

New Paradigms and Old Promises: Central Banks and the Market for Sovereign Debt in the Interwar Period

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**FACULTÉ DES SCIENCES
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Central Banks, a controversial institution

- Central banks are responsible for monetary stability, which is necessary to achieve financial development and economic growth
- A long-dated debate has existed between supporters of free banking and those of central banking
- The institution has evolved, mainly regarding the scope of the functions that it performs

The emergence of central banking

- Despite strong debates, the number of central banks established in the interwar period suggests rather a consensus on the advantages of this regime
 - Why??

Foreign advisors and central banks

Date	Country	Name	Foreign Advisor
01.01.32	Turkey	Central Bank of the Republic of Turkey	----
01.04.34	India	Reserve Bank of India	Hilton Young Commission
01.08.34	New Zealand	Reserve Bank of New Zealand	Otto Niemeyer
30.06.21	South Africa	South Africa Reserve Bank	----
28.05.35	Argentina	Banco Central de la República Argentina	-----
20.07.28	Bolivia	Banco central de Bolivia	Edwin Walter Kemmerer
22.08.25	Chile	Banco Central de Chile	Edwin Walter Kemmerer
11.07.23	Colombia	Banco de la República de Colombia	Edwin Walter Kemmerer
10.08.27	Ecuador	Banco Central de Ecuador	Edwin Walter Kemmerer
19.06.34	El Salvador	Banco Central de Reserva de El Salvador	Frederick Francis Joseph Powell
30.06.26	Guatemala	Banco de Guatemala	Edwin Walter Kemmerer
01.09.25	México	Banco de México	Inspired by E.W. Kemmerer
03.09.31	Peru	Banco Central de Reserva del Perú	Edwin Walter Kemmerer
03.07.34	Canada	Bank of Canada	----

Different reasons

- An evolutionary path in Europe; not so in Latin America; political factors and economic climate of the 1920s
- Adoption of the “Kemmerer model” in the Andean countries, a common receipt that could have been mailed to those interested if monetary technology was all what policy-makers needed
- Canada: Political expediency, related to the perception of the government’s actions against the Great Depression

“The Brussels consensus” (I)

- A conference held in 1923 that gathered technical experts from several countries to agree on certain common principles and produce a set on recommendations on economic policies
- A main result from the conference was the formation of the Economic and Financial Committees of the League of Nations
- Among these resolutions, the establishment of central banks of issue was recommended, and if foreign capital was required, “some form of international control might be necessary”

“The Brussels consensus” (II)

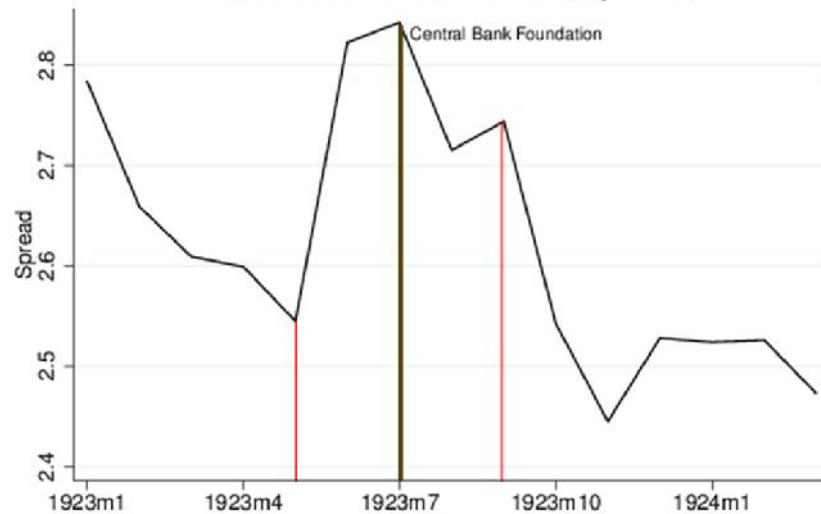
- Central banks should have the monopoly of monetary issues
- They should be free of political interference
- They should guarantee monetary stability under a gold-standard regime

Sovereign debt markets and international consensuses

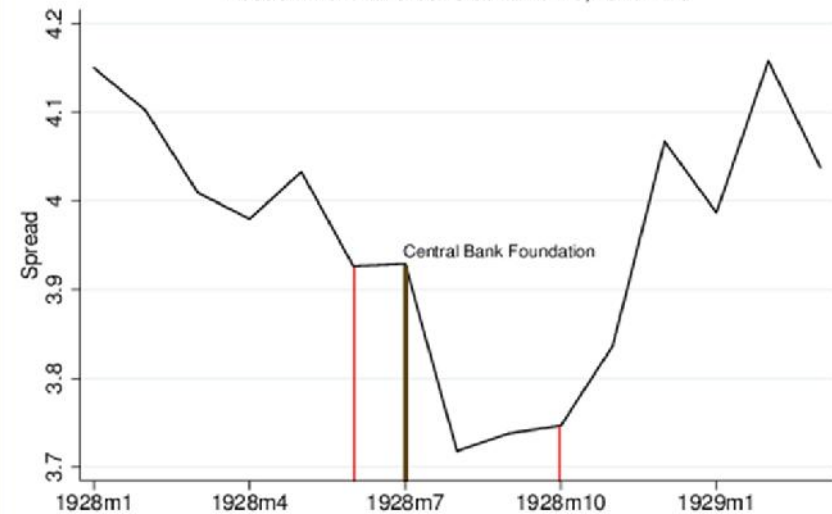
- Adopting central banks should have improved the conditions of new government loans in international financial markets
 - Overall, we expect financial markets to react favorably to the establishment of central banks

New Central Banks in the 1920s

Clemente–Montañés–Reyes double AO test for unit root
Test on Colombia: breaks at 1923m5, 1923m9

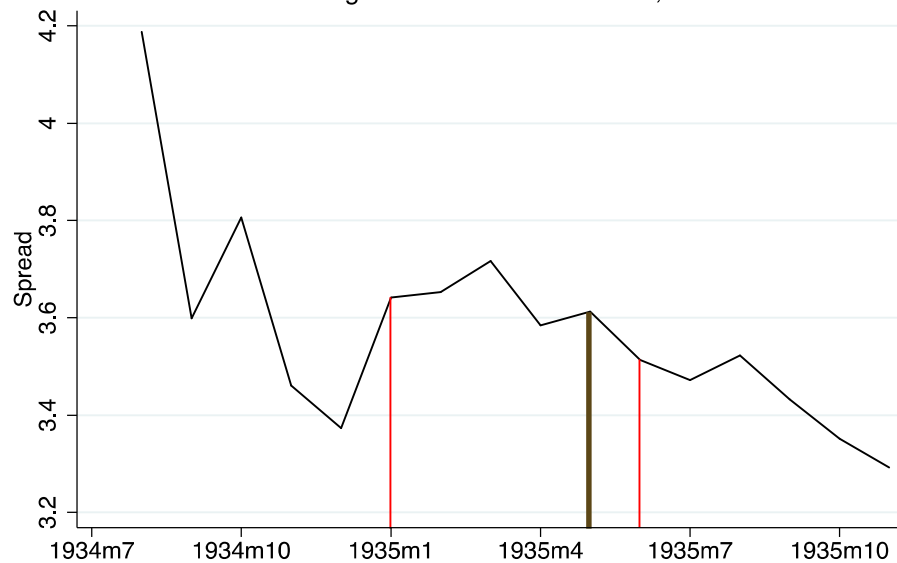


Clemente–Montañés–Reyes double IO test for unit root
Test on Bolivia: breaks at 1928m6, 1928m10

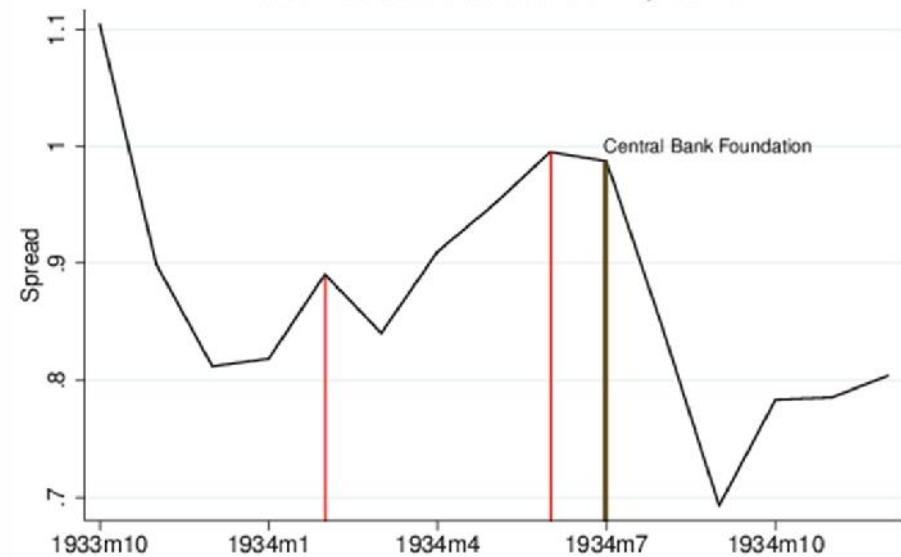


New Central Banks in the 1930s

Clemente–Montañés–Reyes double AO test for unit root
Test on Argentina: breaks at 1935m1, 1935m6



Clemente–Montañés–Reyes double IO test for unit root
Test on Canada: breaks at 1934m2, 1934m6



The case of Argentina

Country	Dates	Titles	Coincidence with BP
Argentina	January 1935	Depression and recovery in Argentina [Foreign Affairs]	yes
	January 15, 1935	New Central Bank for Argentina [Financial Times]	yes
	January 15, 1935	Central Bank For Argentina [Times]	yes
	January 18, 1935	Argentina plans a CB [NYT]	yes
	March 3, 1935	Argentina adopts new bank system [NYT]	no
	March 23, 1935	Central Bank for Argentina [Financial Times]	no
	March 23, 1935	Argentina revises financial system [NYT]	no
	May 1, 1935	Ernesto Bosch heads new Argentina Bank [NYT]	yes
	June 7, 1935	Central Bank opened [NYT]	yes
	September 5, 1935	Bank of Argentina holds reserve ratio [NYT]	no
	October 10, 1935	Bank of Argentina reports for month [NYT]	yes
	November 19, 1935	Argentina paying debts, says Pinedo [NYT]	no
	December 18, 1935	Bank Of London And South America [Times]	no

Analysis on the primary market

- We have looked at the borrowing costs in New York of the new loans for foreign governments between 1923-1929, and have estimated the effects of central banks.
- The controls included in the analysis are:
 - Fiscal variables: debt service to public revenue; public deficits
 - Monetary variables: inflation, depreciation rate, gold standard dummy, reserves to monetary base
 - Microeconomic elements: loan amount, type of issuer and underwriter
 - Institutional quality (Polity IV) and money doctors

Table 3: Central Bank and spreads at issue

	(1)	(2)	(3)	(4)
publicfinance	0.341 (1.12)	0.295 (0.85)	0.165 (0.63)	0.103 (0.40)
inflation	1.114 (1.67)	1.038 (1.35)	2.162 (3.48)	1.895 (3.19)
deprate	0.493 (0.66)	0.401 (0.50)		
CB	0.0196 (0.10)	0.0931 (0.39)	0.148 (0.71)	0.132 (0.61)
majorunder	-0.775 (-3.62)	-0.677 (-2.68)	-0.523 (-2.62)	-0.501 (-2.60)
GoldStandar			-0.496 (-2.14)	-0.652 (-2.81)
Seasoned_I			-1.127 (-4.63)	-1.129 (-4.81)
GReservesMA				-0.191 (-0.45)
_cons	3.589 (15.21)	3.192 (5.12)	4.146 (7.45)	4.154 (7.33)
Year effects	No	Yes	Yes	Yes
N	60	60	62	60
adj. R ²	0.174	0.120	0.436	0.497

t statistics in parentheses

p < 0.05, p < 0.01, p < 0.001

Type of central banks

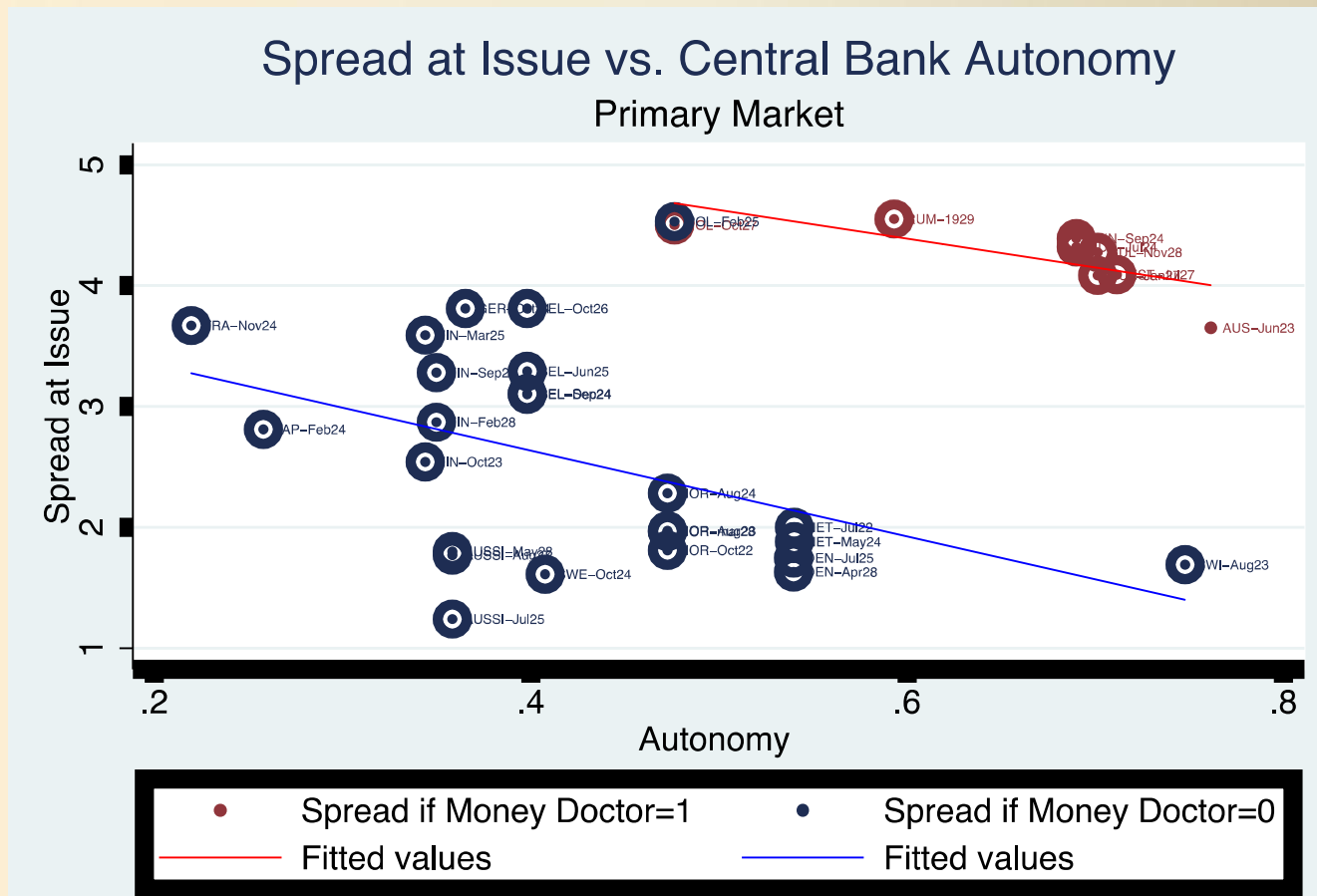


Table 4: Autonomy and spreads at issue

	(1)	(2)	(3)	(4)
publicfinance	0.914 (3.83)	1.053 (3.88)	1.121 (3.65)	1.001 (2.89)
inflation	0.181 (0.39)	0.178 (0.39)	0.219 (0.43)	0.0866 (0.16)
deprate	-2.764 (-3.22)	-2.657 (-3.09)	-2.480 (-2.58)	-2.663 (-2.67)
autonomy	-2.140 (-2.47)	-2.144 (-2.48)	-1.852 (-1.92)	-3.045 (-1.67)
majorunder	-2.169 (-7.72)	-1.742 (-3.56)		
polity2		-0.0299 (-1.07)	-0.116 (-6.46)	-0.217 (-1.65)
MoneyDoctorLN			0.912 (2.43)	0.928 (2.45)
autonomy_polity2				0.151 (0.78)
_cons	5.746 (9.39)	5.664 (9.21)	4.697 (8.31)	5.508 (4.63)
N	30	30	30	30
adj. R ²	0.804	0.805	0.759	0.755

t statistics in parentheses

p < 0.05, p < 0.01, p < 0.001

Table 5: Lender of Last Resort and spreads at issue

	(1)	(2)	(3)	(4)
publicfinance	0.855 (2.48)	0.855 (2.48)	0.777 (2.40)	1.063 (3.23)
deprate	-2.474 (-2.82)	-2.474 (-2.82)	-1.906 (-2.35)	-2.005 (-2.29)
inflation	0.408 (0.76)	0.408 (0.76)	1.175 (2.11)	1.270 (2.14)
MoneyDoctorLN	1.091 (2.53)	1.091 (2.53)		
CBI	-0.0660 (-0.32)	-0.0660 (-0.32)	-0.0816 (-0.39)	
LLR	-0.836 (-2.29)	-0.836 (-2.29)	-0.911 (-2.76)	
MoneyDoctor2			0.791 (3.58)	0.838 (3.53)
Seasoned_I			-0.722 (-1.96)	-0.680 (-1.84)
CB.LLR				-0.275 (-1.48)
_cons	3.671 (11.19)	3.671 (11.19)	4.297 (9.68)	3.620 (10.16)
N	43	43	43	43
adj. R ²	0.434	0.434	0.542	0.478

t statistics in parentheses

(Preliminary) conclusions

- International capital markets became a main force behind the wave of new central banks that emerged in the interwar period
- This paper demonstrates that while the establishment of central banks may have served to attract capital, this did not include lower borrowing costs
- Legal independence and the more general institutional setting were two main factors driving spreads at issue

Děkuji!

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Spreads and inflation, 1930-35

