Macroeconomic Policies against Secular Stagnation

1. From Monetary Policy only (Negative Interest Rates, Quantitative Easing)
2. to Money-Financed Fiscal Stimuli (Helicopter Money)
3. to "pure" Fiscal Policy

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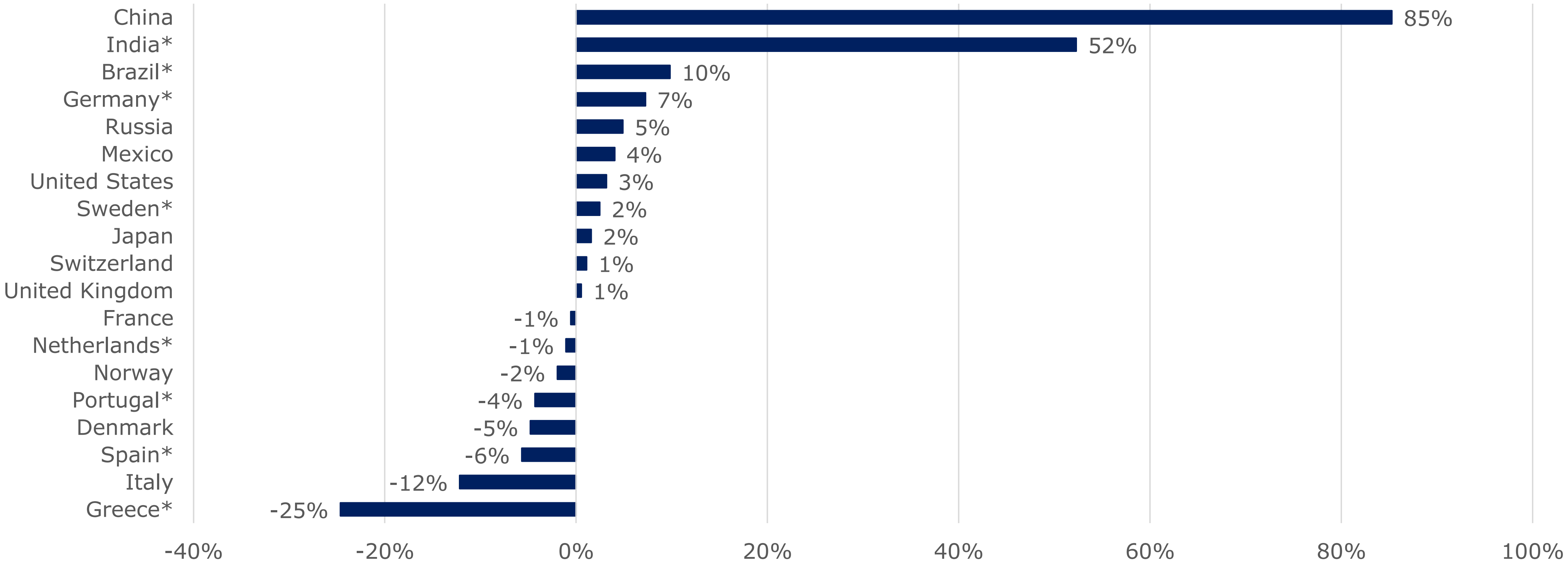
The Economic Scenario: some Effects of the Great Recession and related economic policies choices

Real per-capita GDP, cumulative change over the period 2007 – 2015:

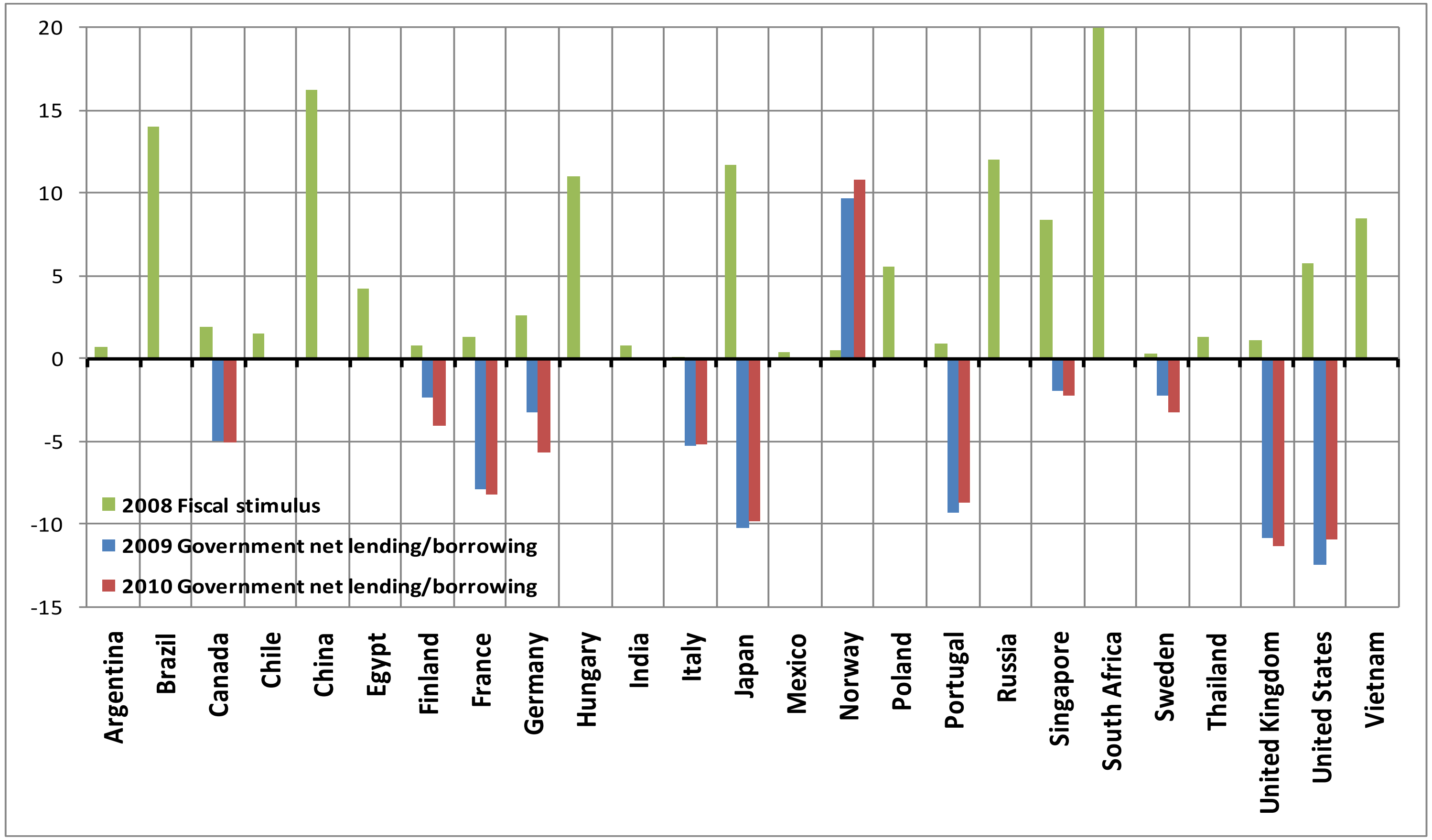


Source: IMF's World Economic Outlook, October 2016

Asymmetric Macroeconomic Policy Responses to the 2007-2008 Crisis

Fiscal policies in the immediate aftermath of the Great Recession

Fiscal stimuli enacted to counter the crisis and public deficits 2009 and 2010 (% of GDP)

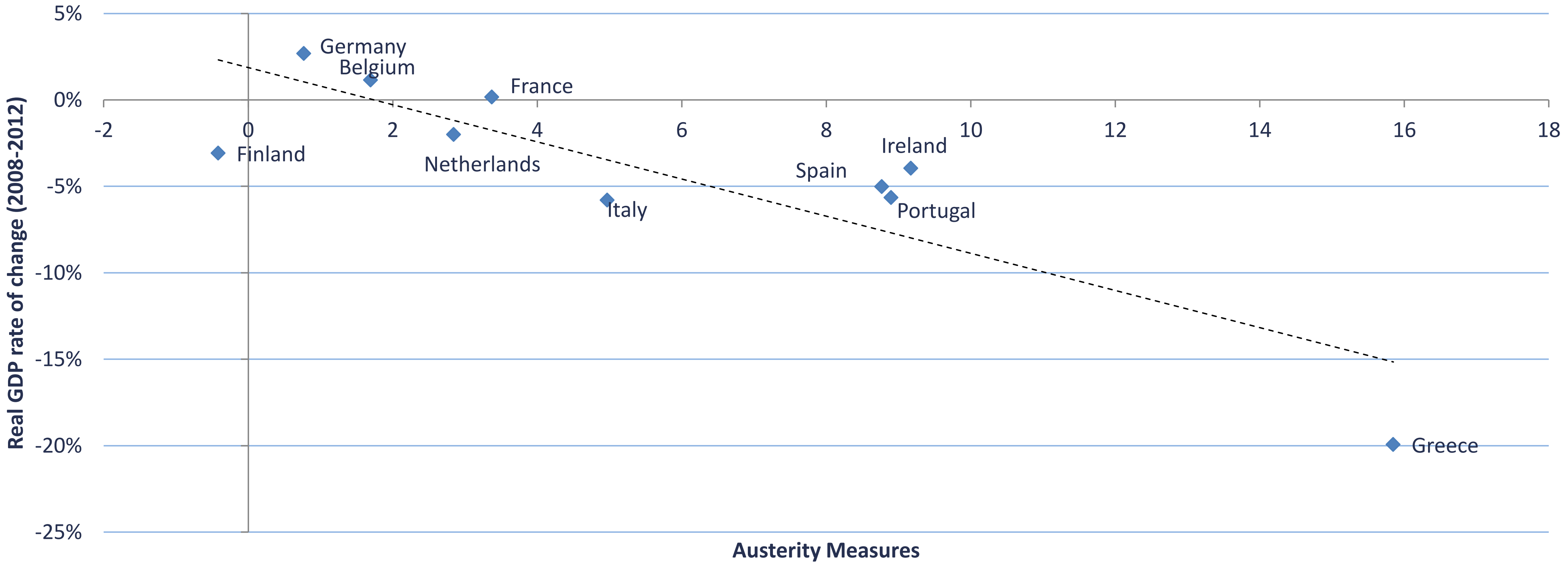


Sources: Gallagher, Kevin P., et al, Survey of Stimulus and IMF Rescue Plans During the Global Financial Crisis; FMI, WEO Database, April 2010

Asymmetric Macroeconomic Policy Responses to the 2007-2008 Crisis

Then, above all in Europe, the austery ideology arises

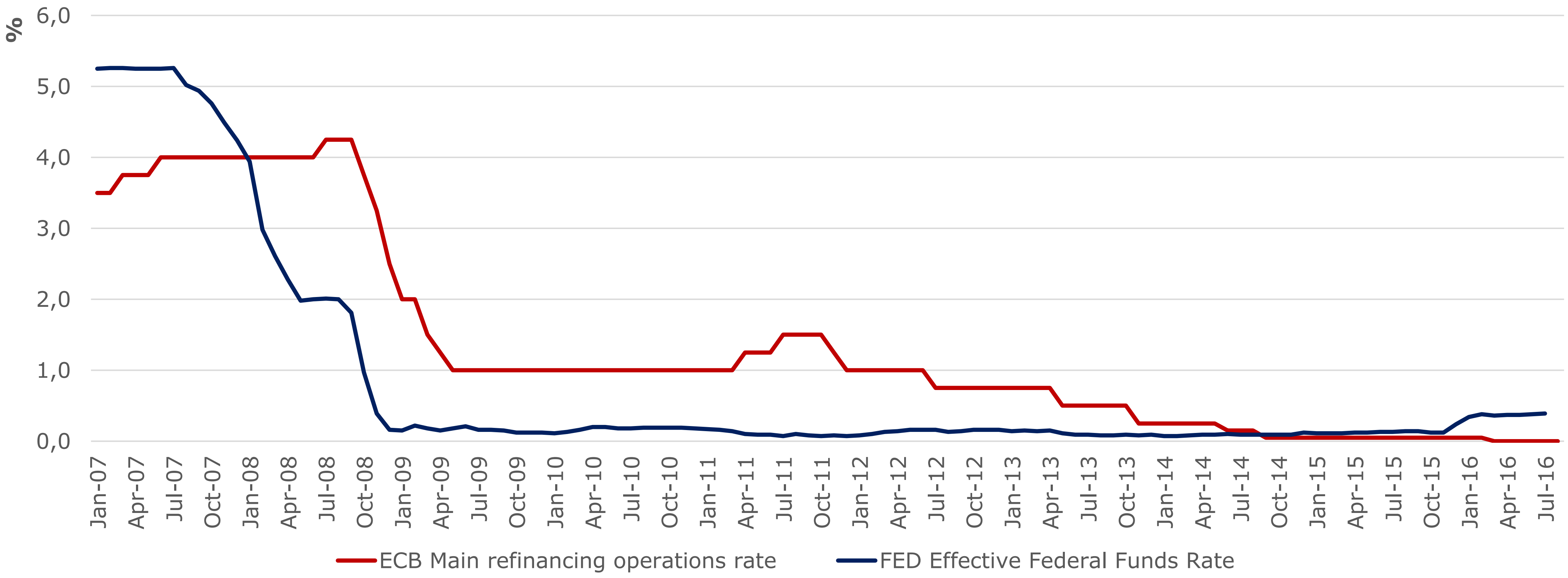
Austerity measures* – spending cuts and tax increases 2009-2012 - as a share of GDP, as estimated by the International Monetary Fund and real per-capita GDP growth



Source: IMF, World Economic Outlook, April 2013; IMF Fiscal Monitor, October 2012; * Austerity measures are defined as the cyclically adjusted primary balance (CAPB) needed to reduce debt; this is the CAPB required in 2020 to reduce the debt-to-GDP ratio to appropriate levels, as defined in IMF Statistical Tables

Asymmetric Macroeconomic Policy Responses to the 2007-2008 Crisis
Traditional Monetary Policy Response

ECB Main Refinancing Operations and FED Effective Federal Funds Rate (%), monthly data, Jan. 2007 – Aug. 2016

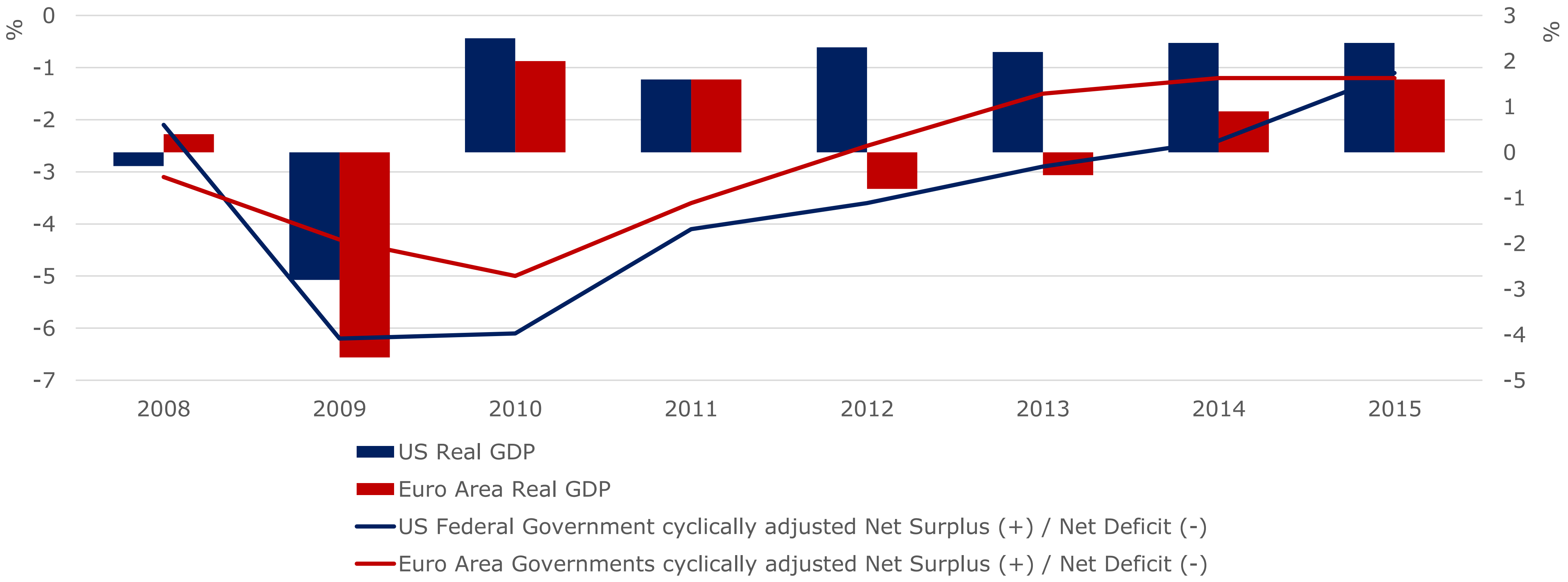


Source: Fred St. Louis, ECB, October 2016; data for the FED are available till Jul. 2016

Asymmetric Macroeconomic Policy Responses to the 2007-2008 Crisis

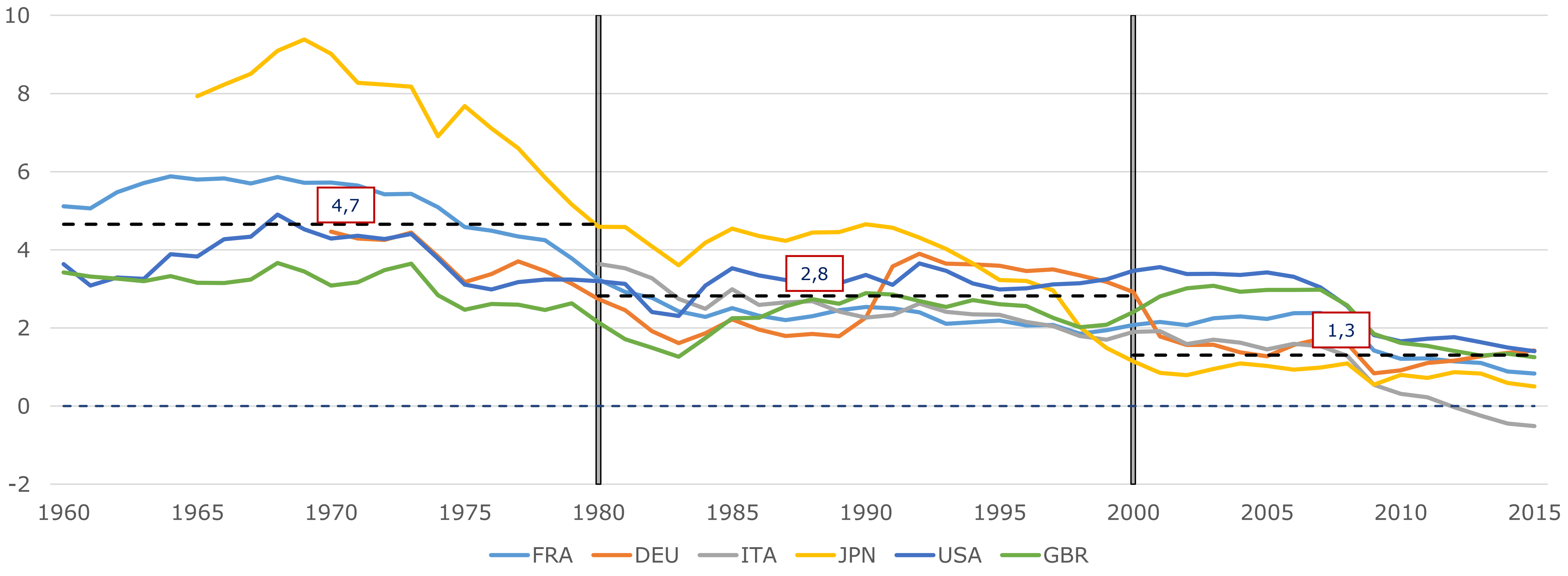
The Role of Fiscal Policy in stimulating US Economy Growth

US and EA Governments cyclically adjusted surplus/deficits (% GDP, left axis) and Real GDP Growth Rate (annual % change, right axis), annual data, 2006 – 2015



Comparing Pre- and Post-2007 Real GDP Growth: the Secular Stagnation Hypothesis

Real GDP Growth, % change over the previous year, 1960 – 2015, 10Y moving average

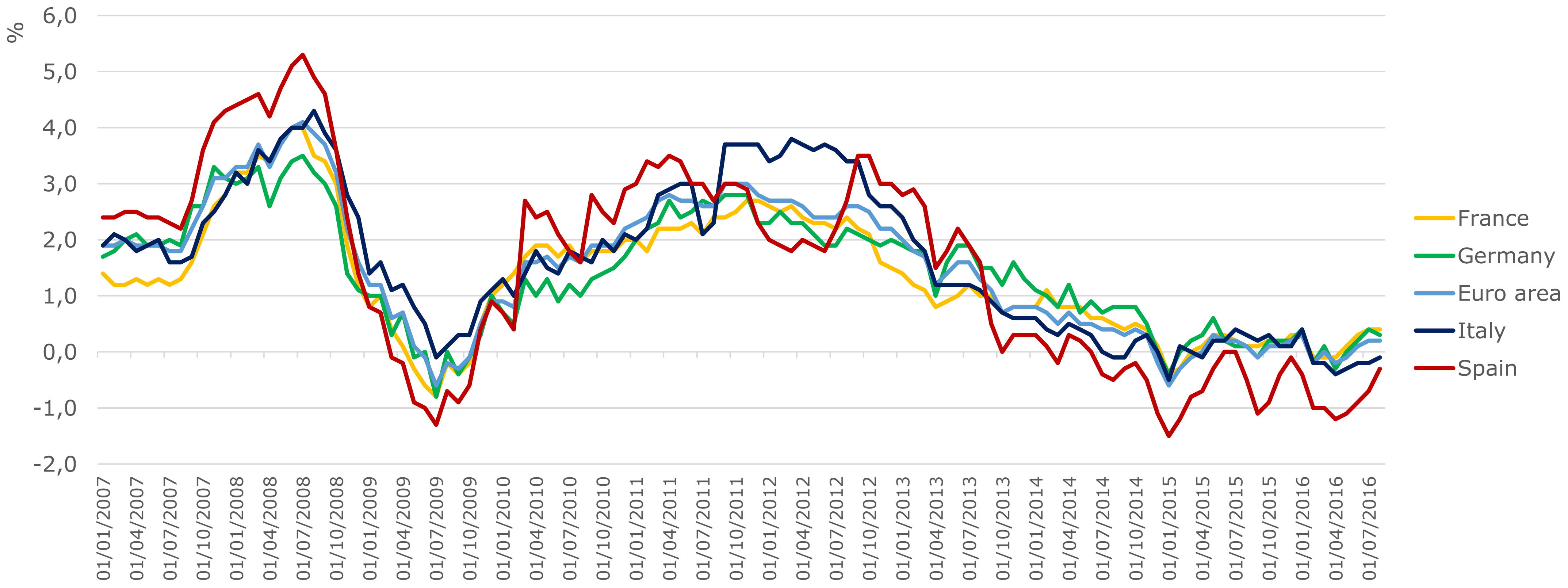


Source: Institute for Fiscal Studies

What exactly will lead us out of stagnation?

Monetary Policy has proven ineffective in maintaining the target inflation rate

Annual rate of change of Harmonized CPI, monthly data, Jan. 2007 – Aug. 2016

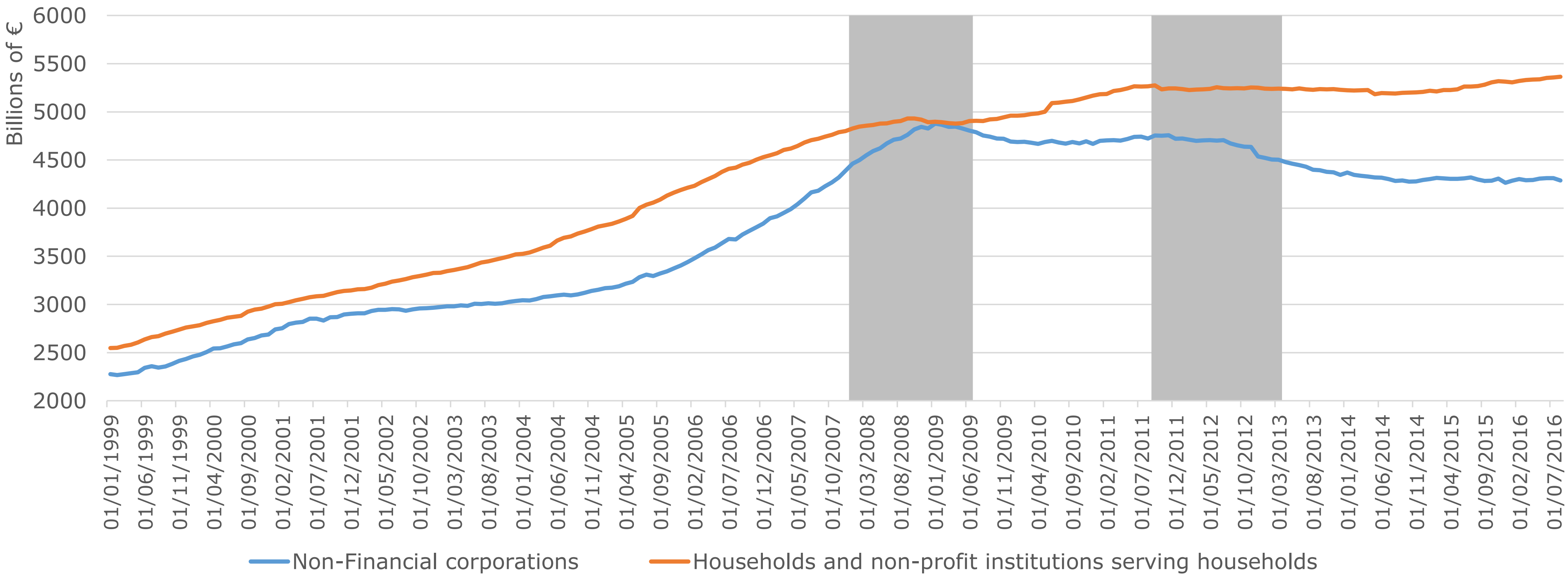


Source: Eurostat, October 2016

What exactly will lead us out of stagnation?

Monetary Policy has proven ineffective in stimulating investments

Loans to Non Financial Corporations and households, Euro Area, (Billions of €, outstanding stock at the end of the period), Jan. 1999 – Aug. 2016:



Source: ECB, October 2016; in grey EA recessions

What exactly will lead us out of stagnation?

From Monetary Policy only to Money-Financed Fiscal Stimuli (Helicopter Money)?

- Definition: **overt monetary finance of fiscal deficits**, i.e. creating additional fiat money to finance increased fiscal deficits
- Original thought by Milton Friedman (1969), *The Optimum Quantity of Money and Other Essays*. Basic idea: to scatter dollar bills from a helicopter so as to stimulate consumer spending
- Different applications:
  1. **The government** issues a zero-interest rate, non-redeemeable bond, acquired by the central bank
  2. **The Government** either **spends** on investment projects or electronically transfers money to private deposit accounts held at commercial banks
  3. **Commercial banks** are credited with additional reserves at the **central bank**, remunerated at a zero interest rate =electronic "money printing" instead of dollar bills "drops")

What exactly will lead us out of stagnation?

US Presidential campaign and election shifting emphasis: from Monetary Policy only to "pure" Fiscal Policy

Fiscal Policy

- **Mr. Trump's** tax plan would reduce the **top individual income tax rate** to 33 per cent (down from today's 39.6%) and the corporate tax rate to 15 per cent and eliminate the estate tax
- **Mr. Trump's** plans for cutting personal and business taxes would, according to analysis from the Tax Policy Center, lead to a rise in the federal debt by $7.2tn over the first decade.
- **Mr. Trump's** transition team has pledged to invest **$550bn in infrastructure** and has spoken of ramping up defence spending

→ Adoption of Expansionary Fiscal Policy

Both **Bernie Sanders** and **Hillary Clinton** were advocates of increasing government spending while increasing tax rate on «top income» household.

The main difference we will see is how the benefits will be distributed?

Monetary Policy

- **Mr. Trump** said in November Ms. Yellen "should have raised" interest rates and suggested she hadn't for political reasons
- **Mr. Trump** could appoint hawks to the two Fed Board seats that are currently vacant, and he could replace Yellen when her term expires in 2018
- **Ms. Janet Yellen**, Federal Reserve chairwoman, told a congressional hearing on Thursday 17th November that an increase in short-term interest rates could "become appropriate relatively soon"
- **Ms. Yellen** said it was "critically important" that central banks had the freedom to make judgments about how best to pursue their goals: "Sometimes central banks need to do things that are not immediately popular for the health of the economy; We've really seen terrible economic outcomes in countries where central banks have been subject to political pressure."

→ Adoption of less expansionary Monetary Policy

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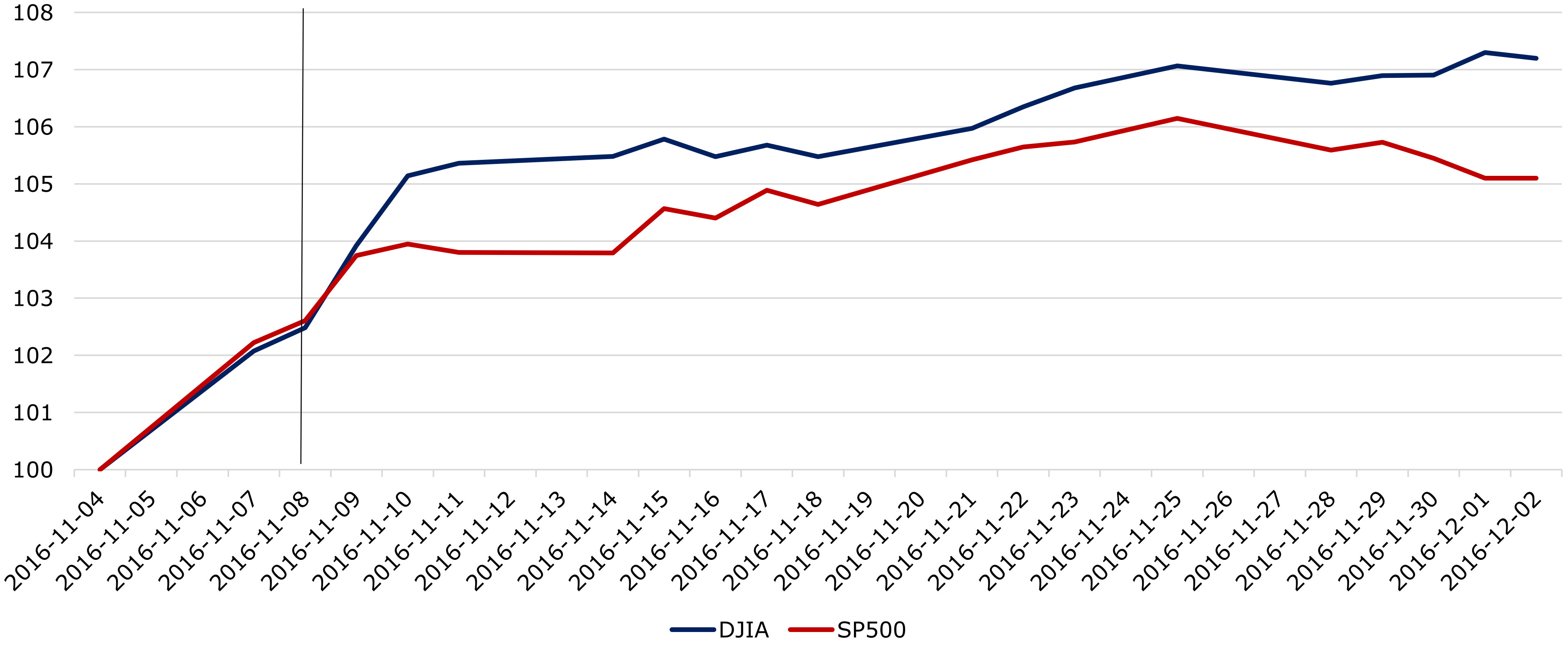
Immediate effects: financial markets

Dow Jones Industrial Average (DJIA) and Standard & Poor's (S&P500) indexes, 4 Nov. 16 – 2 Dic. 16 (4 Nov. 2016=100)



DJIA: + 7,2%

S&P500: + 5,7%

Source: FRED St. Louis, 3 December 2016

Donald Trump, the Markets and Economic Growth

Immediate effects: financial markets

Trade-weighted basket of the US dollar against major currencies (Mar. 73 = 100), 2 Jan. 73 – 23 Nov. 16

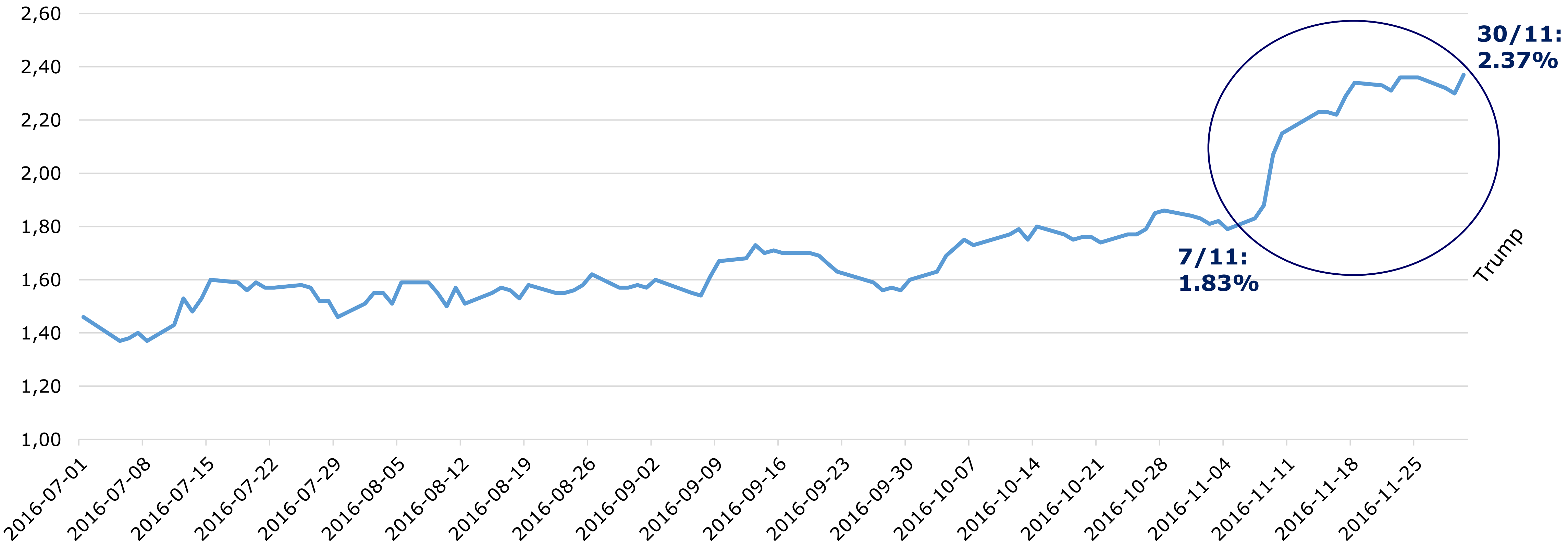
Source: FRED St. Louis, 3 December 2016

Note: the major currencies index is a weighted average of foreign exchange values of the US dollar against a subset of currencies. Major currencies index include: Euro, Canada, Japan, UK, Switzerland, Australia and Sweden

Donald Trump, the Markets and Economic Growth

Immediate effects: bonds

10-Year Treasury Yields (%), 1 Jul. 16 – 30 Nov. 16



Source: FRED St. Louis, 19 November 2016

Donald Trump, the Markets and Economic Growth

Long-term effects: trade

- The Mexican peso has depreciated about 10 per cent relative to the dollar over fears of **new protectionist policies**, and many other emerging market currencies have also fallen sharply
- The impact of this change is to raise the cost of anything the US exports to Mexico and to lower the cost of anything Mexico exports to the US
- The combination of **fiscal loosening** (reducing tax and increasing government spending) with **monetary tightening** would mean a stronger dollar and a rising current account deficit in the medium term
- The **US would re-emerge as the global buyer of last resort** as during the decades before the financial crisis

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Long-term effects: price competitiveness

- US dollar appreciation, other things equal, will reduce US companies competitiveness

- Moreover, protection against imports would raise the currency’s value further, shifting the adjustment on to unprotected sectors — above all, on to sectors that produce tradable goods and services

- Specifically, the manufacturing sector would be armed in terms of both value of exports and share of production activity carried out inside US borders

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Long-term effects: income distribution

- The revised Trump tax plan would **reduce the top individual income tax rate** to 33 per cent and the corporate tax rate to 15 per cent and **would eliminate the estate tax**.

- Thus, **the highest-income taxpayers** — 0.1 per cent of the population, those with incomes over $3.7m in 2016 dollars — **would receive an average cut of more than 14 per cent** of after-tax income. The **poorest fifth's taxes would fall by an average of 0.8 per cent** of taxed income

- The proposal would cut taxes at all income levels, although the largest benefits, in dollar and percentage terms, would go to the highest-income households

Source: Donald Trump's false promises to his supporters (Financial Times, 15th November 2016); Jim Nunns, Len Burman, Ben Page, Jeff Rohaly, and Joe Rosenberg (October 2016), An Analysis of Donald Trump's Revised Tax Plan)

In the Way of a Conclusion

- The recent US presidential campaign and Mr. Trump’s words in the immediate aftermath of his election have put more emphasis **on Fiscal Policy** tools in stimulating economic growth

- **FED** has confirmed its stance of increasing interest rate relatively soon (December?) if incoming data provide some further evidence of continued progress toward the committee’s objectives in terms of price stability and employment

- In the short term, the combination of expansionary fiscal policy and less accommodative monetary policy would increase US Gross Domestic Product

- In the long run, Mr. Trump’s economic plan reduce trade and increase US current account deficit and increase income distribution inequality