

The monetary policy dead end

By Christopher Dembik

The Federal Reserve's September status quo proved how difficult it is for central bankers to bring an end to the emergency measures they adopted in the aftermath of the 2007 crisis. Fed chief Janet Yellen's hesitations and the market turmoil since August seem to validate that it is impossible to stop the accommodative monetary policy, unless you accept that doing so would trigger a new global crisis.

Markets have been used to living in a protracted low rate environment, which led to a \$57 trillion increase in public and private debt between 2008 and 2015. The surge of public debt represents almost half of this growth. It is the result of the fiscal stimulus and rescue measures taken to save the global banking system. In most advanced countries, household debt has also increased, except in the US where the financial situation of households has improved due to the default on real estate loans.

The Fed is aware that raising interest rates too fast and too high could have the same effect as pressing the nuclear button. The whole system could collapse and it cannot be taken for granted that the central banks would be able to extinguish the fire this time. Their strike force has weakened because their balance sheets are exposed to market fluctuations and their credibility was seriously damaged because the measure they have taken have failed to strengthen the economy.

The comeback of financial excesses

The same mistakes that led to the financial crisis are now happening again worldwide. Access to credit, hardened for some time, is softening, leading to over-indebtedness and speculative bubbles. In the United States, first-time buyers can get loans covering the equivalent of 97% of their purchase. In the UK, the housing market moves the same way thanks to a first-purchase aid programme launched in 2012. It met such success that first-time buyers now account for half of real estate loans, a proportion not seen since 2000.

David Cameron's ambition to make the United Kingdom a country of owners is about to be achieved. An easier access to credit, particularly for first-time buyers, was systematically the political answer to favour the forgotten ones of globalisation.

During the past 20 years, only two parts of the world's population have seen their income grow: the Chinese and the top 1%. At the opposite end of the spectrum, the middle and working classes in western countries, as well as the poorer, have benefited sparsely from the economic spinoffs of the increasing commercial exchanges and trade restrictions removals.

Their stagnating incomes urged them to borrow at attractive rates to maintain their living standards which, until now, allowed social peace. Nevertheless, this patch found by the political authorities is illusive. Should even a slight rise occur in interest rates, the most fragile households will prove unable to make their loan repayments, with consequent negative effects on demand and economic activity.

Increasing income inequality

Even if European GDP rises at 2% per year in the next few years, leading to a decrease of the unemployment rate, this growth would be nothing but a flash in the pan as the financial system hasn't actually been drained and no serious anti-inequality fight has started. We live in the middle of a huge speculative bubble, possibly bigger than in 2007 because of the rise of shadow banking and quantitative easing by central banks.

We can credit economist Thomas Piketty for picking on the figure of the *rentier*, as John Maynard Keynes did decades before, but his long-term analysis forgets the misdistribution of incomes, despite the fact that this element is enough to explain the last crisis and the one we are leaning towards.

The 1914-1950 period enabled an unprecedented decrease of income inequality, but that movement was then brutally stopped. The wage differential between those who have access to knowledge and technology and those whose instruction is insufficient for highly qualified jobs is increasing and will increase with the digitalisation and robotisation of the economy. This increasing income inequality explains why demand, a traditional supporting factor in the advanced economies, is no longer sufficient to restart growth.

There is no readymade solution available to impulse a better wealth distribution. Everyone knows that keeping interest rates low longer is not the solution. It prepares the ground for a new financial crisis. From this perspective, we certainly have to get used to the idea that capitalism will suffer more and more frequent upheavals, given the fact that households are not ready to accept a reduction of their consumption and that politicians are reluctant to focus on the core issues.

Bien cordialement | Best regards Dembik Christopher | Economist

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