

Ultra-Easy Money: Digging the Hole Deeper?

Presentation by W R White

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The Consensus View on the Global Economy

- Most forecast slow recovery and low inflation
- Consistent with a return to “equilibrium”
- But in complex, adaptive systems there is no “equilibrium”
- While the search for efficiency has put us on a bad path
- With easy money playing a particularly dangerous role

The Lead Up to the Crisis of 2007

- Demographics, the “fall of the wall” and global disinflation
- Fiat money and irrational exuberance in AME’s
- Leading to real and financial “imbalances”
- Spreading to EME’s via semi-fixed exchange rates
- In short, an accident waiting to happen
- And the policymakers all missed it

Ultra Easy Monetary Policy: Why it Hasn't Worked as Intended

- Premised on belief that it will stimulate demand BUT
- Smacks of panic and raises levels of uncertainty
- Bringing spending forward only works for a while
- Consumers restrained by many factors including debt
- While corporate investment also faces headwinds
- Just as Keynes himself suggested

Ultra Easy Monetary Policy: Why Unintended Consequences Matter

- McKinsey says global debt ratios are almost 20 percentage points of GDP above pre crisis levels
- Asset prices in AMEs raised to unsustainable levels?
- Risk Off/Risk On investment patterns and other market “anomalies”
- Threatened financial institutions also lower “potential” growth
- EME corporates run many risks
- Other “unintended consequences”?
- More dangers now than in 2007?

Regional Weaknesses with Potential Global Implications

- Every major geographical region has serious economic problems
- Often compounded by political difficulties
- Could problems anywhere spread everywhere?
- As IMF and OECD simulations seem to imply
- And our macro tools are all used up?

Global End Games: Sustained Recovery Possible But Not Certain

- **Assume** global recovers strengthens
- Policy rates and long rates (“exit”) could rise in an orderly way
- Prospective growth supports elevated price of other assets
- But inflation must be kept well under control
- However, many reasons for expecting a disorderly “exit”
- Which could also threaten the **assumed** recovery

Global End Games: World Slowdown or Worse?

- **Assume** slowdown or global recession
- Implies policy rates and long rates stay low
- But other asset prices fall sharply
- Increasing the risks of “debt deflation” and a policy response
- Financial repression and still more aggressive monetary policy?
- Leading to hyperinflation in countries with a bad fiscal situation?

Could Government Policies Help Crisis Resolution?

- Central banks cannot resolve insolvency problems
- Both Hayek and Keynes were “right”
- The need for orderly debt restructuring and structural reform
- Fiscal expansion today and credible restraint tomorrow
- The need to revisit factor shares, not only in China

And Why Such Changes are Unlikely

- Resistance from governments and others affected badly
- The difficulty of paradigm shifts in “normal” times
- The difficulty of paradigm shifts in “abnormal” times
- Complications due to the false beliefs of others
- The special problem faced by central bankers

GOOD LUCK TO NABE ECONOMISTS – YOU MIGHT JUST NEED IT