

Problems with the Helicopter

JRC Conference- March 1, 2013

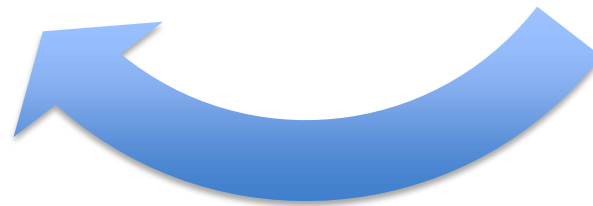
"An airplane by its nature wants to fly. ... A helicopter does not want to fly. It is maintained in the air by a variety of forces and controls working in opposition to each other, and if there is any disturbance in this delicate balance, the helicopter stops flying, immediately and disastrously. There is no such thing as a gliding helicopter"

Harry Reasoner (1971)



deleveraging

uncertainty



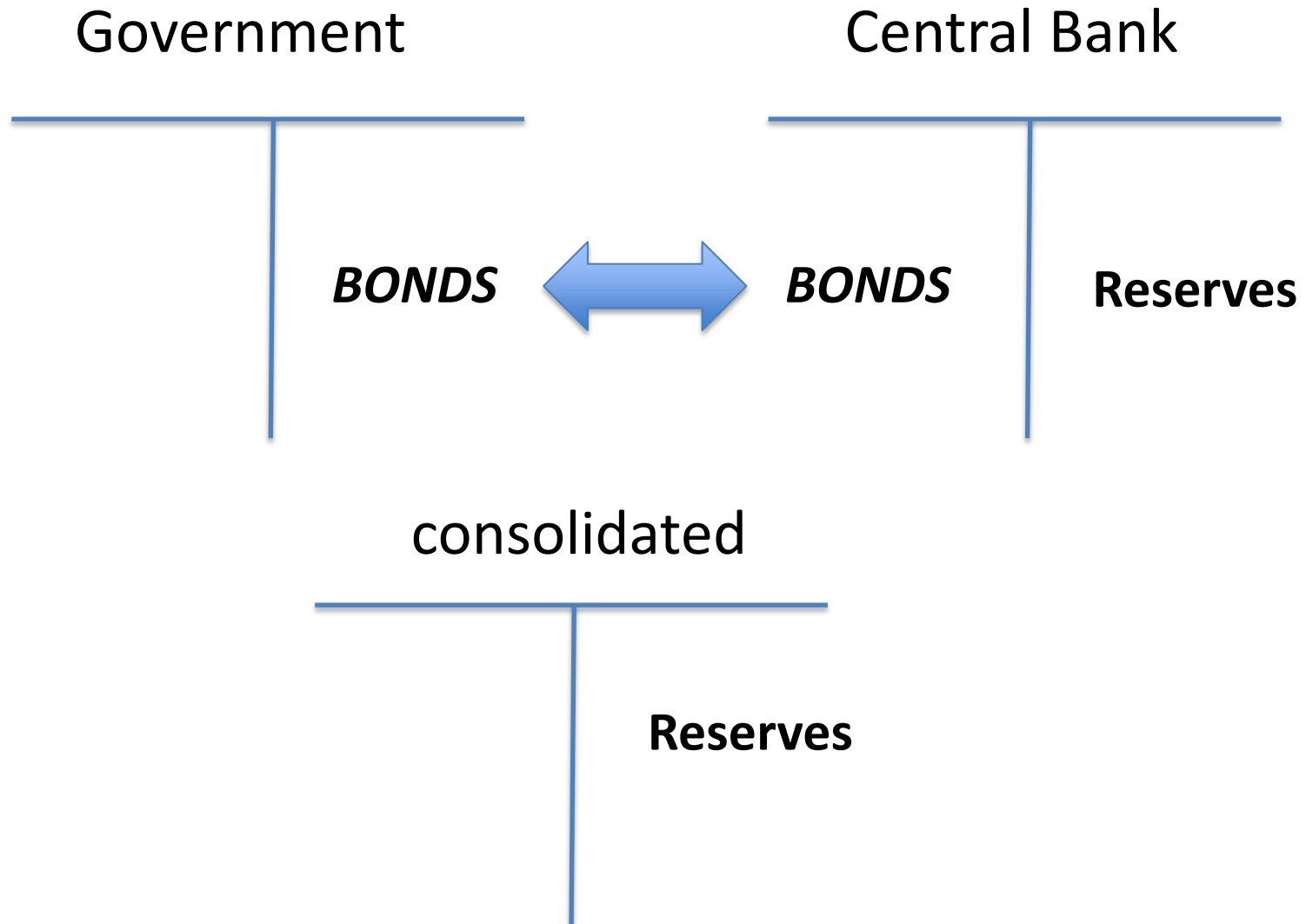
deleveraging, uncertainty and growth

- deleveraging by one agent creates externalities on others – a coordination problem- liquidity helps this coordination problem.
- nobody knows the end point. " safe levels of leverage are subject to change over time" (Eggertson and Woodford)
- no one knows how long it will last
- very difficult to define an optimal path two opposite strategies : (1) abrupt and macro shock (2) delay and misallocation of resources

rationale behind "helicopter drop"

- finance the only economic agent willing to leverage
- avoid Ricardian equivalence (no additional public debt)
- no inflation threat (broad money stable and money multiplier has collapsed)

a missing element : Banks' reserves **are** Government debt



debt and the demand for reserves

- a safety premium at the moment
- one cannot "run" from the Central Bank's balance sheet in a floating exchange rate regime : adjustment through exchange rate and long term rates (run from Government debt)
- increase in interest rates and unpleasant monetary arithmetic; reserve requirements ?
- perceived fiscal dominance and inflation expectations ??

crashing the helicopter : the wrong policy mix

- very accommodative monetary policy (appropriate)
- very restrictive prudential policies : deleveraging
- prudential policy fuels uncertainty (deadlines, permanent adjustments)
- distortions in portfolio choices and asset prices (interest rate risk piling up in balance sheets)

macro prudential rebalancing

- marginal capital requirements lower than average capital requirements : preserve loss absorption capacity and better incentives to new credits
- account for interest rate risk in balance sheets