AIP Alhambra Investment Partners

An SEC-registered Investment Advisor

Eurodollar University

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www.alhambrapartners.com

How Dollar becomes 'Dollar'

"The downside of a "dollar" as a opposed to a dollar is that so much is now unobservable in the form of bank activities that never see the light of day (again, the bank at the center). Since we cannot even define a wholesale "dollar" we cannot think to even attempt its measure as it amounts to **chasing a phantom.**

AIP Research
January 21, 2015
What Is A Dollar?

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“The market for bankers’ acceptances was one of the first tasks of the Federal Reserve. There was a flourishing financial trade in acceptances in sterling which was purely a matter of the British pound being something like the global reserve currency, at least for a vast portion of global geography. With the United States becoming an industrial and trading power, American interests in financing trade from the point of view of the dollar were relatively uncontroversial. The Fed’s role in acceptances was to provide liquidity as “needed”, as the Fed was authorized to buy them with some discretion.


GUARANTY TRUST COMPANY OF NEW YORK

£ 10,000 New York, October 19 1909

Ninety days after sight of this First of Exchange (Second unpaid) pay to the Order of

Ten Thousand Pounds Sterling

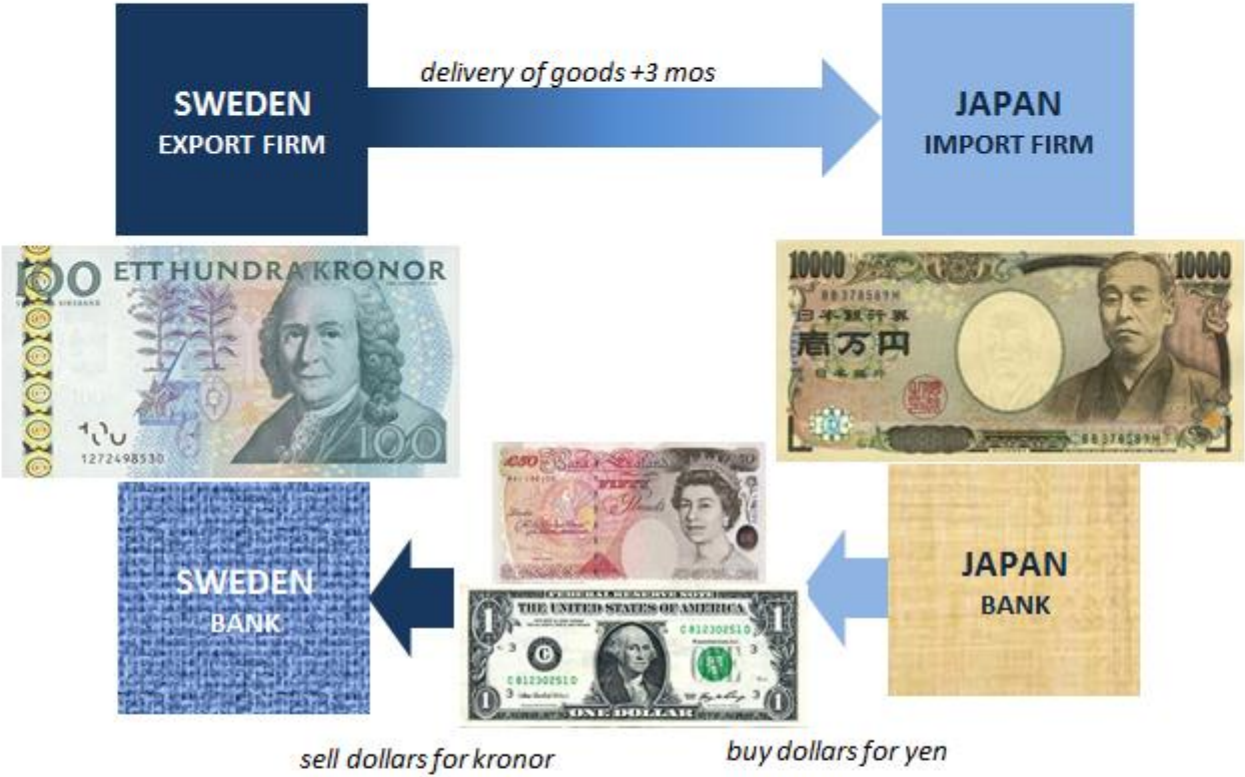
Value received and charge to the account of

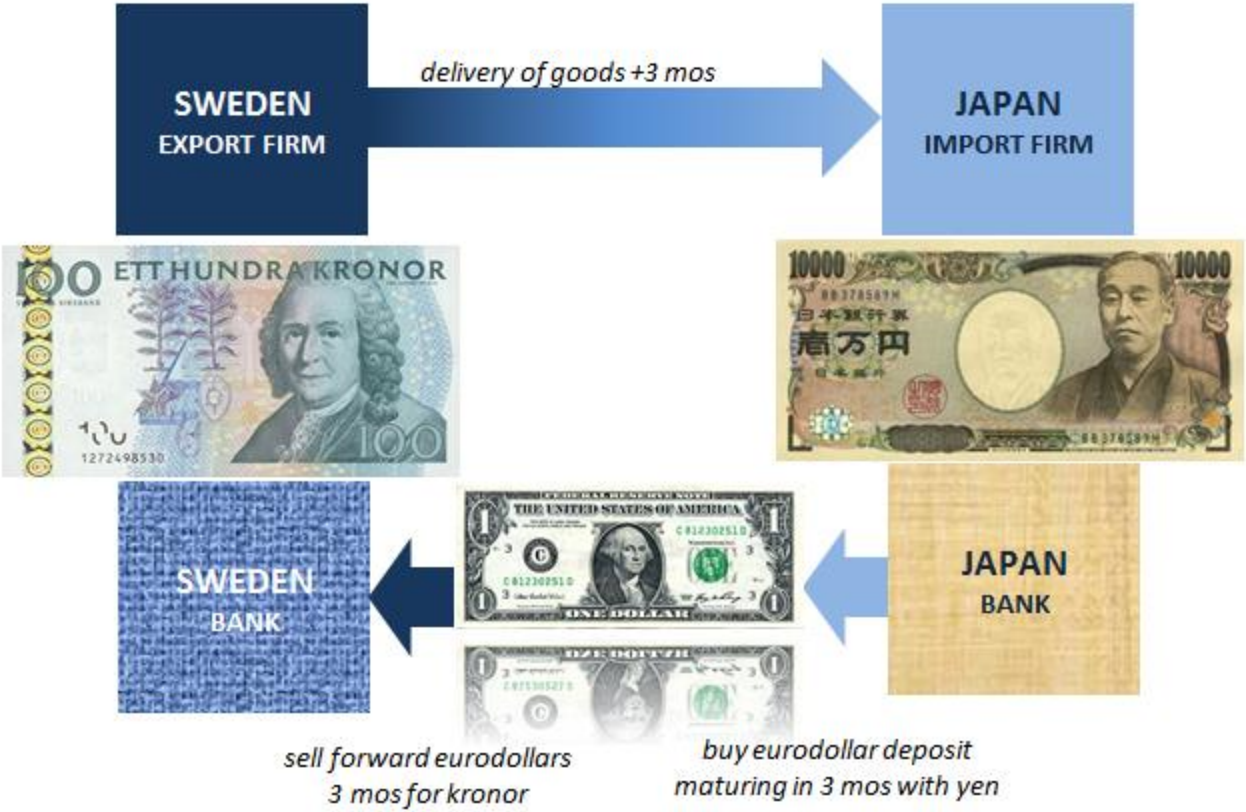
GUARANTY TRUST CO. OF NEW YORK.

To Guaranty Trust Co. of N.Y. London, England

No. L 0308

AIP Research
January 5, 2016
Forward China


SWEDEN
EXPORT FIRM
delivery of goods +3 mos
JAPAN
IMPORT FIRM
SWEDEN
BANK
JAPAN
BANK
sell dollars for kronor
buy dollars for yen


SWEDEN
EXPORT FIRM
delivery of goods +3 mos
JAPAN
IMPORT FIRM
ETT HUNDRA KRONOR
100
10000
THE UNITED STATES OF AMERICA
ONE DOLLAR
SWEDEN
BANK
JAPAN
BANK
sell forward eurodollars
3 mos for kronor
buy eurodollar deposit
maturing in 3 mos with yen

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Where Do Eurodollars Come From?

“Recently, I heard a high official of an international financial organization discuss the Euro-dollar market before a collection of high-powered international bankers. He estimated that Euro-dollar deposits totaled some $30 billion. He was then asked: “What is the source of these deposits?” **His answer was: partly, U.S. balance-of-payments deficits; partly, dollar reserves of non-U.S. central banks; partly, the proceeds from the sale of Euro-dollar bonds.**

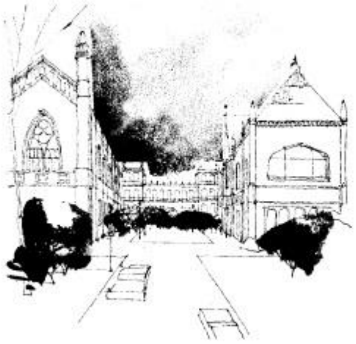
This answer is almost complete nonsense.

Milton Friedman
Re-Published July 1971

Selected Papers . No. 34

The Euro-Dollar Market: Some First Principles

By MILTON FRIEDMAN



GRADUATE SCHOOL OF BUSINESS
UNIVERSITY OF CHICAGO

“The correct answer for both Euro-dollars and liabilities of U.S. banks is that **their major source is a bookkeeper’s pen.**

Selected Papers . No. 34

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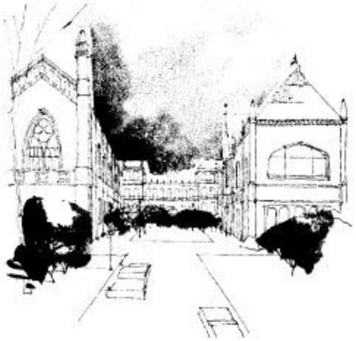

GRADUATE SCHOOL OF BUSINESS
UNIVERSITY OF CHICAGO

Milton Friedman
Re-Published July 1971

EURODOLLAR

Bank H of London

Assets		Liabilities	
Cash	$ 1,000,000	Deposits	$ 10,000,000
	+ 100,000		+ 1,000,000
US$ Loans	7,000,000	Due to other Banks	300,000
	+ 900,000		
US$ Bonds	2,500,000	Capital Accounts	200,000
Total Assets	$11,500,000		$ 11,500,000

Morgan Guaranty NYC

Deposit Balances - Liabilities of Morgan

- 1,000,000	Sheik's Account
+ 100,000	Bank H of London
+ 900,000	UK Ltd. Account
$0	Total Change for Morgan Guaranty NYC

Calculated Money Supply of the US

- 1,000,000	Sheik's Account
+ 100,000	Bank H of London
+ 900,000	UK Ltd. Account

NO CHANGE

TOTAL WORLD SUPPLY OF US$

+ 1,000,000	Sheik's Deposit at Bank H London
- 100,000	Interbank Liabilities Between H & Morgan NYC

Change in Total Supply Available to World $ 900,000

NOTE: $100,000 is transferred from NYC to London, Interbank double counted

EURODOLLAR

Bank H of London + Bank R, Cumulative

Assets		Liabilities	
Cash	$ 1,000,000	Deposits	$ 10,000,000
	+ 100,000		+ 1,000,000
	+ 90,000		+ 900,000
US$ Loans	7,000,000	Due to other Banks	300,000
	+ 900,000		
	+ 810,000		
US$ Bonds	2,500,000	Capital Accounts	200,000
Total Assets	$12,400,000		$ 12,400,000

Morgan Guaranty NYC

Deposit Balances - Liabilities of Morgan	
- 1,000,000	Sheik's Account
+ 100,000	Bank H of London
+ 90,000	UK Ltd. Account to Bank R to Morgan
+ 810,000	Loans from Bank R to Someone back to Morgan
$0	Total Change for Morgan Guaranty NYC

Calculated Money Supply of the US		
	- 1,000,000	Sheik's Account
	+ 100,000	Bank H of London
	+ 90,000	Bank R of London
	+ 810,000	Ultimate Disposition of Loans
	NO CHANGE	

FULL MULTIPLIER EFFECT (ASSUMING 10% RESERVES HELD BACK due to BANK CONSIDERATIONS)

TOTAL WORLD SUPPLY OF US$	+ 1,000,000	Sheik's Deposit at Bank H London
	- 1,000,000	Interbank Liabilities Between
	... total multipliers	Eurodollar Banks & NYC
Change in Total Supply Available to World	$ 9,000,000	

To **EVERY** banker in the multiplier chain, the additional Eurodollar deposit came in the form of a check from Morgan Guaranty NYC. There are now $10 of eurodollar claims on each $1 of Morgan Guaranty 'money.'

NEW YORK PARENT OFFICE

Assets		Liabilities	
Deposits at FRBNY	$ 6,000,000	Time Deposits	$ 100,000,000
Other Cash Assets	4,000,000	(CD's)	
Loans	76,000,000		
Bonds	14,000,000		-
Total Assets	$ 100,000,000	Total Liaibilities	$ 100,000,000

Required Reserves (in 1969 before change in Regulation M) $6mm

London Subsidiary Branch - Eurodollar Operation

Assets		Liabilities	
	$ -		$ -

SHEIK CD matures of $10mm, wants higher rates but NYC office unable to pay due to Regulation Q.

To save the relationship, NYC notes that its London sub is not prohibited and can pay competitive rates.

NYC issues a check to London sub for $10mm

NEW YORK PARENT OFFICE

Assets		Liabilities		
Deposits at FRBNY	$ 6,000,000	Time Deposits		$ 100,000,000
Other Cash Assets	4,000,000	(CD's)	-	10,000,000
Loans	76,000,000			
Bonds	14,000,000	Due to London sub	+	10,000,000
Total Assets	$ 100,000,000	Total Liabilities		$ 100,000,000

Required Reserves (in 1969 before change in Regulation M) $5.4mm

Not required to reserve against liabilities to foreign branches

London Subsidiary Branch - Eurodollar Operation

Assets		Liabilities		
Due from NYC parent	$ 10,000,000	Time Deposits	+	$ 10,000,000
		(CD's)		

On a consolidated basis, NYC bank books are wholly unchanged.

However, NYC Parent was able to pay competitive deposit rate and reduce its reserve requirement at the same time.

Not a single Federal Reserve Note moves anywhere everything remains interbank liabilities

THE WORD

EURODOLLAR

IS NOT

A TECHNICALLY PRECISE

TERM

’

"In reply, Mr. Coombs said an effort could be made to develop such a measure, but he doubted that it would be successful. The volume of funds which might be shifted back and forth between the of the monetary statistics arose in connection with Euro-dollars; **he suspected that at least some part of the Euro-dollar-based money supply should be included in the U.S. money supply. More generally, he thought M1 was becoming increasingly obsolete as a monetary indicator**. The Committee should be focusing more on M2, and it should be moving toward some new version of M3--especially because of the participation of nonbank thrift institutions in money transfer activities. Some of those institutions were offering 5-1/4 per cent on time accounts from which funds could be transferred into a demand deposit by making a telephone call.

FOMC
September 1974
Memorandum of Discussion

"For example, in the mid-1970s, just when the FOMC began to specify money growth targets, econometric estimates of M1 money demand relationships began to break down, predicting faster money growth than was actually observed. This breakdown--dubbed "the case of the missing money" by Princeton economist Stephen Goldfeld (1976)--significantly complicated the selection of appropriate targets for money growth. Similar problems arose in the early 1980s--the period of the Volcker experiment--when the introduction of new types of bank accounts again made M1 money demand difficult to predict.

Chairman Ben Bernanke
Nov. 10, 2006
Speaking at 4th ECB Conf.

STEPHEN M. GOLDFELD
Princeton University

The Case of the Missing Money

THE RELATION between the demand for money balances and its determinants is a fundamental building block in most theories of macroeconomic behavior. Since it is also a critical component in the formulation of monetary policy, it is not surprising that the money-demand function has been subjected to extensive empirical scrutiny. The evidence that emerged, at least prior to 1974, suggested that only a few factors (essentially income and interest rates, with due allowance for lags) were needed to explain adequately the quarterly movements in money demand. There were episodes that, during their course, gave the impression that the money-demand function was shifting. On the whole, however, in the time allowed for final data revisions by a "wait and see" attitude, the apparent puzzles tended to clear up.[1]

As has been widely documented,[2] the U.S. economy is once again experiencing an apparent shift in the money-demand function. In particular, when money-demand functions that have been successfully fitted to pre-1974 data are extrapolated into the post-sample period, they consistently and significantly overpredict actual money demand. Furthermore, as the economy has moved into the upturn phase of the business cycle, the forecasting errors have mushroomed. While one might hope that subsequent data revisions could "solve" the present puzzle, this sanguine attitude

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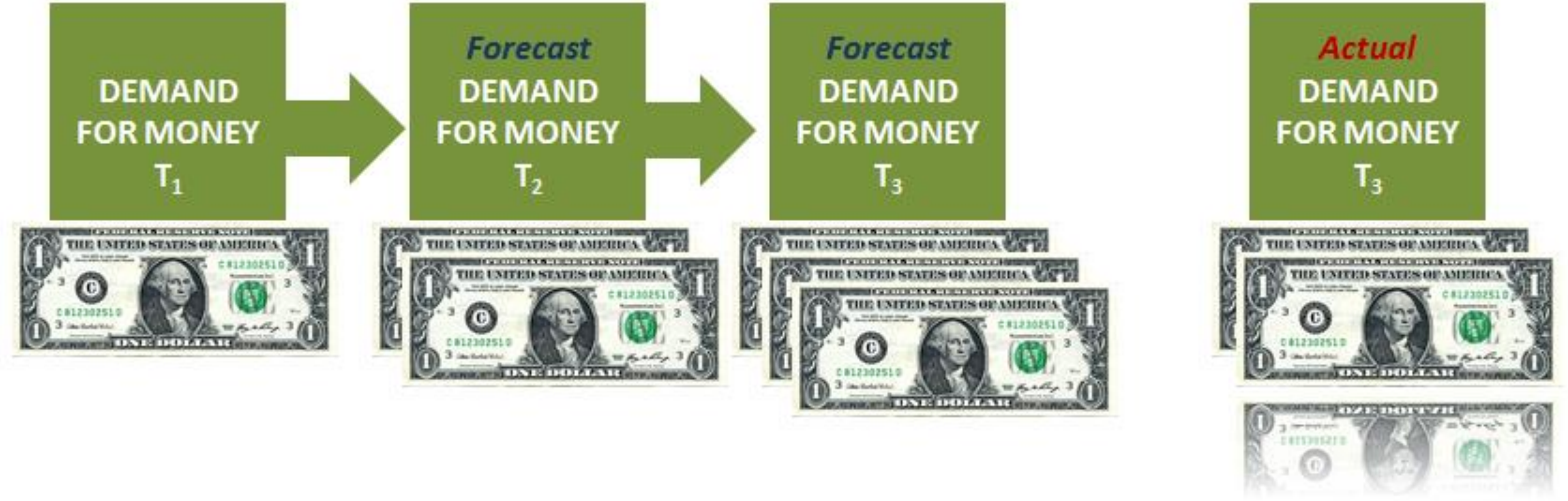
“The results of this paper are difficult to characterize. Insofar as the objective was an improved specification of the demand function for M1, capable of explaining the current shortfall in money demand, the paper is rather a failure. Specifications that seem most reasonable on the basis of earlier data are not the ones that make a substantial dent in explaining the recent data.

Stephen Goldfeld

The Case of the Missing Money



EURODOLLAR IS NOT STRICTLY OFFSHORE DEPOSITS OF OTHERWISE DOLLARS. IT INCLUDES THE TRANSFORMATION OF BANKING INTO A **WHOLESALE** MODEL OFTEN FREE OF DEPOSITS ALTOGETHER.

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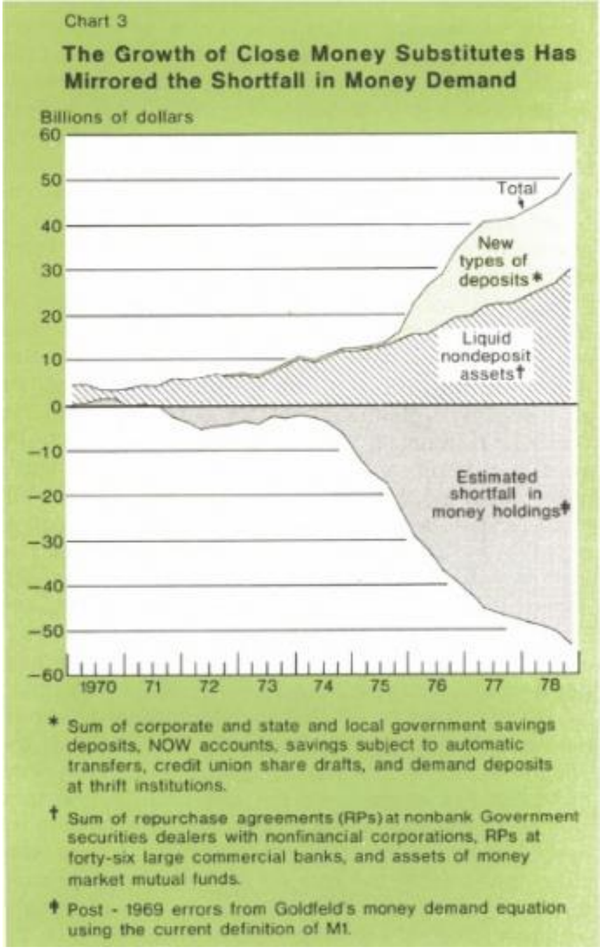
“Large corporations are able to minimize their demand deposit balances by placing excess funds each day in the short-term money market. One way to do this is by arranging an RP – a secured placement of immediately available funds in which the borrower sells securities to the lender and agrees to repurchase them at a predetermined price at a future date (often the next day). **Such a transaction between a corporation and a commercial bank would convert a corporation’s demand deposit asset into an interest-bearing asset that would not be counted in any of the current or proposed aggregates**. Yet, since the funds can be committed for periods of time as brief as just overnight, they are still readily available for transaction purposes.

FRBNY
Spring 1979
Quarterly Review



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MISSING MONEY = WHOLESALE

ANY NON-TRADITIONAL ACCOUNT TRANSACTION THAT SATISFIES MONETARY NEEDS OUTSIDE THE CLASSIFICATION OF TRADITIONAL MONEY AND THE FRAMEWORK OF TRADITIONAL MONEY MECHANICS.

TRADED **BANK LIABILITIES**