



THE UNIVERSITY OF
BUCKINGHAM



INSTITUTE OF
INTERNATIONAL
MONETARY RESEARCH

Analysis and insight into trends in money and banking,
and their impact on the world's leading economies

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THE FLEXIBILITY OF THE CLASSICAL GOLD STANDARD (1870s-1914).

ANY LESSONS FOR THE EUROZONE?

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This paper does not reflect the views of the Banque de France or Eurosystem

HISTORY OF THE GOLD STANDARD. INSPIRATION FOR THE EUROPEAN MONETARY UNION (EMU)

- Two waves:
 - Before EMU: Foreman-Peck (1991), Panic (1993), Friedman (1997), Flandreau et al. (1998)
 - Since the European debt crisis: Ogren & Oksendal (2011), Eichengreen & Temin (2010), Dellas & Tavlas (2013), O'Rourke & Taylor (2013), Morys (2014)
- Focus on constraints of fixed-exchange rate with full capital mobility (*trilemma*).
- Adjustment cannot work through monetary policy because no autonomy in setting interest rates

OPPOSITE PERSPECTIVE: THE FLEXIBILITY OF THE GOLD STANDARD

- Polanyi (1944), Bloomfield (1959, 1963): central banks could sterilize, absorb asymmetric shocks. A “buffer between internal and external economy”. The role of the balance sheet.
- New paper (Bazot, Monnet, Morys 2018): comprehensive investigation using monthly balance sheets of 21 central banks
- Sterilization was the norm in core countries (key role of domestic assets of CBs). Peripheral countries relied on capital controls (restrictions on gold convertibility)
- Key mechanism: a central bank provides liquidity on demand at a fixed rate. Absorbs asymmetric shocks when responding to this demand
- Discussion: can the ECB provide a similar buffer through refinancing operations (MRO; LTRO, ELA)? When are capital controls needed?

INTERNATIONAL SHOCKS AND CENTRAL BANK BALANCE SHEETS

- How did central banks respond to an increase in the Bank of England rate?
- Follow Bazot, Bordo & Monnet (2016) on France
- Use an ‘exogenous measure’ of BoE decisions (Lennard 2018)
- Theoretical predictions (for countries in the gold standard):
 - If “rules of the game”/trilemma, the CB follows the BOE. Positive correlation between domestic & international assets.
 - If sterilization, stable interest rate and negative correlation between domestic and international assets
 - If restrictions on gold convertibility, stable interest rates and gold reserves.

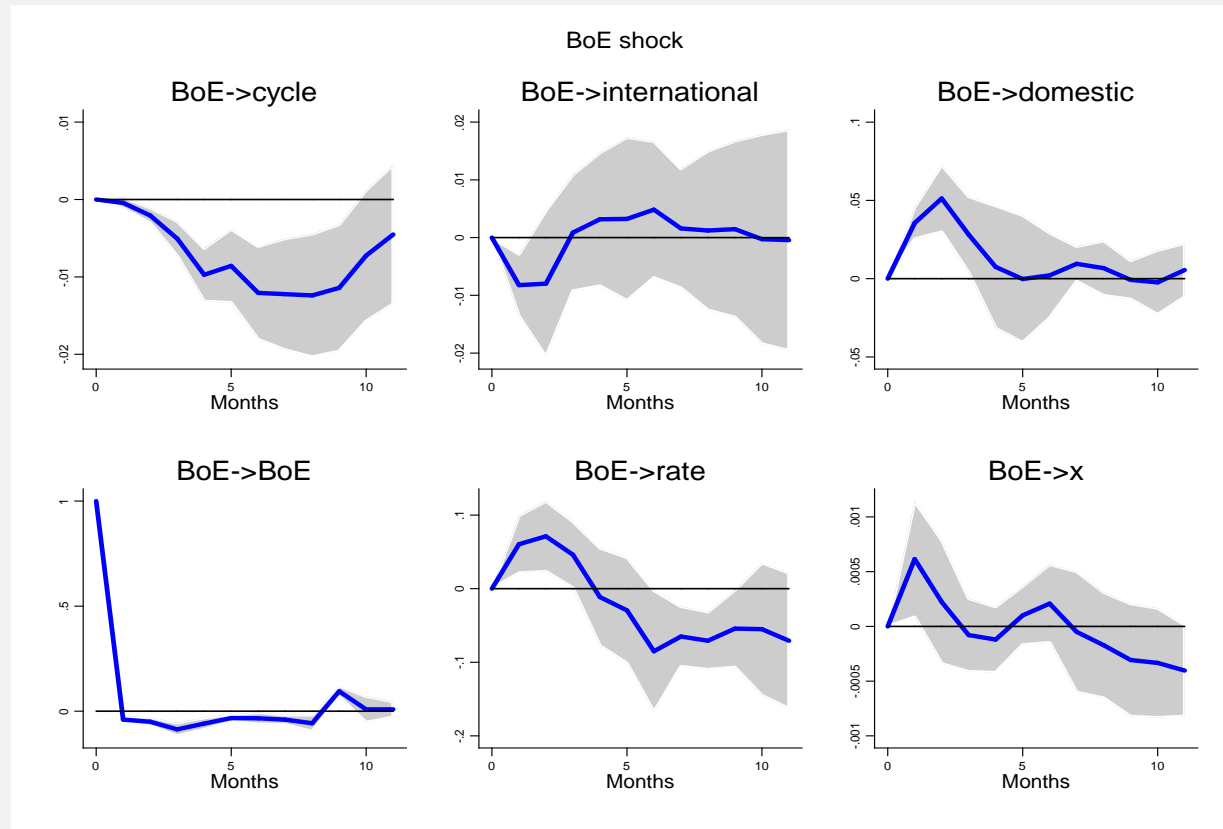
EMPIRICS CORE VS. PERIPHERY

- 3 groups: core, periphery, out of the gold standard
- Martin-Acena et al. (2012): “imperfect gold convertibility was the norm in the peripheral gold standard countries”

Core	Periphery	Out
Germany, France, Netherlands, Belgium, Austria-Hungary	Norway, Sweden, Denmark, Finland, Romania, + Japan, Russia, Italy, Bulgaria, Serbia, Greece	Portugal, Spain, Russia (before 1897), Italy (before 1902), Greece (before 1910), Bulgaria & Serbia (before 1906)

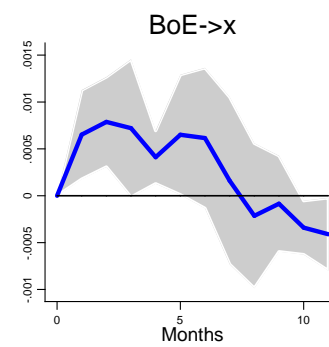
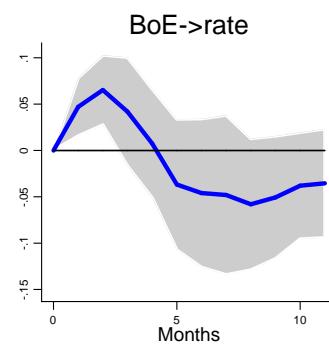
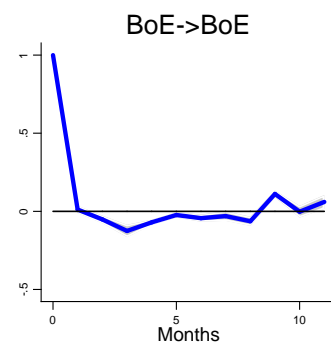
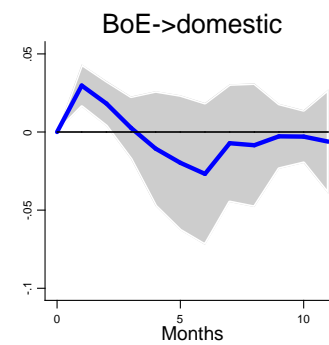
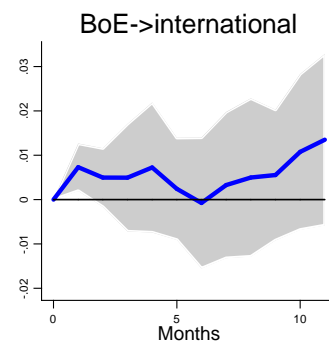
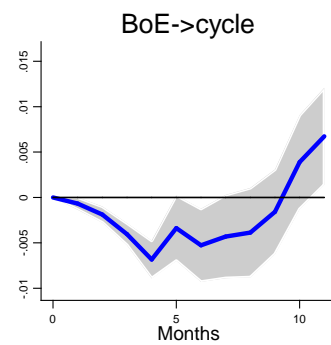
- Control for international business cycle
- Panel local projections (Jorda, Schularick, Taylor 2017, 2018). Robust to different specifications and estimation methods.

CORE



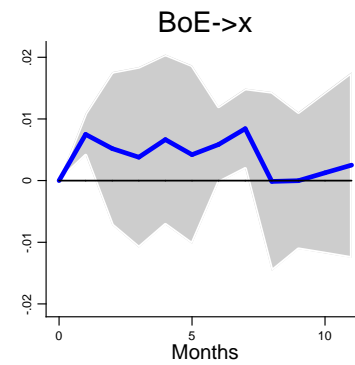
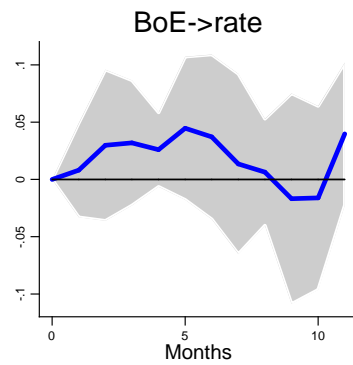
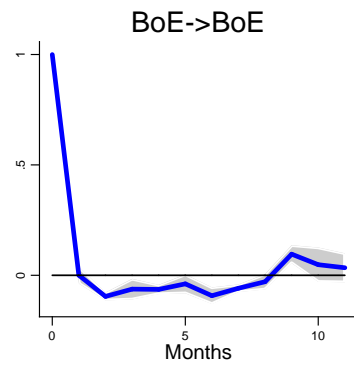
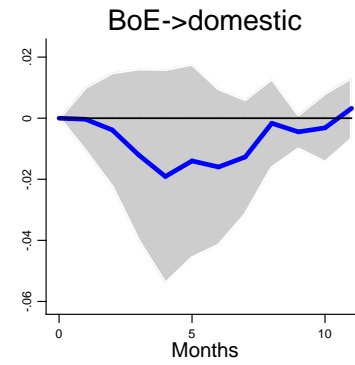
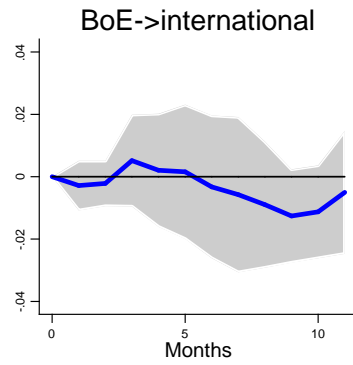
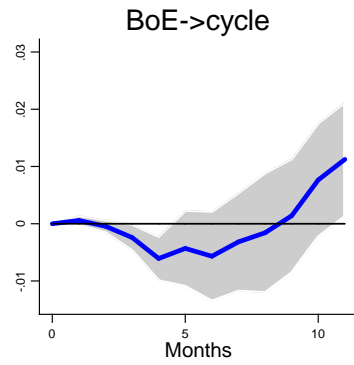
PERIPHERY

BoE shock

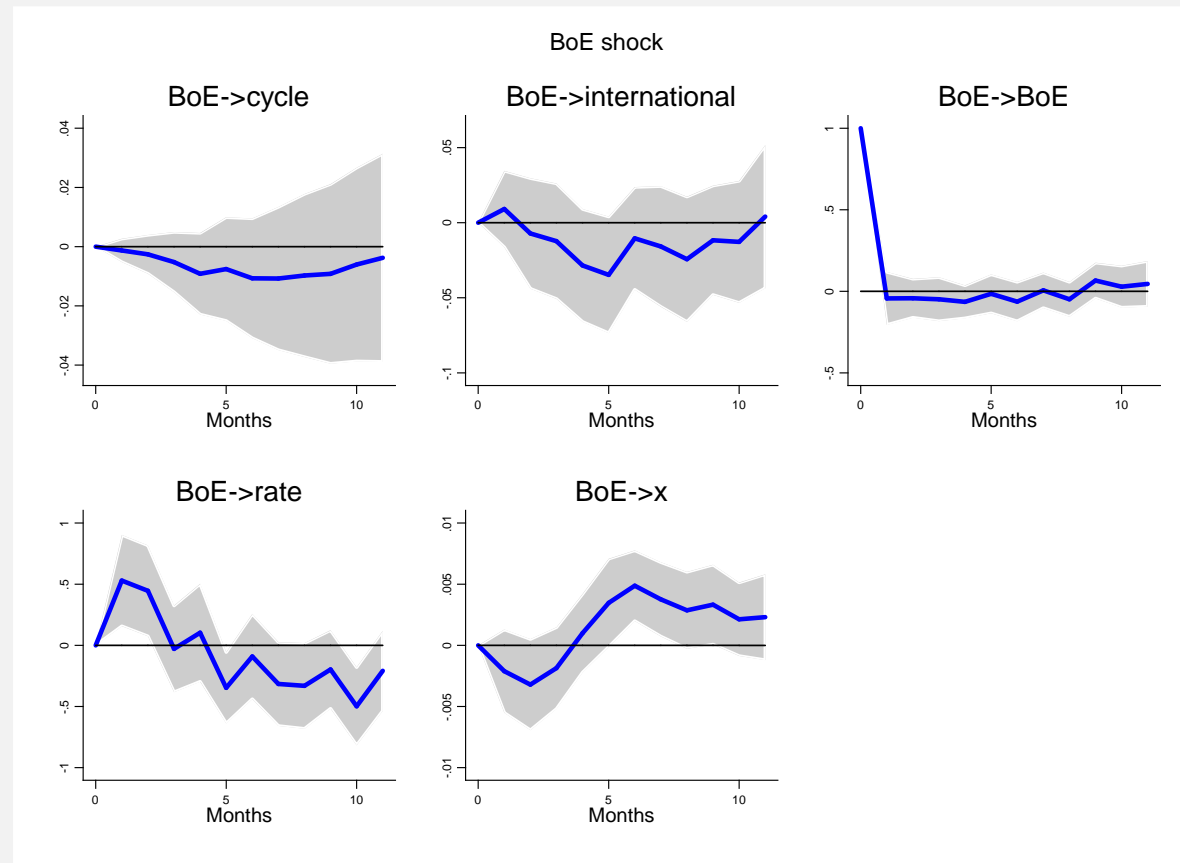


OUT

BoE shock



UNITED STATES (GOLD STANDARD WITHOUT A CENTRAL BANK)



CONCLUSION: THE GOLD STANDARD WAS NOT A RIGID FRAMEWORK

- Not a single central bank followed the “rules of the game”
- Sterilization in core countries. Convertibility restrictions (and sterilization) in periphery
- In the US, the impact of BoE rate on New York money market rate was 10 times higher than in countries with central banks
- Central banks as shock absorbers
- Mechanism driven by increasing demand at the central bank in times of international financial shocks. Sterilization = maintaining the money/credit supply constant and stable interest rates

ANY LESSONS FOR THE EUROZONE?

- More flexibility in the eurosystem than usually thought.
- As in the gold standard, the ECB lends to banks on demand in order to achieve homogenous credit conditions across the zone. Decentralized operations
- Responses to asymmetric shocks show up in Target II imbalances
- Capital controls as substitutes to sterilization when the latter is no longer (politically/economically?) feasible
- Such function of central banks works for smoothing short-term shocks. Do not solve structural imbalances (as in the gold standard)