What Were Once Vices Are Now Habits

Old black water, keep on rollin'
Mississippi moon, won't you keep on shinin' on me
-- Doobie Brothers, "Black Water"

The central banks of the West announced today via an ECB press release that "their existing temporary bilateral liquidity swap arrangements are being converted to standing arrangements."

These swap lines were a big part of what saved the world in the dark days of late 2008 and early 2009. Like QE, this was an emergency policy measure that prevented a liquidity crunch from becoming a liquidity panic, a Great Recession from becoming a Great Deflationary Spiral. But also like QE, this emergency policy response has now been institutionalized and transformed into a permanent government program. The ECB explains that the permanent swap lines will "serve as a prudent liquidity backstop" that can "ease strains in financial markets and mitigate their effects on economic conditions". In other words, the *meaning* of central bank swap lines has changed in exactly the same way that the *meaning* of QE has changed, from a massive policy intervention against an acute and life-threatening economic injury to a massive insurance program against a chronic and annoying economic condition.

Is this a big surprise? No. This sort of bureaucratic capture and expansion is what *always* happens in the aftermath of an economic shock that's the equivalent of losing a medium-sized war.

Is this a bad thing? I don't know how to answer that question. Compared to what? I do believe that there is a *cost* associated with these gigantic insurance programs, particularly in the way that they ossify a deeply disappointing status quo. These insurance policies may buy time for structural economic reforms, but they are even more effective at eliminating the political will for those same reforms. A Mississippi River of liquidity can mask insolvency for a looooooong time, even national insolvencies, which is why these monetary insurance policies are so politically popular across the globe. But without the recognition of insolvency and the assignment of losses, without a deleveraging of the public sector as well as the private sector … well, we're all zombies now, consigned to wander listlessly across a low-growth world. Reasonably happy zombies, to be sure (Spain exits recession with a 0.1% annualized quarter-over-quarter growth rate! Huzzah! S&P at record highs! Double Huzzah!), and maybe that's good enough for the human animal in the 21st century. Certainly it's good enough for now.

Maybe the future belongs to the happy zombies forever and ever, in which case we can all put our money into passive stock ETF's and call it a day. But I'm betting it doesn't. These shifts in *meaning* within the social forces that control our world create *structural change* in social institutions like markets. Always have. Always will. You can't predict the form of that structural change in advance, and it's always a bumpy ride. That's what it means to live in a world of uncertainty as opposed to merely a world of risk, that's why I think adaptive and behaviorally-focused investment strategies hold such promise, and that's what Epsilon Theory is trying to explore.

