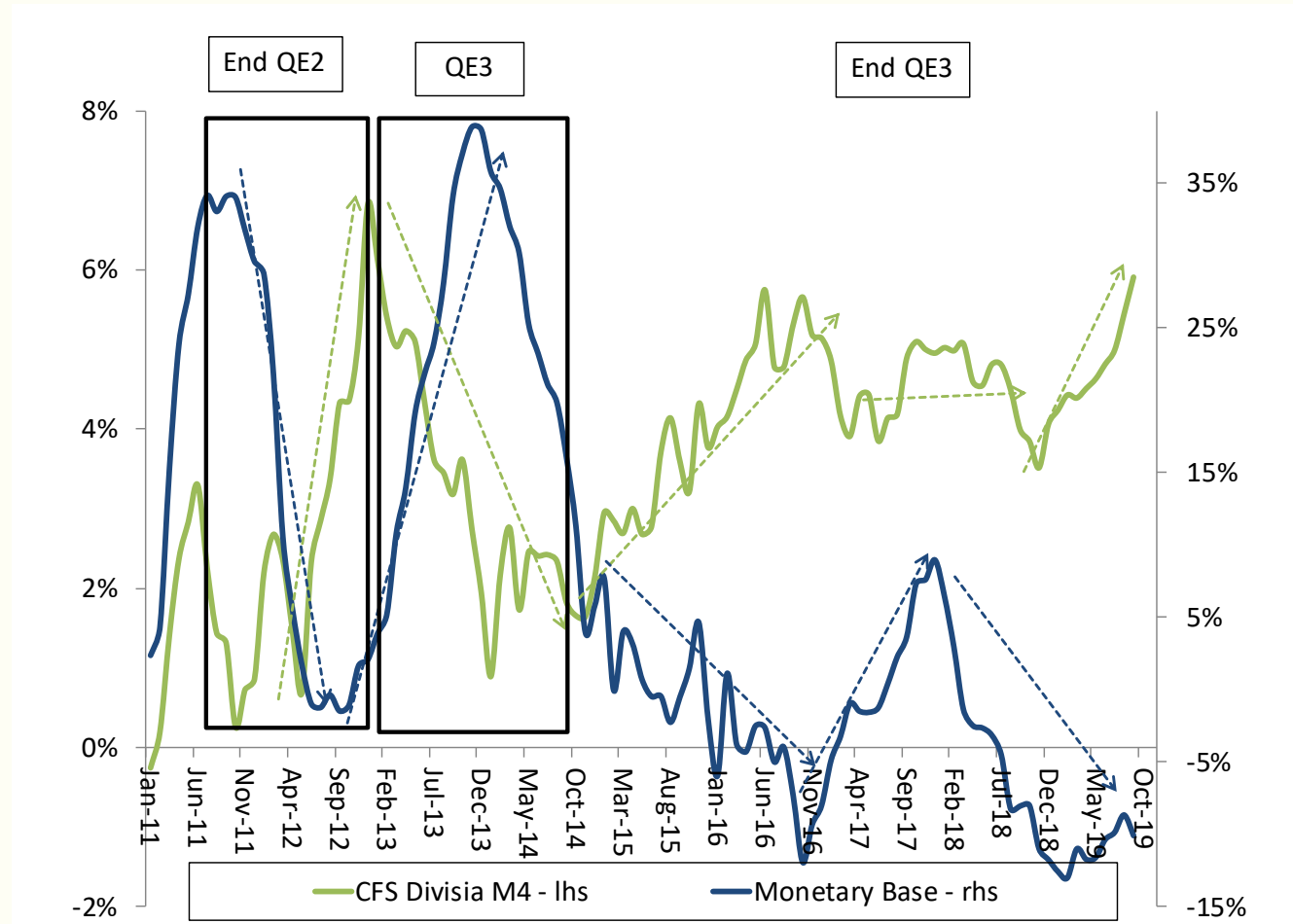
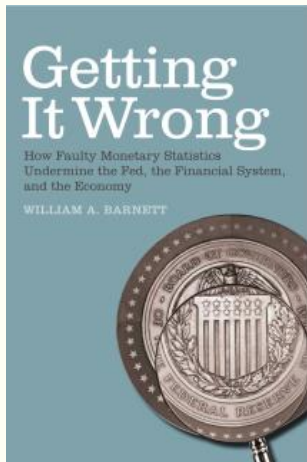


Source: Federal Reserve Bank of St. Louis and Center for Financial Stability.



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## Unclear targets and limited benefit from QE 2 and 3: CFS Divisia M4 and base money move oppositely



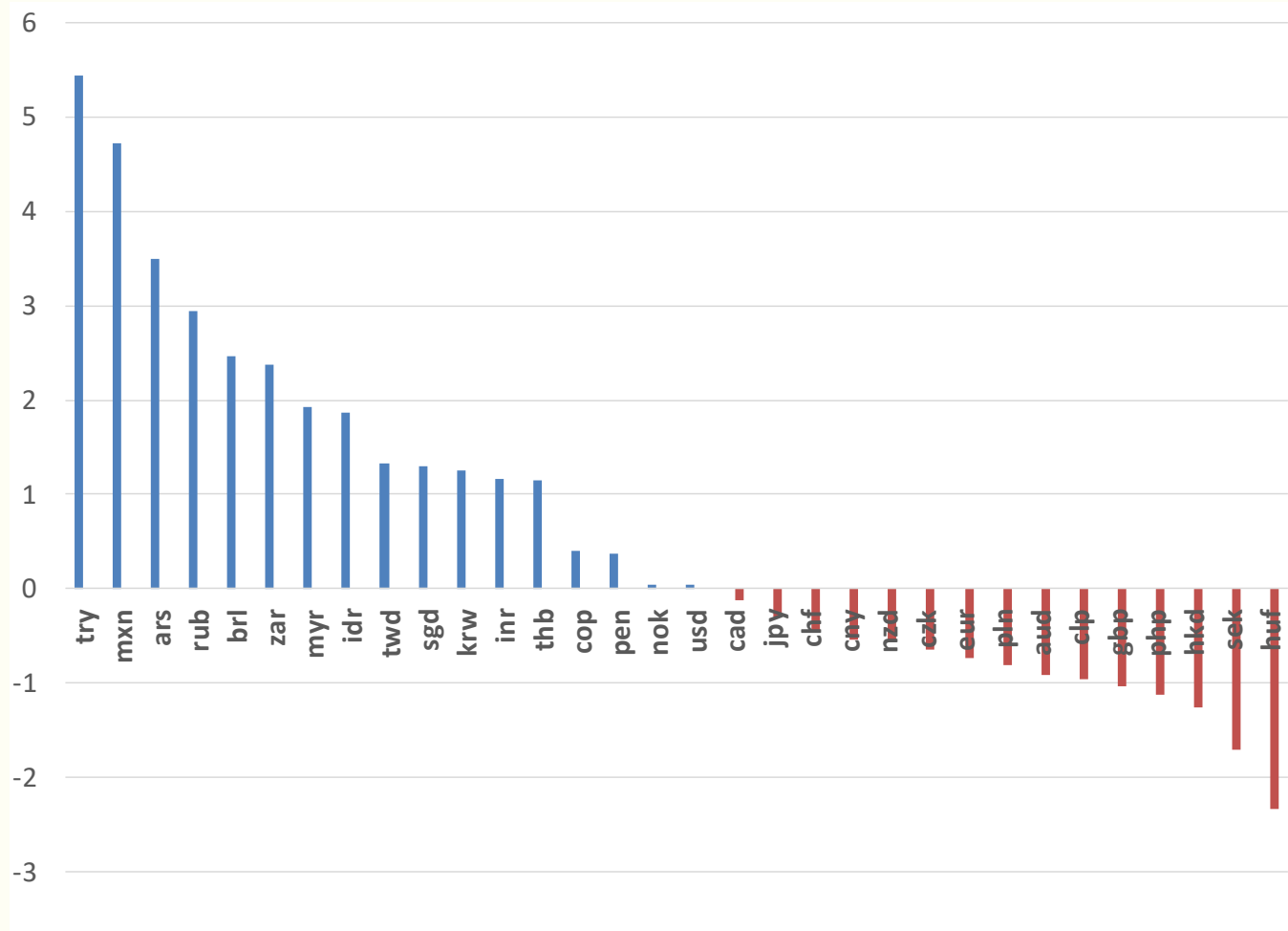
Source: Federal Reserve, Bloomberg LP, and the Center for Financial Stability.





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## Negative real interest rates distort economic and financial incentives...



Source: Bloomberg LP and Center for Financial Stability.



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### III. Effect on global markets and economics

- **Asset price distortions... equity and bond market valuations.**
- **Skewed incentives for savers and investors.**
- **Uncertainty.**
- **Limited growth.**



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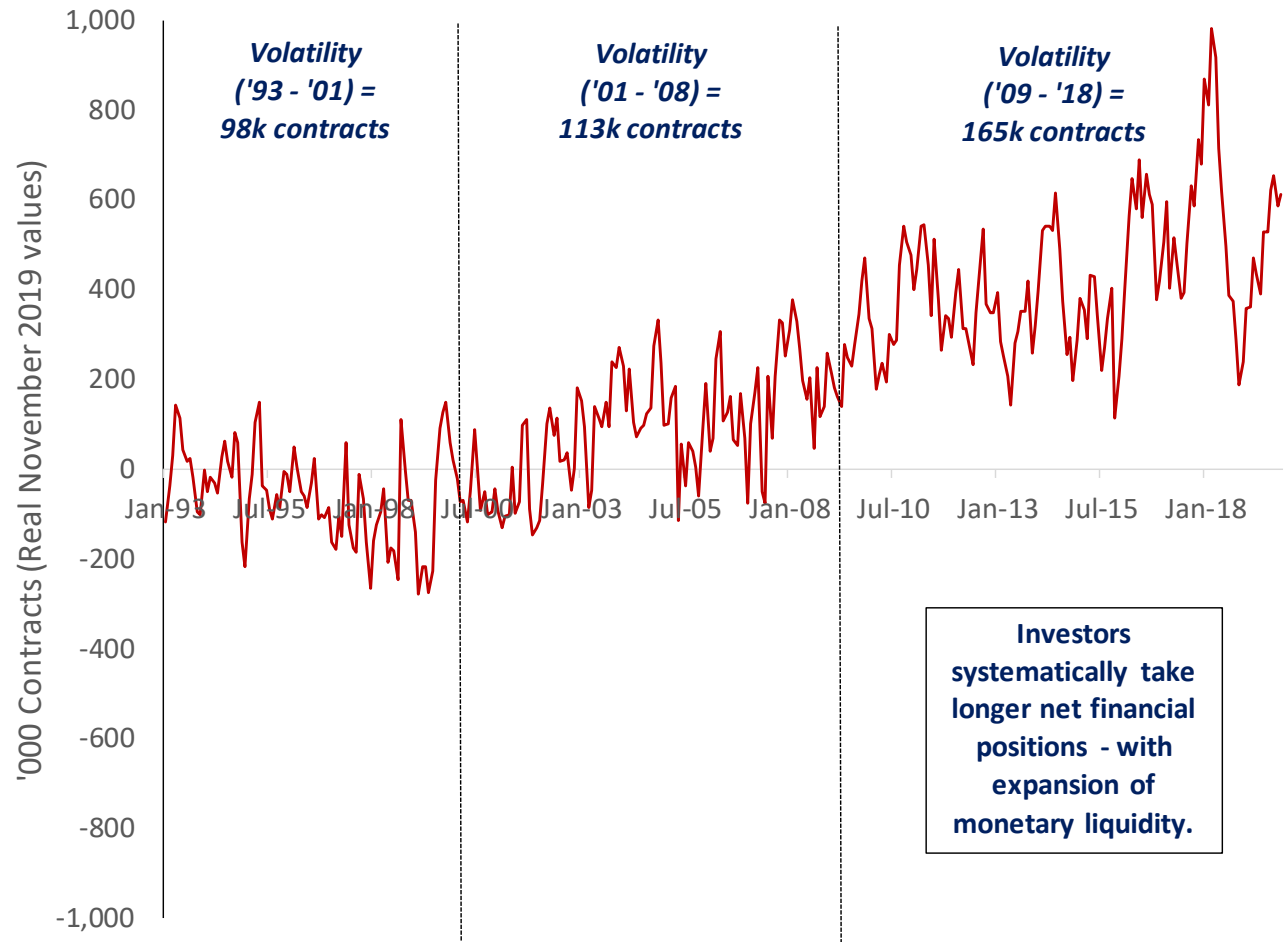
## Accommodative Monetary Policy spurs Speculative Investor Behavior



Note: Includes futures positions in NYMEX crude, S&P 500 index, JPY, gold, CHF, Nikkei, and GBP held by speculative investors.  
Source: CFTC, Bloomberg LP, and Center for Financial Stability.



# Accommodative Monetary Policy boosts Volatility and Long Bets



Note: Includes futures positions in NYMEX crude, S&P 500 index, JPY, gold, CHF, Nikkei, and GBP held by speculative investors.  
Source: CFTC, Bloomberg LP, and Center for Financial Stability.



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## IV. Conclusions and Solutions

- **MMT is a dangerous policy idea.** It has already been tried and performed poorly.
- Practice and theory have changed. **Monetary mistakes in the past have paved the way for more experiments and the surfacing of ideas such as MMT.**
- **Extension of extraordinary monetary policies has damaged the global economy and distorted financial markets.**

***Although tricky, a slow and careful restoration of normalcy is essential. It is today's critical constrained maximization problem.***



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