CfP Walter Bagehot and Lombard Street (1873): A 150-Year Retrospective
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Paper proposal by Elke Muchlinski, Berlin[1]
Working title: ***Bagehot and the Stabilization Function of Central Banks***

"Bagehot probably had not considered the possibility that a central bank would serve as lender of last resort beyond the borders of its own country" (Bernanke (2015b, 410).

Abstract

In his book '*Lombard Street. A Description of the Money Market' (1873)*, Bagehot describes the endogenous creation of money in the light of a (still) incomplete theory of the monetary economy. He highlights the importance of banks for all sectors and points to the potential and systemic disruptions. He explains that the creditor-debtor relationship must be anchored in a framework that goes beyond this relationship, thus referring to a third institution.

He emphasizes the peculiarities of the creditor-debtor relationship by pointing out the inherent fragility of trust. Consequently, he draws attention to the various aspects of an asymmetry inherent in this game. To name just a few of these asymmetries, e.g. time, power, ability to act, information and responsibility.

Bagehot's description of the situation of the Bank of England (BoE) as an international financial center in the 19th century offers an excellent starting point for my research question to analyze the resilience conditions of the global monetary system more specifically in the 21st century. A well-functioning monetary system is fundamentally based on trust. International capital movements generate highly volatile and vulnerable financing relationships, in the context of which the US performs the role of global investment banker.

The function of the Fed as an international lender of last resort (ILOR) should not be understood episodically. The global US dollar funding activities manifest itself in international strongly branched financial relationships. These financial linkages can be highly complex and opaque and can lead to spillovers and contagions. The need for US dollar liquidity rewards the highly integrated and liquid financial market in the USA. International debt markets, primarily the US Treasury bond market, act as the control center for the monetary stability.

The US dollar swaps e.g. B. in 2001, 2007-2008 and as part of the 'Dash for Cash' in 2020 are to be interpreted as elementary indicators of the need for global emergency liquidity and of the effectiveness of the US in its function as ILOR.

Securing trust in a monetary system is a complicated and lengthy process, the success of which depends on effective responses to the predictable and unplanned factors. The success is therefore based on the continuity of adequate measures, but can be destroyed comparatively abrupt.

This means that the role of expectations and preference for liquidity, hence money demand, becomes relevant for an analysis of this context. Current research confirms the crucial importance of a central bank, as it is responsible to the public for this stabilizing function with different monetary policy instruments. Central banks could stabilize financing conditions and expectations in the event of exogenous or endogenous shocks in order to avert contagion, and they need to show their ability to perform.

JEL: ***E 44, E 5, E 58, F 33, G 01, G 15*** *Central Banking and their Policies, International Monetary Arrangements, International Financial Markets*

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