Money Market Mutual Funds in the Era of Trump

A Minskyan Analysis

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Association for Social Economics at the Allied Social Sciences Association conference
Philadelphia, PA, January 6, 2018

Outline

- Social origins of money
- Money Market Mutual Funds (MMMFs): Characteristics
- H. Minsky’s 1980s warnings about MMMFs and financial instability
- MMMFs in global financial crisis (GFC)
- Aftermath of GFC: Regulatory response
- Trump-era regulatory proposals for future of MMMFs
- A critique and alternative proposal
- Implications in Post Keynesian world
- Possible futures for money-like retail instruments

Social origins of money and my topic

- "We start from the presumption that money is a fundamentally social phenomenon or institution, whose origins must lie in varied and complex social practices." --Eric Tymoigne and L. Randall Wray, in telling their “alternative story” about money.
- The heterodox story contrasts with neoclassical story based on a need for money for exchange.
- The tale of MMMFs is a story of a varied and complex social practice

Money Market Mutual Funds: Characteristics

- Limited check-writing privileges
- Historically, pay a “market” rate of interest that varies with other short-term rates such as the federal funds rate
- Hence, there is a similarity to deposits
- Not technically deposits
- minimum balances in the 1,000s of dollars
- Relatively high interest rates available combined with high liquidity for a retail investment
- MMMFs Invest in short-term paper: bank CDs, commercial paper, securitized loans, etc. Different types allowed to invest in different types of paper.

MMMFs in the 1980s (H. Minsky, *Stabilizing an Unstable Economy,* 1986)

- MMMFs do not make loans directly
- Minsky notes industrial loans are increasingly made by **non-bank financial institutions** (NBFIs)—more or less the **shadow banking system** of today
- In particular, "finance companies" were increasingly important in 1980s as lenders to business
- Potential for runs on their paper, potentially leading to a debt deflation
- MMMFs were big buyers of short-term securities issued by these companies and other NBFIs

Role of MMMFs in recent global financial crisis (GFC) beginning in 2007-2008

- Key event in crisis is collapse of funding sources for investment banks
- One important “market” for overnight funds was the tri-party repo market
- MMMFs among those holding repos of investment banks that held and mortgage-related securities
- When Lehman Brothers and Bear Stearns faced possible collapse in 2008, concerns heightened about runs

MMMFs in GFC, slide 2

- As they approached bankruptcy in 2008, they became aware of potential problems with repayment and sought help from the Fed
- Fed credit facilities were made available, but Lehman could not be saved
- Contagion from the events in 2008 threatened stability of yields on all types of short-term paper—a more general run
- Here I have relied on *The Financial Crisis Inquiry Report* by the Financial Crisis Inquiry Commission

MMMFs in GFC, slide 3

- The 2008 U.S. Crisis saw Reserve Primary Fund "break the buck"—impose capital losses—causing it to become an M3 "money" with a relatively elastic standard of value
- Also, at times, uncertainty existed that shareholders would be able to withdraw their money—a rare event for MMMFs
- Huge outflows occurred—runs, more or less
- During crisis, MMMF "sponsors"—controlling firms—1) subsidized with cash; 2) purchased fund assets at above-market prices; and 3) provided assurances of support
- Fed purchases of commercial paper and asset-backed paper to stabilize prices

Aftermath of GFC and policy response to it, slide 1

- 2010 post–U.S. crisis regulatory tightening for MMMFs
- Ultra low (even negative) rates on relatively safe paper courtesy of central banks
- Some MMMFs cited low yields in moves to riskier assets
- Some firms dropped funds with stable share price (NAV) guarantee
- MMMFs not in systemically risky institutions category under Dodd-Frank
- 2012: Boston Fed President Rosengren says MMMFs have “taken on significant credit risk,” calls for buffer capital requirements--somewhat like bank reserves--plus restrictions on types and amounts of assets

Aftermath of GFC and policy response to it, slide 2

- 2013: New rules proposed by SEC that would (1) require floating share price ("NAV") more like other mutual funds OR (2) allow suspension of or imposition of fees on redemptions in the event of a developing run
- Rejected by SEC: proposals that would have required holding of buffer capital—(erosion of margins)
- Data show that MMMFs are increasingly holding types of paper that are regarded as more risky. Some of these are liabilities of still-weak European banks and shaky emerging markets. (2014 Cleveland Fed report)

Trump-era regulatory proposals on MMMFs

- SEC-proposed changes fail to get through as Obama administration ends
- Angel proposal—impediments to redemptions
- Libertarian arguments to drop restrictions: consumers would move funds to even riskier instruments, etc.
- 2017: Mainstream proposals: SRC (Systemic Risk Council) proposes stability principles to G20 leaders. Emphasis on capital adequacy, bail-ins, removal of need for fiscal bailouts. Member P. Volcker publicly argues MMMFs should be either banks under bank rules or mutual funds that allow capital losses.

Objections recent proposals!

- Proposals to drop bail-outs will not work well, given people's desires to hold safe moneys for large deposits. MMMFs with stable share price cater to a demand that requires a regulated product.
- MMMFs are profitable in normal times, partly because of economies of large deposits and complementarity with other investment products
- Negative retail interest rates to unsqueeze net interest margins instead of unforecastable capital losses
- Availability of MMMFs increases demand for the dollar
- As safe, liquid assets MMMFs stabilize portfolios—a social good
- Buffer capital (like bank reserves) inevitably too small in major, systemic crises
- Capital adds to costs and is hard to raise in crises
- For households, tax complications with possible capital gains on these accounts (Angel)

Response to populist sentiments and policy concerns, slide 1

- Populists right about endless future crises and bailouts in the absence of fundamental reform
- Seek to debunk “populist” and crackpot claims about the Fed that involve misunderstandings of its role and power
- Use Fed’s money-creating capacity as backstop, combined with heightened asset restrictions
- Make clear that some justifications for eliminating implicit guarantee rest on false fiscal arguments from “sound money” school
- No reason not to offer safe vehicles for ALL savers willing to accept lower interest rates

Response to populist sentiments and policy concerns, slide 2

- In fairness, government should sanction creation of “popular” options that are like MMMFs but with lower minimum balances, using principles of MMMFs
- These would be more consumer-friendly than many “savings” instruments offered by many financial institutions
- Specific example: State banks that handle deposits of state and local governments and agree by “charters” to invest locally, regionally, or statewide in socially productive projects and offer such accounts
- More generally, “Democratic” moneys (safe alternatives to, predatory institutions for all—low minimum deposits)

Response to populist sentiments and policy concerns, slide 3

- Key regulatory issues involve (1) what types of MMMFs will carry what guarantees on liquidity and (2) what they will have to do to make sure they will not have huge losses; planned reforms have been stalled in SEC, and new commissioners will have influence.
- Minsky would perhaps favor preservation of asset-based restrictions combined with regulation and insurance to protect depositors

Larger picture: Undermining of monetary qualities of money

- Money plays a role in the economy in making it possible to make provisions for forward commitments in an uncertain world
- The role of a stable unit of account, touted by J. M. Keynes and prominent Post Keynesians, perhaps most notably Paul Davidson, is undermined
- Monetary instruments then becomes more subject to runs in the event of a rise in perceived default risks.
- With less liquidity, agents are less protected against financial turbulence
- This instability would increase the risk of a debt deflation.

Thank you

- Greg Hannsgen, Greg Hannsgen's Economics Blog, www.greghannsgen.org

Minsky’s theory of monetary endogeneity is relevant: Money grows over Minskyan “cycle”

- Money largely came from innovations in private sector
- Government used controls to try to keep growth of money stock in check. Example: aggregate growth rate rules.
- New types of instruments develop endogenously
- These added to any economically meaningful measure of money stock, since these were also highly liquid instruments: e.g., M3
- Occasional crashes occur
- Government then forced to validate payment commitments by making good on claims that backed broad moneys. Hence, new financial instruments gain implicit guarantee.