Beyond the Great Moderation

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Recent History

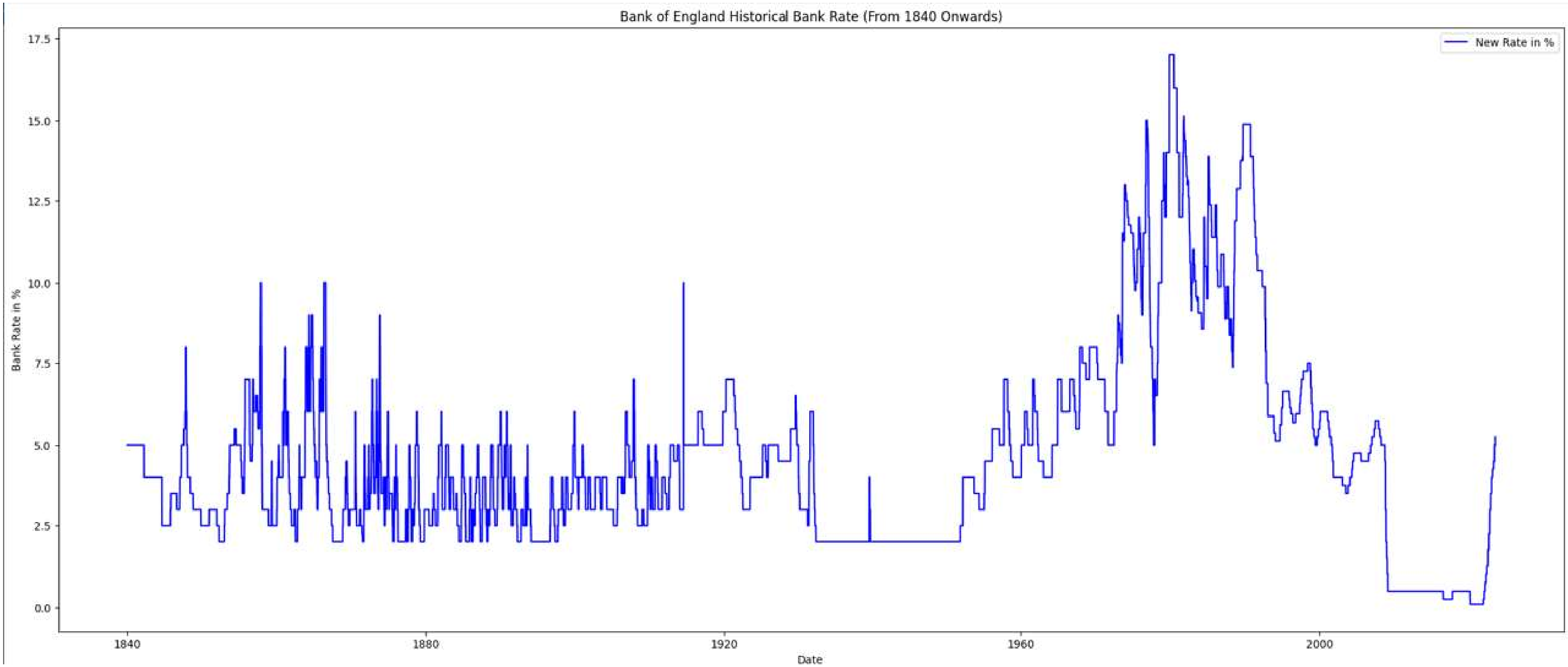
The last thirty years were *not* normal, indeed particularly NICE, non-inflationary, continuous expansion (ex GFC). Features were:-

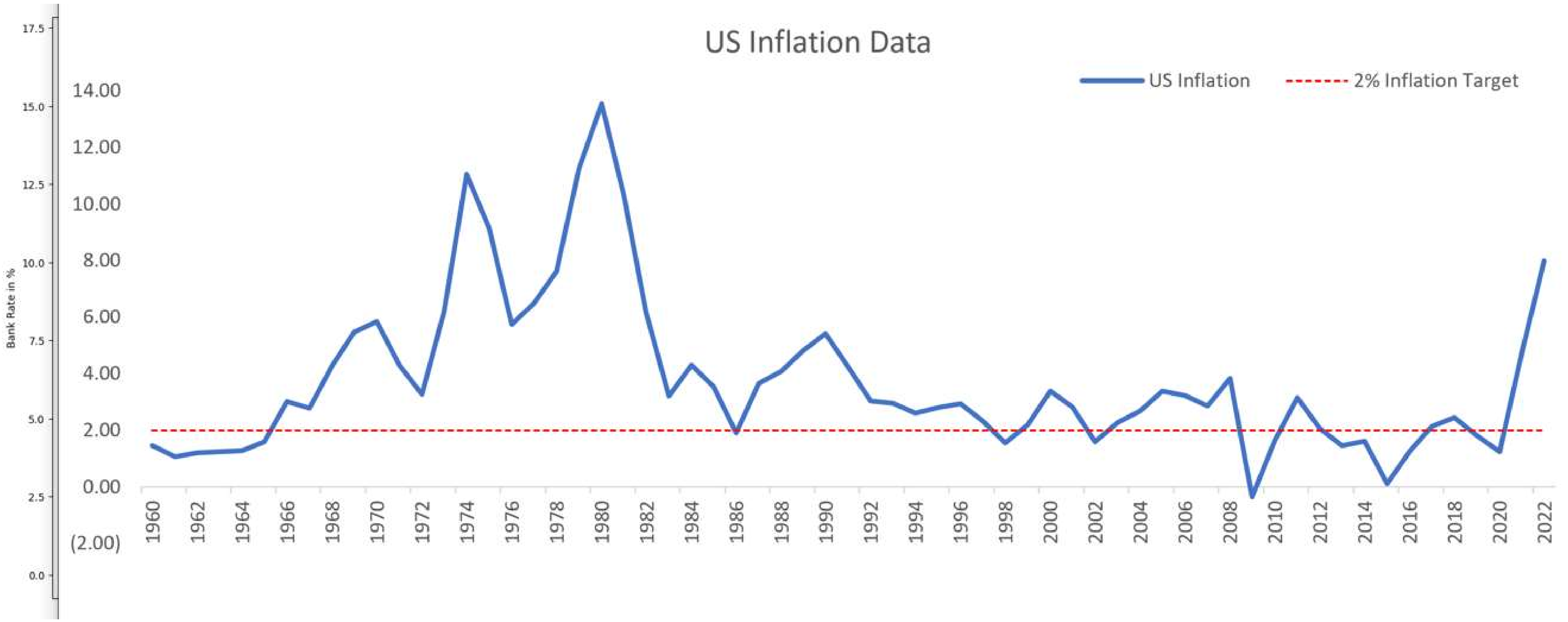
1) Interest rates, especially official short rates, falling to, and staying at, unprecedently low levels;

2) Inflation dropping to, or even below, 2% target;

3) More people taken out of poverty than ever before;

4) Growth was uneven, but overall good.


Bank of England Historical Bank Rate (From 1840 Onwards)
New Rate in %
Bank Rate in %
17.5
15.0
12.5
10.0
7.5
5.0
2.5
0.0
1840
1880
1920
1960
2000
Date



US Inflation Data
US Inflation
2% Inflation Target
Bank Rate in %
14.00
12.00
10.00
8.00
6.00
4.00
2.00
0.00
(2.00)
1960
1962
1964
1966
1968
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012
2014
2016
2018
2020
2022

What were reasons for good outcome:-

1) Demography; Baby boom, 1945-65, entering work force; falling birth rate enabling more women to enter labour force; internal migration; subsistence farming to factories.
2) Geopolitics: China and E. Europe.
3) Better policies?

Central banks take too much credit for these outcomes, and excessively worried about deflationary spiral. Result has been over-inflated asset prices and inequality, blamed on immigrants, leading to Populism.

Basic Problems Arising

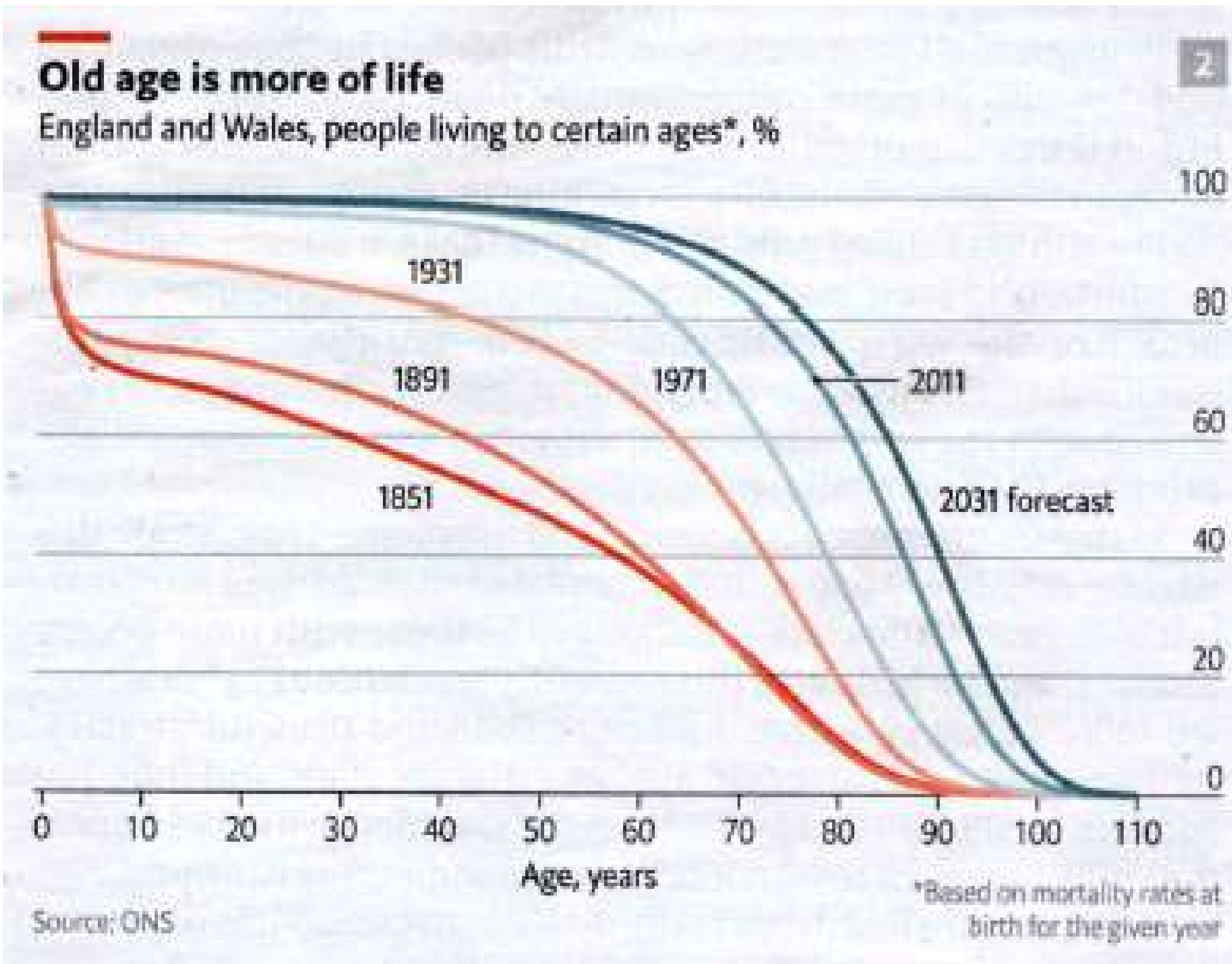
Christine Lagarde's three Ds:-

1) Demography
2) Decarbonisation
3) Deglobalisation

Not competent to speak about (2) and (3), except to note that both will be very expensive, and that we are currently failing in both.

Demography

- Life expectancy rising, mainly because fewer people dying before they reach 80.



- Little progress on diseases of the old, e.g. Dementia, Parkinson's, though lifestyle better. What matters is incapacity, not so much age by itself.

- Downwards trend in birth rate, well below sustainability.

- Ratio of workers to incapacitated.   Can technology help?

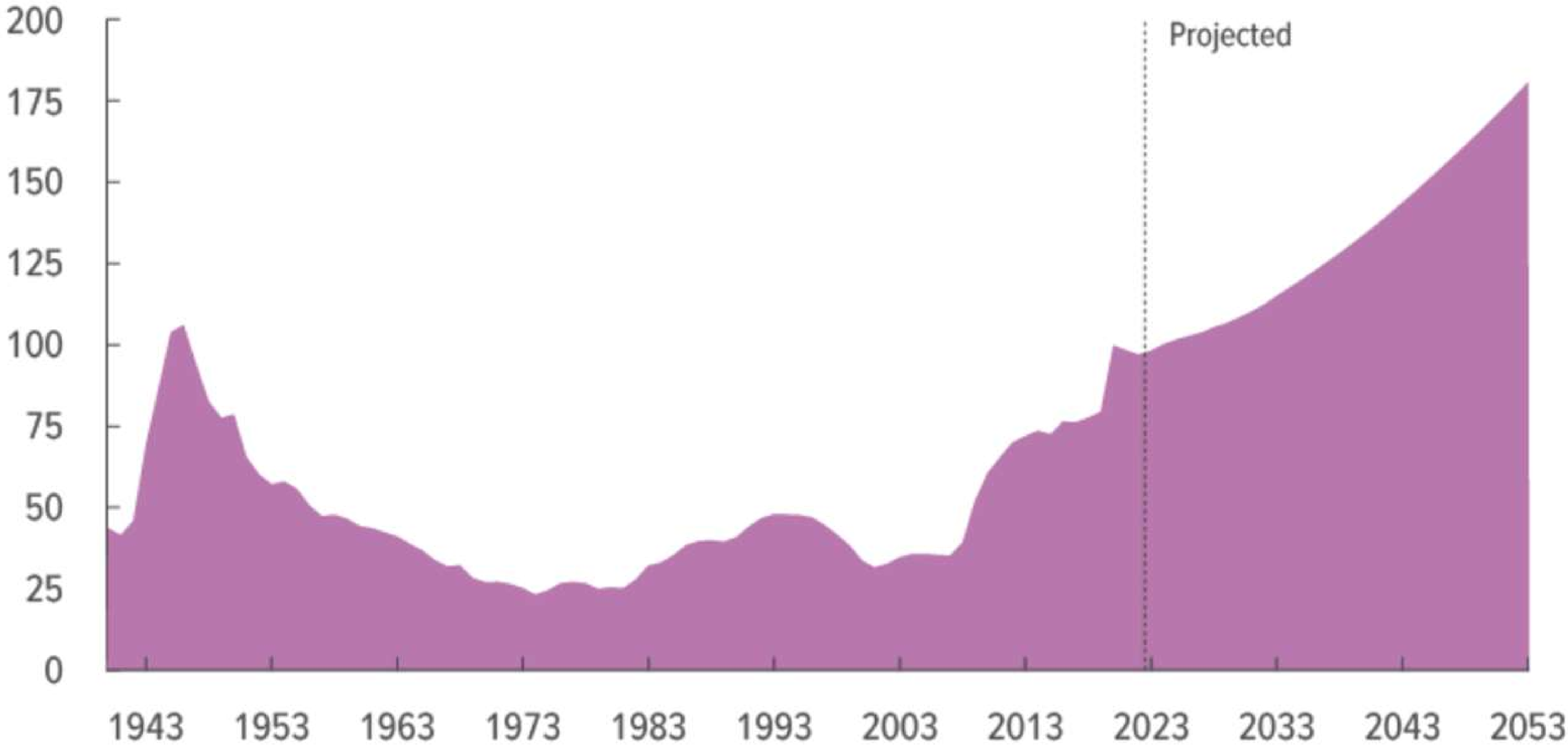
Main Policy Problems

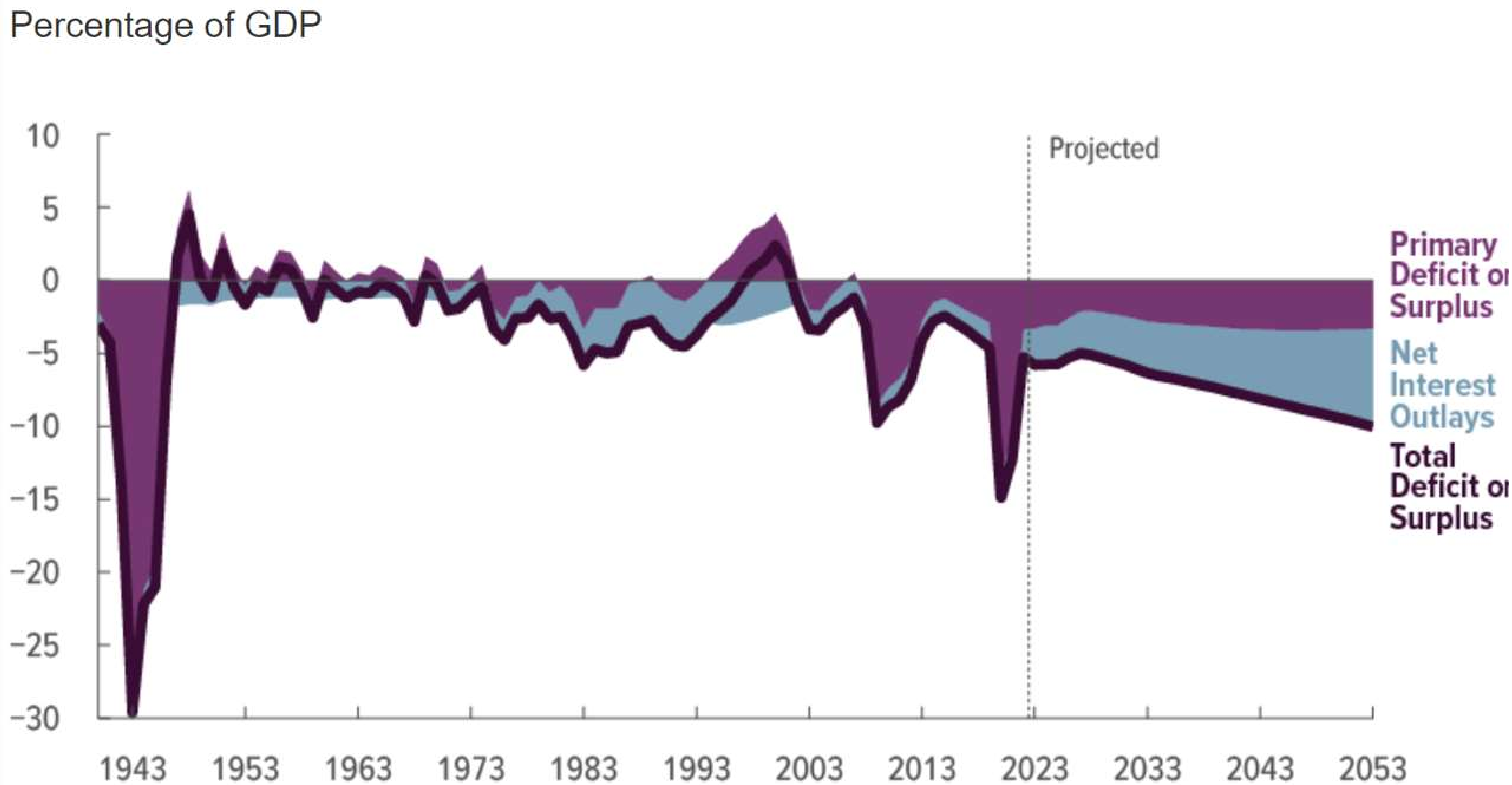
Fiscal Problems

On present problems governmental deficits and debt on unsustainable trajectories, especially in the U.S.A.

Federal Debt Held by the Public

Percentage of GDP





Percentage of GDP
10
5
0
−5
−10
−15
−20
−25
−30
Projected
1943
1953
1963
1973
1983
1993
2003
2013
2023
2033
2043
2053
Primary Deficit or Surplus
Net Interest Outlays
Total Deficit or Surplus

But cutting public expenditures or raising taxation is politically very hard to do. Tendency to hope for the best (a growth miracle) and leave solution to some future government.

That, plus demographic pressures, will lead to endemic inflation problems, and the potential onset of bond market crises. Liz Truss was a canary in a coal mine.

Longer Term Problems for Central Banks

Will there be fiscal dominance? How could the CB cope with a collapsing bond market? Worries about doom loop? Long bonds carry interest rate risk. Of particular concern to EU. Revise of Stability and Growth pact.

Will financial repression occur? But needs external capital controls. Probably needs a financial crisis to be imposed.

Impose tax burdens on banks? But shift of intermediation business to NBFI, less transparent and less well regulated.

Short Term Outlook

Geopolitics. Conflicts. Trump.

Assuming these do *not* blow up, then headline CPI falling to target, and output stagnant, so cuts in nominal rates, even though core inflation, and wages/unit labour costs, above levels consistent with target.

If so, 2024, would be a comfortable year for CBs, with:-

1) Falling headline inflation
2) Slowly falling nominal interest rates
3) Some slow recovery in growth

But, beware 2025 and future decades.

None of the 3Ds are yet looking good.

Best of luck to us all, especially to the young!