EVENTS MPF

Monetary Policy Forum 2018 Q4

Time to lay off the monetary meds

12 December 2018 Kevin Loane

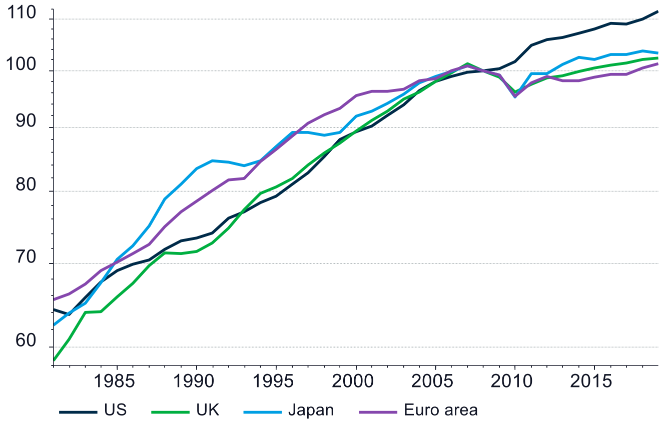
Last Friday, at an event hosted in partnership with Refinitiv, we called for the advanced economies to shift decisively to a higher yield environment. Ten years before, in the throes of the most severe global financial crisis for 80 years, Fathom used the first Monetary Policy Forum (MPF) to argue strongly in favour of unconventional monetary policy, such as quantitative easing (QE). A decade on, in the final quarterly instalment of the MPF, we called for these policies to be reversed in order to escape the low growth, low interest rate environment that the advanced economies remain stuck in. We were joined by former Bank of England policymakers Sir Charlie Bean, Rachel Lomax and Andrew Sentance. Our clients can access the slides from the event by clicking here.

The event began with a Fathom presentation on economic developments in the advanced economies since the advent of independent central banking in the UK 21 years ago. Since the Global Financial Crisis, while independent central banks have broadly met their inflation targets, it has come at the cost of severely negative side effects including financial imbalances and dire productivity growth.

We expect a US-led global recession in two years for reasons that we have previously outlined to clients. When the next recession arrives, policymakers will find themselves with few tools in the cupboard to deal with it. Even without a recession, the advanced economies were facing the prospect of a permanent bad equilibrium: high debt, low interest rates and low productivity growth.

Labour productivity

Index 2007 = 100, log scale



Source: Thomson Reuters Datastream / Fathom Consulting

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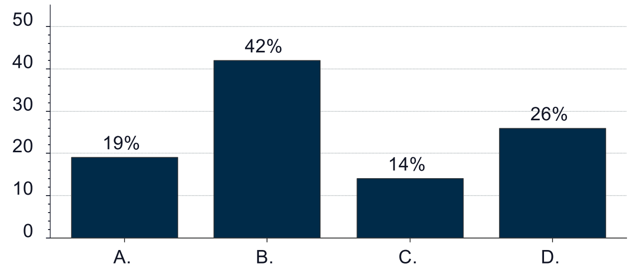
The current macroeconomic policy framework is not only not helping, it may in fact be making things worse. Monetary policy is maxed out and looks to be undermining the supply side as record low interest rates are keeping unviable ‘zombie’ firms in business. There is some hope for fiscal policy, but in all likelihood it will not be able to pick up fully the slack from monetary policy. Economists need a third dimension. Macroeconomic policy needs to be better coordinated and should not simply target inflation, but also respond to other variables, such as financial imbalances, that destabilise and undermine growth.

Our panellists then gave their assessment of the Fathom view. Sir Charlie Bean acknowledged the large number of potential downside risks to the global economy, but said that he felt that the policy cupboard was less bare than Fathom made out. In his view, central banks could find ways to reduce the real rate of interest, such as by increasing their inflation targets. Andrew Sentance agreed that low interest rates may now be having a negative impact on economic growth. However, for him, it was not just about zombie firms, but also about the lack of positive incentives that real interest rates provide. From his standpoint, central banks had become less independent in recent years, as evidenced by increasing consensus among MPC members. He was fairly sanguine about the current levels of government debt, noting that these were not far from the historical average. Rachel Lomax was of the view that it was not just that central bank mandates were too narrowly conceived, but also that institutions suffered from a lack of joined-up thinking.

We closed the event by inviting our audience to express their own views on the macroeconomic and financial market outlook.

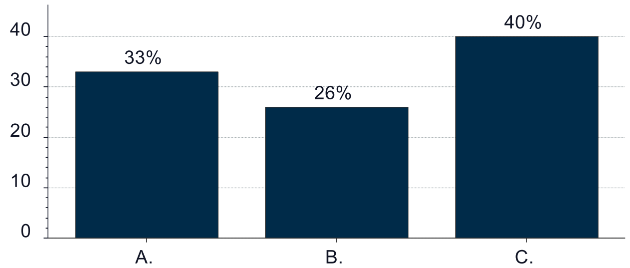
When are we likely to see the next recession across the major economies?



A. 2019
B. 2020
C. 2021
D. 2022 or later

Source: Thomson Reuters Datastream / Fathom Consulting

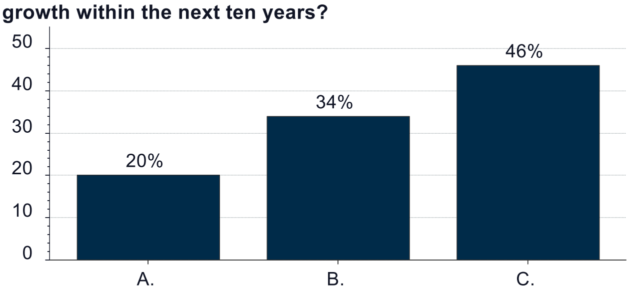
Do policymakers in the major economies have the tools to fight the next recession?



A. Yes, through a combination of (unconventional) monetary policy and fiscal policy
B. Yes, but only fiscal policy will be effective
C. No, neither monetary nor fiscal policy will be effective

Source: Thomson Reuters Datastream / Fathom Consulting

Will the major economies return to pre-crisis rates of productivity growth within the next ten years?



A. Yes, productivity growth will return to its historic average with no government intervention
B. Yes, but only when interest rates reach pre-crisis levels
C. No, the major economies are in a period of secular stagnation and there is nothing that can be done about it

Source: Thomson Reuters Datastream / Fathom Consulting

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