REYKJAVIK1

SLIDE1

Ladies and Gentlemen, Dear colleagues
In February 1991, Iceland was the first country in the world to recognize the independence of Lithuania. And i have to say TAKK FYRIR. Thank you very much.

By that time our countries lived in a different universes. Not any more. The world has changed and we are all now immersed in to the same complex financial system by FINANCIAL GLOBALISATION or GLOBAL FINANCIALISATION. And even ANTI GLOBALISTS are unable to escape this.

To figure out and to succesfully deal with the SEEMINGLY EVER CHANGING FINANCIAL REALITY, investors have to develop up to date framework.
In today's presentation I would like to show a NEW WAY of THINKING. Which allows investors more easily to see dynamics of WHOLE FINANCIAL SYSTEM. The VIEW to be presented has been coined as a "MONEY VIEW" by prof Perry Mehrling from Institute for a NEW ECONOMIC THINKING. Most of YOU, I hope, will find it useful when it comes to management of your financial instruments portfolio.

SLIDE2
Before introducing you to the main point of this presentation I shall remind you two CONCEPTS Investors has to always bear in mind: this TIME VALUE of MONEY and HIERARCHICAL system of FINANCIAL INSTRUMENTS. The experience shows that during day-to-day times not all of us realise this DEEPLY enough.
This presentation is about the HIERARCHY and its MANAGEMENT.
An idealised view of all financial instruments you can see in the picture: GOLD is always on top as a highest QUALITY assets and nobody's LIABILITY.
All other financial instruments – are only some kind of CREDIT or PROMISE ultimately to pay GOLD. In short, these instruments are called IOU. As is depicted the quality of CURRENCY is always higher than the quality of DEPOSITS. The quality of DEPOSITS is always higher then the quality of SECURITIES.
The punctuation line here is to separate "OUTSIDE or INTERNATIONAL MONEY" from " INSIDE or NATIONAL MONEY". Of course in todays REAL WORLD US Dollar also plays major role as an OUTSIDE or INTERNATIONAL MONEY. To keep it simple model presented abstracts from Money as a chartelist phenomenon.

SLIDE3
Further. Realisation of a HIERARCHY of FINANCIAL INSTRUMENTS leads us to the hierarchy of FINANCIAL INSTITUTIONS who issue and hold them.
CENTRAL BANKS are always on top of the hierarchy. On a basis of GOLD HOLDINGS they issue national currency as their liability. On the currency holdings, COMMERCIAL BANKING SYSTEM issues DEPOSITS as their liabilities. In their turn the PRIVATE SECTOR on their DEPOSIT holdings issues different kinds of SECURITIES (stocks, bonds and other IOU). The presented hierarchy is also idealised and has not taking into account such powerful institutions like SHADOW BANKS.

The punctuation separates the MONEY SYSTEM from other financial instruments market. As money SUPPLY and DEMAND is artificially manipulated by the banking system, it is wise to use the word "SYSTEM" and not a "MARKET".
Actually there are only four or five CENTRAL BANKS that matter. Moreover, Worlds financial cycle is to large extent driven by US monetary policy of which is in charge SYSTEM of FEDERAL RESERVES . As you know it is formed of 12 banks. But actually three of the banks are more equell among the 12 equels. In addition from the MONEY point of VIEW it shoud be mentioned one CLEARING HOUSE sitting on top of the hierarchy. It is shortly called CHIPS and actually run by JP Morgan in NY.

SLIDE4
And now we are right to the MAIN point! If there is something to bring home from this presentation then this picture definetly stands as a number one.
The PYRAMID reflects QUANTITY and QUALITY of financial instruments present in a financial system. Horizontal axes shows total amount of ASSETS and LIABILITIES present. Vertical axes – marks quality. On the apex of the pyramid is GOLD - the financial assets of a highest quality and at the same time the

SCAREST one. The lower you go down the quality axes the bigger stock of financial instruments is available. The EMPIRIC data to illustrate how big GLOBAL financial stock is I shall present later.
The pyramid is always breathing on a different FREQUENCIES. Starting at a cycle of one day. It is also expanding and contracting in accordance with business cycles and even in accordance with rise and fall of Nations.
ELASTICITY part during the day and DISCIPLINE part by the end of the Day when day's CREDIT has to be settled. In a similar way it is BREATHING in accordance with business cycles:
-when economy is in a BOOM much of credit is created in the system and the pyramid expands. At the BUST time credit contracts. And MARKET PARTICIPANTS driven by “ SURVIVAL or LIQUIDITY CONSTRAIN"or in other words by RATIONAL or irracional fear of DEFAULT starts to HOARD CASH for future payments. PYRAMID CONTRACTS.
There is no possibility to distinguish BUSINESS CYCLE from CREDIT cycle! That is why we can use the MONEY VIEW to figure out through the financial system an economic REALITY.
If pyramid contracts too much or in other words there is too much DISCIPLINE in the system all the bad things happen: a STAGE is SET for CREDIT CRUNCH and collapse of assets value or so called the MINSKY MOMENT. Our colleague Vilhjalmur Bjarnason from ICELANDIC SAVERS has introduced an interesting concept - an ANOMIE. It could be said that this is the time for Anomie to reveal itself.
The prices for financial instruments are being driven by EXPANSION and CONTRACTION of the pyramid so powerfully that even FUNDAMENTAL value of most financial instruments does not play significant role then it comes to its price on the market. Especially this is true for stocks which are not obligation to pay but just stands as a shareholders claim to company's residual assets.
That’s why the investors should always estimate ELASTICITY and DISCIPLINE dynamics in the system. Some EU countries are considered to be rather good at discipline but It is not always a good idea to replicate it onto other national economies.

SLIDE5
When there is too much discipline in the financial system, the system might collapse and Central Bank should start acting to provide ELASTICITY.

The role of Central Bank has evolved over time. In 19th century they learned how to bring elasticity as a LENDER of LAST RESORT. Later on they have learned how to manipulate short-term interest rate. I shall show in the next slide the mechanics of this exercise.
Now the role of Central Banks has been broadened from maintaining CONSUMER PRICE STABILITY to maintaining FINANCIAL STABILITY. And for this Central Banks have developed different policy exercises. New techniques like QUANTATIVE EASING , OPERATiONAL TWIST or FORWARD GUIDANCE has been introduced recently. Not going into details, the investor and saver should be able to identify effects of these exercises by at least one CRITERIA: Is the measure going to bring ELASTICITY or DISCIPLINE into the financial system?

SLIDE 6
Here is how Central Bank artificially manages the hierarchy of financial instruments. By manipulating short term rate Central Banks could influence prices for securities. Empirically it is proved to be a very powerful remedy in ordinary times. But the crisis of 2008 was so deep that despite almost zero interest rates for overnight loans enougt ELASTICITY into the system has not been injected.

SLIDE 7
Let me bring to your attention a case from Lithuania. AS we have LITAS pegged to Euro since 2002, Lithuanian Bank is unable to introduce ELASTICITY into the financial system. There is one exception however - REGULATION of RESERVES kept by commercial banks. It was used once during the crises but it failed to bring much needed elasticity to Lithuanian financial market.
Acctually the discipline and elasticity MANAGEMENT POWERS in the Lithuanian financial system has been sold for a bargain to Scandinavian banks. These banks formed oligopoly (and possibly cartel) not only in the Baltic States market but at their home countries as well.
In 2008 they caused an extremally brutal introduction of DISCIPLINE using different exercises. You can see a chart on manipulation of VILIBOR rate. This affected 7-8 billion EURos of loans denominated in LITAS outstanding for local households and businesses. This action alone has transfered LIQUIDE and eventually ILLIQUIDE WEALTH calculated in hundreds of millions of Euros from borrowers to the lenders. Leaving the borrowers id est lithuanian businesses and households under an unbearable burden of debt and downsized prospect for survival. The managers of the banks in charge of these actions has really enjoyed their comparative advantage during the crises.

History repeats itself. When Vasa's royal house from Sweden took over as a monarch of the united Polish–Lithuanian Commonwealth in a late sixteen century (1587 to 1632) an unprecedented plundering of the country has been started. They were so passionate about this that many ships overloaded with artifacts and goods robbed sunk in the Baltic Sea unable to reach Swedish ports.

SLIDE 8
Another technique used by Central Banks - the manipulation of requirements for capital reserves.
When in a banking sector, the quality of loans worsens on a macro scale, Central Banks or threatened commercial entities themselves start to raise the capital requirements to form a buffer against possible loses. The government also seeks the bank's investors rather than the taxpayers to absorb these loses. Every one is keen to RAISE capital and diminish exposure on financial instruments. HOARDING of cash starts. This process called DELEVERAGING incepts a very dangerous and self-inducing vicious cycle. Or as we NOW may say – Pyramid contracts and more and more discipline gets injected into the system. By the end of 2008 investors witnessed DELEVERAGING on a scale compared with this of 1930s all over the Western World. As an example Iceland's banks exposure to financial instruments was extremely high as compared to its GDP. and this process took here an extreme magnitude . I am sure professor Ólafur Ísleifsson have much to say about this .
The deleveraging in the EU is not finished yet. The new rules of Eurozone's FISCAL COMPACT in place from 2016 will amplify the effects of private sector deleveraging. INVESTORS are put FIRST to pay for financial institutions failure so they would seek to form a precautionary capital against possible insolvency. There will be more DISCIPLINE introduced into the system . Because of this post-crisis adjustment retail investors and savers could lose money, as the price for securities might go down.

SLIDE 9
In the next three SLIDES I shall present empirical data on how the hierarchy of financial instruments changed its shape during crises. The picture demonstrates GOLD price dynamics. Now it is easy to explain in terms of the MONEY VIEW what happend. All participants are divesting lower quality financial instruments and trying to "climb up in the pyramid" to acquire higher quality assets and thus overcome LIQUIDITY CONSTRAIN.
After Central Banks have injectected more elasticity into the system prices start go down as Investors become less fearfull and start seeking riskier assets with a higher return. Ussualy it is securities.

SLIDE 10
In 2008 Central Banks have started to implement so called ACCOMODATIVE MONETARY POLICY. And you can see a significant rise in quantity of main CURRENCES. Also quantity of DEPOSITS has risen significantly (not reflected here)
To avoid collapse, the Central banks has done this exercise on unprecedented scale. As you remember we wittnessed first WorldWide concerted action performed by five CENTRAL BANKS.

SLIDE 11
From this Exhibit presented by McKinsey Global Institute we can see how world's financial stock evolved from 1990 till 2010. It shrunk by 15 percent during crises and rebounded above pre crises levels up to 212 trln USD in 2010. Its clear that global financial stock despite crises has strong tendency of growth. Derivatives here are not taken into account.

Of course global average downsize by 15 percent in financial stock does not illustrate situation in such countries as Lithuania and Iceland. The contraction of financial stock in these countries should be counted in times not percentage points.

SLIDE12
Before i finish, ladies and gentlemen, let me to provocate discussions by raising a question: does the creation and management of ARTIFICIAL HIERARCHY facilitate capital accumulation?

A study by Swiss physicists empirically revealed that a small number of around 150 mostly financial TRANSNATIONAL CORPORATIONS (TNCs in short) have constructed a network of economic power and took control of almost 2/3 of the Worlds economy.

They used a database ORBIS 2007 listing of 37 million companies and investors worldwide and pulled out 43060 TNC   and the SHARE OWNERSHIP LINKING them. It allowed for the scientists to construct a power network of superconnected TNCs. On the slide you can see twenty most powerful TNCs in the World.

I think this adds a new dimension to the findings of Thomas Pikkety in his famous book “ Capital in 21st century “. He has clearly showed us that then growth rate is less than the average rate of return on capital (and this is the case since 1970ies), the inequality of distribution of income rises on a compounding rate. This diverging force behind perennial capital concentration in some countries are so powerful that threatens or has already damaged SOCIAL FABRIC.

Only public initiatives on an International level can counter balance diverging forces fostered by patrimonial capital. Thats why such an initiatives like BETTER FINANCE for all needs to be strenghthenned.

I hope the MONEY VIEW presented here will be HELPFUL for retail investors and savers. THANK YOU.
TAKK FYRIR