Unconventional Monetary Policy

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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

Unconventional Monetary Policy: the Facts

- Hitting the Zero Lower Bound
- Quantitative easing
- Qualitative easing and Operation Twist
- Forward guidance
- Negative rates on bank reserves
- What next?

Unconventional 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

Unconventional Monetary Policy: 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?

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?

Implications for Governments and Central Banks

- Central banks have “bought time” for governments to act
- Now governments must do what only they can do
- But “politics” implies they will fail to act
- Leaving central banks to do “more of the same”
- And taking the blame when things go wrong.