

Contents

Chapter 1	Motivation for Understanding Liquidity Risk . . .	1
	1.1 Peso Problem	2
	1.2 Liquidity Risk—The Peso Problem of Our Time	3
	1.3 WorldCom	4
	1.4 Hedge Fund Returns	6
	1.5 The Structure of This Book	8
	Endnotes	9
Chapter 2	Liquidity Risk: Concepts	11
	2.1 Introduction	11
	2.2 What Is Liquidity?	11
	2.3 Model of Liquidity Costs	15
	2.4 Liquidity Risk and Liquidity Shocks	21
	2.5 Liquidity Risk Premium	25
	2.6 Why Bear Liquidity Risk?	32
	2.7 Liquidity-Driven Investing (LqDI)	34
	2.8 Liquidity Risk Exposure in Bank Balance Sheets	42
	2.9 Propagation of Liquidity Shocks: Systemic Risk	46
	2.10 From Liquidity Crisis to Credit Crisis	50
	Endnotes	52

Chapter 3	The Great Depression	59
	3.1 The Stages of a Liquidity Shock	59
	3.2 Recognizing a Liquidity Shock— Interpreting the Data	65
	3.3 Setting the Stage for the Trigger—the Background for the Great Depression	73
	3.4 Stage 1: The Trigger	79
	3.5 Stage 2: Change in Liquidity Demanded Throughout the Economy	82
	3.6 Stage 3: Changes in Bank Balance Sheets	85
	3.7 Stage 4: Banks Change Activities to Bolster Balance Sheets	87
	3.8 Stage 5: Effect on Liquidity and Availability of Credit Throughout the Economy	90
	3.9 Stage 6: Real Effects of Decline in Liquidity Observed Throughout the Economy	93
	3.10 Conclusion: The Great Depression, a True Liquidity Shock	98
	Endnotes	100
	References	103
Chapter 4	Japan's Lost Decade	105
	4.1 The Stages of a Liquidity Shock— Revisited and Expanded	105
	4.2 Recognizing a Liquidity Shock— Interpreting the Data	110
	4.3 Setting the Stage for the Trigger— the Background to Japan's Lost Decade	117
	4.4 Stage 1: The Trigger	124

CONTENTS

4.5 Stage 2: Change in Liquidity Demanded Throughout the Economy	125
4.6 Stage 3: Changes in Bank Balance Sheets ..	129
4.7 Stage 4: Banks Change Activities to Bolster Balance Sheets	141
4.8 Stage 5: Effect on Liquidity and Availability of Credit Throughout the Economy	149
4.9 Stage 6: Real Effects of Decline in Liquidity Observed Throughout the Economy	155
4.10 Conclusion: Japan's Lost Decade, a Liquidity Shock That Dragged On	161
Endnotes	162
References	169
 Chapter 5 The Great Recession	173
5.1 The Stages of a Liquidity Shock—Same Applies Now as with the Great Depression	173
5.2 Recognizing a Liquidity Shock—Interpreting the Data	176
5.3 Setting the Stage for the Trigger—the Background to the Great Recession	182
5.4 Stage 1: The Trigger	196
5.5 Stage 2: Change in Liquidity Demanded Throughout the Economy	201
5.6 Stage 3: Changes in Bank Balance Sheets	205
5.7 Stage 4: Banks Change Activities to Bolster Balance Sheets	212

THE GLOBAL ECONOMIC SYSTEM

5.8 Stage 5: Effect on Liquidity and Availability of Credit Throughout the Economy	217
5.9 Stage 6: Real Effects of Decline in Liquidity Observed Throughout the Economy	224
5.10 Conclusion	237
Endnotes	238
References	243
Chapter 6 Conclusion	247
6.1 A Liquidity Crisis	247
6.2 Bank Accounting Changes	249
6.3 Bank Nationalization	250
6.4 Debt Guarantees	252
6.5 Central Bank Lending	253
6.6 Monetary Policy	255
6.7 Fiscal Spending	256
6.8 Preventing Liquidity Crises	258
Endnotes	259
Index	261