Escaping the trap: Secular stagnation, monetary policy and financial fragility

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1. Escaping the trap

Everything depends on everything else
Escaping the trap

1. The strange economic world
2. Explaining the strange world
3. Policy in the strange world
4. Uncertain end game
1. The strange economic world
1. The strange economic world

YIELD ON 10-YEAR INDEX-LINKED GILTS

7.17.92 7.17.97 7.17.02 7.17.07 7.17.12 7.17.17
1. The strange economic world

![Central Bank Intervention Rates Graph]

- **Fed**
- **BoE**
- **Buba**
- **ECB**
- **BoJ**
1. The strange economic world

CORE CONSUMER PRICE INFLATION

Jän.06  Jän.08  Jän.10  Jän.12  Jän.14  Jän.16  Jän.18

US  Japan  UK  Eurozone
1. The strange economic world

DEBT OVER GDP OF MATURE ECONOMIES (per cent)(IIF)

- Household
- Non-financial corporates
- Financial Corporates
- Government
1. The strange economic world

DEBT OVER GDP IN MATURE ECONOMIES (IIF Database)

Households  Non-fin corporates  Financial Corporates  Government
2. Explaining the strange world

CHINA INDEBTEDNESS (per cent of GDP)

- Household
- Non-financial corporate
- Financial corporate
- Government

Q1 1996 Q1 1999 Q1 2002 Q1 2005 Q1 2008 Q1 2011 Q1 2014 Q1 2017
4. Uncertain end game

• So how might this end?
• There are five broad possibilities:
  • Interest rates remain consistently below long-term nominal growth. Demand becomes structurally stronger. Exceptional monetary (and fiscal) policies are withdrawn. Economies grow out of indebtedness.
  • The status quo continues, with ultra-low interest rates, but also tolerable growth of nominal and real GDP.
  • There is an inflationary surprise. Central banks fail to respond quickly. So the real burden of debt is substantially reduced, as in the 1970s.
4. Uncertain end game

- Policy generates an inflationary surprise, central banks raise rates sharply. Debt liquidation (that is, mass bankruptcy and a deep recession) ensues, along with another financial crisis.
- There is an unexpectedly deep downturn, perhaps because of a policy shock, or perhaps for some other reason. Central banks are unable to respond. Again, there is debt liquidation and a deep recession.
- We are in a global policy trap. We need to find a way out of it.
- The requirements for this are sources of demand that do not depend on explosive expansions in arguably unsustainable debt.