

2020s vs 1970s: echoes, not a replay*



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Our view, reinforced by the Covid-19 crisis and the Russia-Ukraine war, that the 2020s bear some similarities with the 1970s has gained traction since 2021, primarily due to high inflation. While the 1970s were followed by structural economic changes that included the triumph of supply-side economics, globalisation and a shift of value-added in favour of capital, there is now a widely shared narrative that incoming transformations will move the opposite way. Despite near-term worries, inflation remains less persistent than during the early 1970s. From a cyclical point of view, it is likely to more easily return to levels closer to targets, especially because monetary policy has been more decisive. Longer term, while arguments in favour of a change in the macroeconomic regime abound, both inflation and growth are likely to be caught in a tug-of-war between opposite forces. There is still uncertainty about the end game, but we expect high volatility in the global cycle, regarding growth and inflation, due to the challenges that lie ahead, such as the energy transition and the road to net zero, and forces in some Developed Economies gaining more strategic independence. The implications for financial markets include changes in correlation dynamics across asset classes (due to expectations of more frequent co-movements of bonds and stocks, lower expected Return on Equity – ROEs), and more regional diversification. Asset class behaviour is likely to be increasingly driven by cyclical swings in growth and inflation dynamics (with a horizon of 1-3 years).

*This policy brief is based on “2020s vs 1970s: echoes, not a replay”, June 2023, Amundi Asset Management. The views expressed are those of the authors and not necessarily Amundi Asset Management S.A.S.

A regime shift vs the past decade, still including some 70s features

	1970s	2000-20	2020s
ECONOMY	Capitalism Crisis	Financial capitalism	Sharing of value added more in favour of wages?
	Great Inflation	Deflation	High cyclical inflation followed by structural inflation higher than 2000-20
		Peace, limited geopolitical hotspots	A new era of geopolitical risk
		Globalisation	Regionalism, US-China blocs
		Inequality increasing	Inclusion taken seriously
MARKETS		Large caps	Equal weight – no mega caps
	Value	Growth	Value
	Energy	Tech Asset inflation	Financials and green tech
	Cash, Gold, Real assets	Govies & Credit	Cash, Govies, EM bonds
		DM favoured vs EM	EM favoured vs DM
	Dollar devaluation	Dollar hegemony	Dollar Status Questioned
	60-40 paradigm	60-40 reloaded with real and alternatives assets and commodities	

Source: Amundi Institute.

Are the 2020s like the 1970s?

Even before the current decade began, and before Covid-19 and the Ukraine war, we believed the 2020s would bear similarities to the 1970s. What happened in recent years has obviously reinforced this conviction. These events began with a sharp surge in inflation, combined with fledgling economic growth (stagflation) starting in 2021. They also extend to some of the certain and presumed causes of this stagflation:

- A war generating a surge in energy prices (the Ukraine war like the Yom Kippur conflict) as a short-term trigger.
- The lagged effect of monetary and / or fiscal profligacy (post-Lehman QE and Covid-19 policies like a series of pre-70s policies addressing the financing of the Vietnam war, Lyndon Johnson's Great Society and the post-war reconstruction) as a long-term cause.

Inflation and monetary policy in the 1970s and their consequences for the real economy

What followed from the early 1970s was a decade of volatile and sometimes very high inflation (with two spikes, in late 1974 and early 1980), which was only tamed by a complete revamp of the monetary policy framework, ultra-high interest rates and a sharp recession (at least in the US). Regarding output, the 1970s also paved the way for a paradigm change for supply-side economics (implemented from the 1980s on, having won the academic debate in the 1970s), deregulation, offshoring, the triumph of so-called "shareholder capitalism", and several decades of deindustrialisation that deeply disorientated Western lower and middle classes. These changes were accompanied by a shift in the sharing of value-added away from wages and towards capital, both by companies and through housing.

In light of this experience, today's burning questions are:

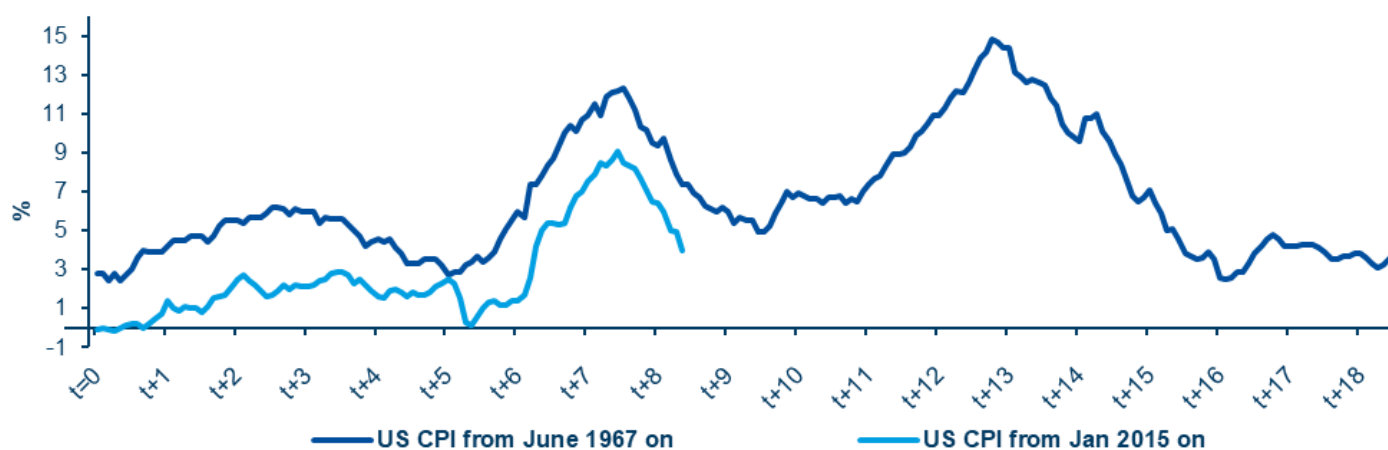
- **does bringing down today's high inflation need to be as painful as it was then**, and, if so, will Central Banks show the required determination?
- **whether we should expect another paradigm change in the global economy?**

Nonetheless, the two scenarios are not identical

Regarding the short term, there are many differences between today's inflation and that seen in the 1970s, which lead us to believe price pressures may abate more quickly this time.

- **First, inflation has not been as high as it was in the early 1970s**, at least so far, largely owing to Central Banks' decisive action and wariness of second-round effects. Double-digit inflation has remained a rarity, notably avoided by the US and only very briefly experienced by the euro area and other countries.

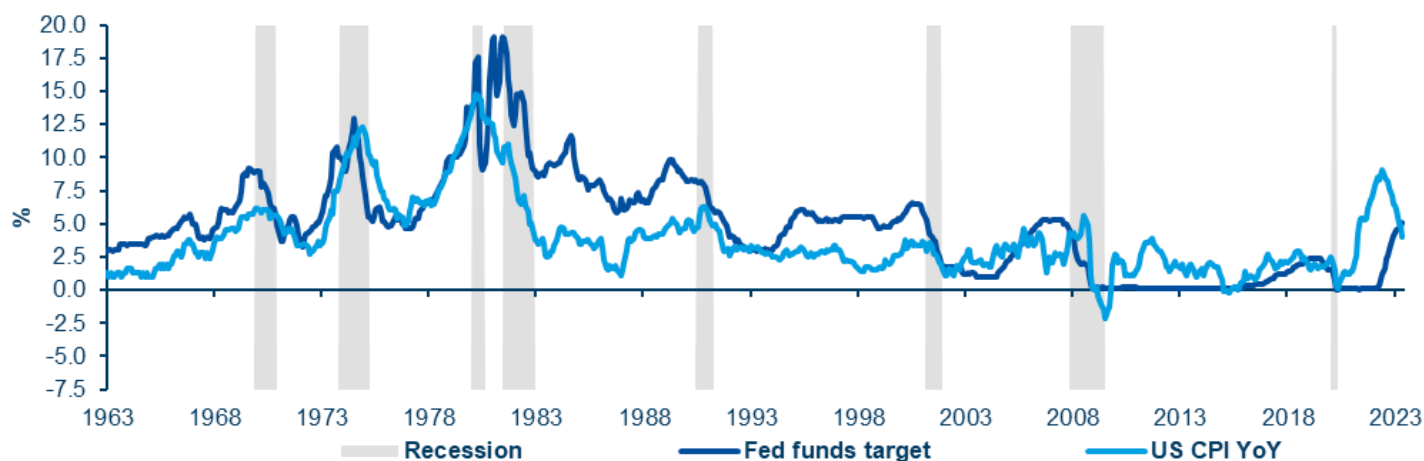
Figure 1: Inflation – 1970s vs early 2020s



Source: Amundi Institute, Bloomberg. Data as of 31 May 2023.

- **Furthermore, the causes of high inflation are different.** In this regard, it is essential to recall that the high inflation of the 1970s followed the exceptional monetary event represented by the end of the US dollar's fixed peg to gold and therefore the demise of the Bretton Woods framework. In other words, the very nature of the common numeraire of the global financial system changed (from gold-based to fiat), logically leading to a large swing in its real value. There has not recently been a similar referential-changing event. Nowadays, the topic of the USD's global status has risen since some countries have been diversifying reserves away from it (for instance as a risk management decision), particularly as some trades have been settled in currencies other than the dollar (e.g. India-Russia for oil) although such examples are limited.
- **Central Banks' reaction to inflation has been strong** after an initially slow start. We could argue that rate hikes at the beginning of the 1970s were also very sharp, at least in the US. Yet, this time, thanks to lessons from the past, Central Banks are unlikely to cut rates as quickly as they did then and have signalled their intent to remain on the hawkish side as long as economic conditions make it bearable.

Figure 2: Fed's response to higher inflation



Source: Amundi Institute, Bloomberg. Data as of 31 May 2023.

Furthermore, long-term inflation expectations have only slightly moved upwards, signalling that **Central Banks' credibility on inflation is not at risk**. Indeed, inflation expectations are a conventional indicator of Central Banks' reliability, yet are also influenced by the experience of past inflation episodes. In other words, a combination of rational and adaptive expectations. Current economic participants do retain the memory of decades of disinflation. According to basic macroeconomic theory, anchored inflation expectations should help inflation move lower and prevent initial supply shocks from morphing into a prolonged price-wage feedback loop. Little of this existed in the 1970s, as short-term memories were of relatively low inflation and Central Banks had not built specific credibility in this regard (as they tended to pursue and communicate on multiple macroeconomic and financial goals).

- **Regarding the labour market, conclusions of a price-wage feedback loop are premature**, as wage increases have fallen short of inflation so far (i.e. there has been no increase in real wages). Note that the much more flexible structure of the labour market compared to the 1970s (much less inflation indexation and, overall, less powerful trade unions) also makes this type of loop less likely.

Taking these factors into account, a second spike in inflation (similar to that at the end-1970s) is unlikely. At the same time, for Central Banks, bringing inflation back to their targets may not require a deep recession.

Note, though, the caveat here is that the second spike in inflation in the late 1970s was accelerated by a second oil price shock (post-1979 Iranian revolution). Another large geopolitically-driven energy supply shock in the coming quarters or years cannot be ruled out and it is a risk to watch.

Table 1: Differences between the two scenarios

Inflation	First of all, inflation in 1970s was higher and more persistent, while in 2020s we experienced double-digit inflation very briefly. Furthermore, the causes behind 1970s inflation were also more structural, e.g. the end of the Bretton Woods framework.
CBs' response	As in the 70s, this time CBs' reaction has again been strong and energetic (aside from the initial period until H1 2022), but, unlike then, CBs now seem to be determined to remain hawkish as long as it is necessary.
Price-wage loop	A price-wage loop in the labour market seems to be unlikely this time, as there has not been any increase in real wages and given the much more flexible structure of this market compared to the 1970s.

A tug-of-war between opposite forces

However, even though markets can expect inflation to be less persistent than in the 1970s in terms of magnitude and duration, they must also mind that it could nonetheless trigger more financial, as well as macroeconomic, volatility.

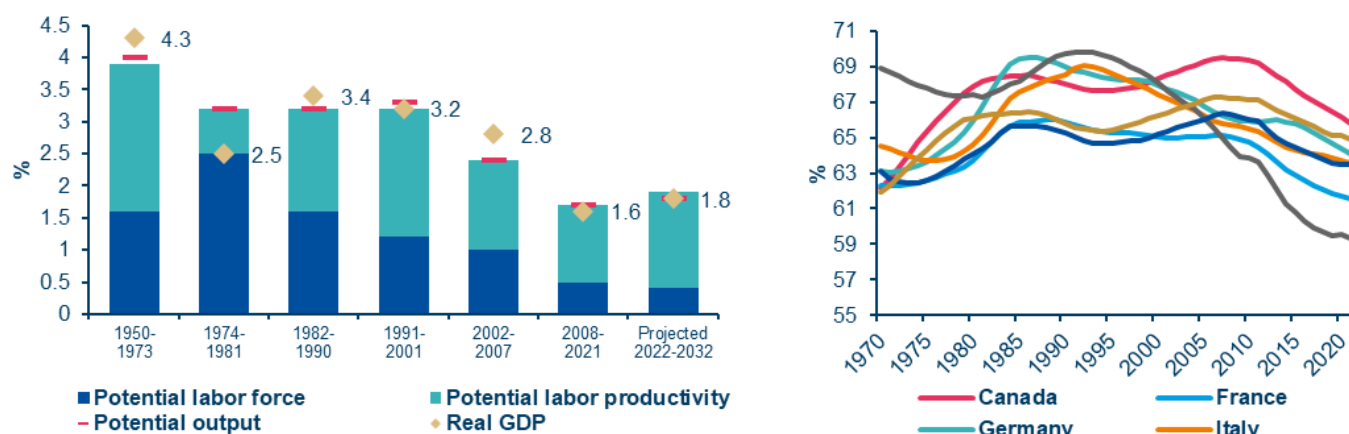
This is largely due to much higher leverage than in the 1970s, be it in public or private (household and corporate) sectors. Firstly, high debt levels mean that governments will be more constrained in how they can respond to economic shocks. Then, debt-related public or private financial accidents cannot be ruled out as a lagged effect of the rise in rates over the past 18 months. Moreover, the valuation of assets has sharply readjusted (in the case of bonds), or may still have to do following the rate hikes (i.e. some illiquid assets). Although the situation appears far less risky than in the pre-Lehman era, we can still see the risk of some shockwaves (through various channels) crossing from asset markets to the general economy. Low market liquidity may amplify them.

- Regarding inflation**, while globalisation has often been identified as a key cause of the low inflation in recent decades, its predicted reversal is logically seen as carrying the opposite effect. It is, however, not so clear whether that will actually be the case. **Firstly, even if a supply shock is considered prolonged and gradually negative, deglobalisation may end up being more growth-negative than inflation-positive. Moreover, how deglobalisation proceeds (if at all) is still questionable:** it is often seen as taking shape largely through the reshoring of manufacturing activities, accelerated by deliberate reindustrialisation policies. However, goods now represent a much smaller share in inflation baskets than services, with new technologies potentially opening the way for a deepening of globalisation within services activities (i.e. the international fragmentation of value chains).

Other factors often mentioned as inflationary over the long term include expected large investment plans for such goals as sovereignty / strategic autonomy in key sectors, climate change or the reduction in social inequalities. However, the extent to which these changes are structurally inflationary will largely depend on how they will be financed: whether Central Banks accompany them with long-lasting accommodation or whether they will be financed by tax increases.

- When it comes to economic growth, a higher appetite for investment may be a clear positive.** On paper at least, this is the ideal vector of higher demand and productivity growth at the same time. However, investment plans could well fall short of ambitions if bogged down in conflicting priorities, red tape and resistance from vested interests. **Moreover, some forces of secular stagnation are still here**, such as the factors behind declining productivity growth (ageing populations and the transition from manufacturing to services) or **falling growth in the working-age population**. Negative factors may even be supplemented by more frequent and intense episodes of climate change and geopolitical disruption that hurt growth.

Figure 3: US average real GDP growth and working age population as % of total population, G7 countries



Source: Amundi Institute on Congressional Budget office for data and estimations 1950- 2032 forecast. Data as of April 2023.

Source: Amundi Institute on OECD. Data as of April 2023.

- **In terms of the sharing of value-added, opposite factors are also at play.** On the one hand, policies aimed at calming fatigue towards the supply-side economy and the rise in non-conventional political forces may lead to a rebalancing of value-added towards wages (with uncertain implications for the speed of growth). On the other hand, accelerating new technologies, while benefitting a minority, could make the majority of workers even less marginally productive and shift the value-added further in favour of capital.

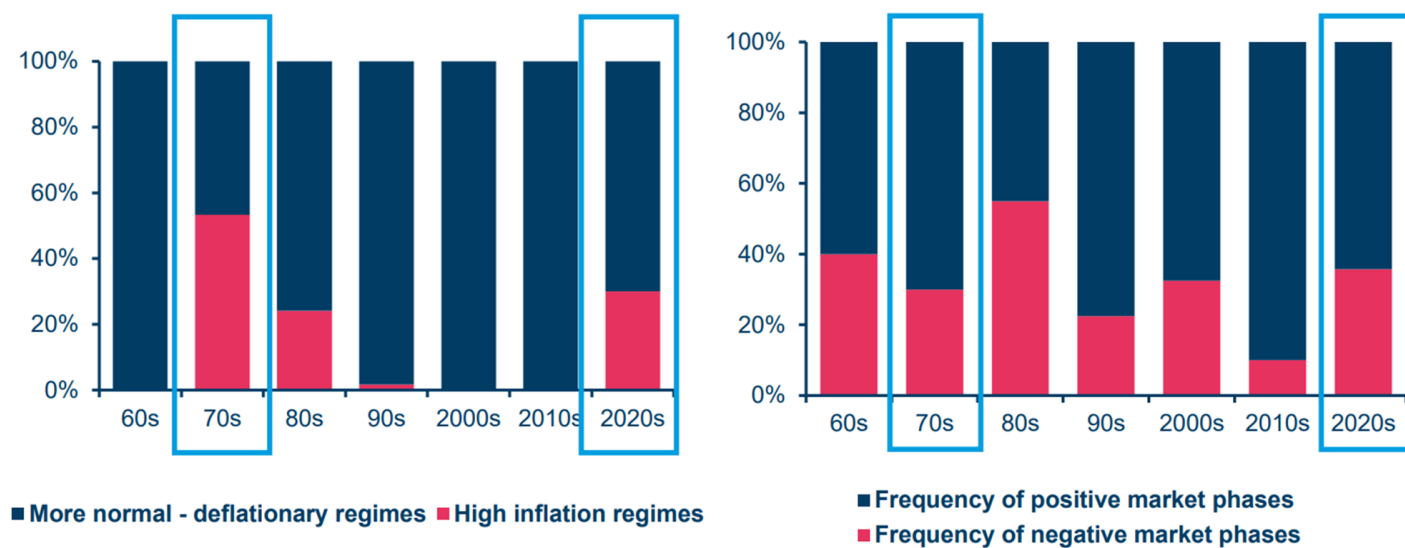
Nonetheless, as of today, the likely features of the new regime are: mildly higher structural inflation (this could mean CBs simply reaching their targets, instead of the frequent 2000-20 undershoots), a slight extension of de-globalisation, growth rates similar to the previous decade, a slightly higher share of the pie directed towards wages at the expense of capital.

New tools to navigate a more uncertain environment

Considering this uncertain environment, financial market adjustments towards a new regime will not be linear. The resurgent inflation episodes of the 1970s and more recently in the early 2020s triggered frequent episodes of negative risk asset performance, as we can see in the chart below.

Therefore, an investment framework able to capture higher volatility in growth and inflation, and an asset allocation able to adapt to different regimes are areas of development needed to assess financial market behaviour.

Figure 4: Frequency of high inflation regimes and Frequency of neg. / pos. regimes for risk assets



Source. Amundi Institute. For illustrative purposes. Historical analysis from 1930 to March 2023 on the probability of financial and inflationary regimes based on Amundi Institute proprietary models Inflation Phazer and Advanced Investment Phazer. Hyperinflation regimes are those with US CPI > 6%.

Enhanced diversification will be in focus:

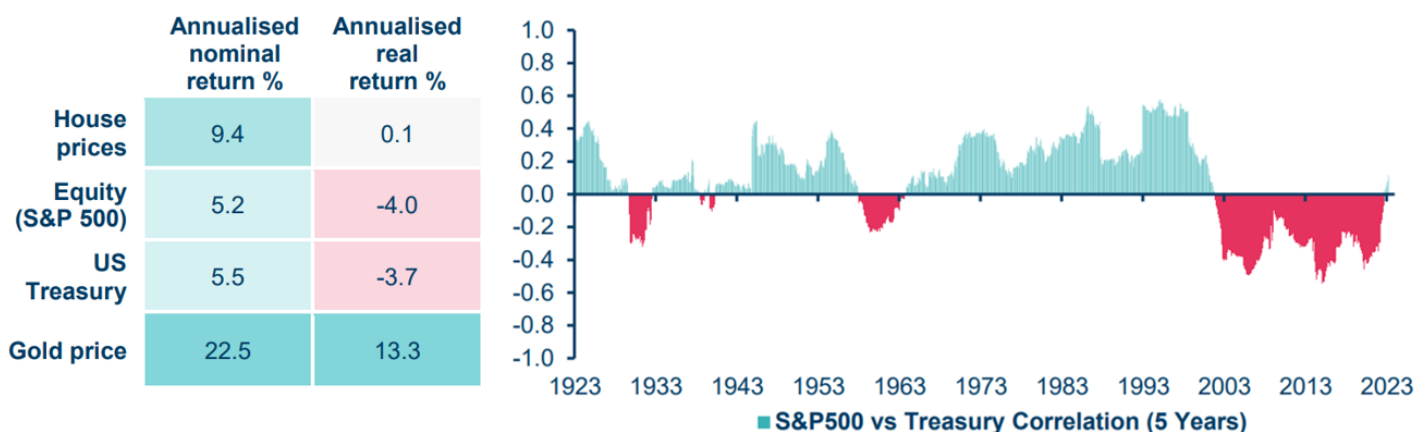
- **In the short term, the risk of a reacceleration in inflation is moderate, but the volatility of inflation will likely remain high as multiple adjustments occur.** From a growth and income perspective, the cyclical outlook remains weak. Some cracks may appear in the real economy due to tighter financial conditions (commercial real estate and highly leveraged companies), while equity markets are too buoyant. A dynamic asset allocation framework could help detect inflation points in the cycle and assess valuation levels.

- **Over the longer term, slightly higher structural inflation (vs 2000-20) means more frequent co-movement between bonds and equities** (through the common expected inflation part of the discount factor), something already illustrated spectacularly in 2022 (the worst year for balanced portfolios since 1974, according to some metrics). Thus, a broader diversification (going beyond these two asset classes) is needed, recalling that in the 1970s most asset classes delivered negative real rates, with the exception of commodities such as gold and oil.

A retreat of globalisation or regionalisation, even limited, is likely to lead to less synchronised economic cycles and monetary policies across major economic regions, and thus **more value for regional and currency diversification**. Moreover, continuing Emerging Markets (EM) growth outperformance, combined with less recycling of EM current surpluses on Developed Markets (DM) (the capital market side of de-globalisation), could lead to **EM assets outperforming DM assets**.

Due to a possible rebalancing towards wages, margins are likely to represent a smaller share of value added, at least in DM. Therefore, ROEs on DM equities are expected to be lower with an equivalent level of risk. With a longer-term view, and factoring in the consequences of the energy transition (different impacts on growth depending on the countries), real, alternative and EM assets should increasingly be in demand in the search for diversification and higher returns.

Figure 5: Asset class returns in 1972-1981 and Evolution in equity / bond correlation



Source: Amundi elaboration on Bloomberg data. Period 31 December 1972 to 31 December 1981. S&P 500 Index refers to the total return gross dividend index, US Treasury Index refers to ICE BofAML US Treasury & Agency Index, House price refers to the US Home Price from Shiller.

Source: Amundi elaboration on Global Financial Data. 5 year rolling correlation on monthly data between S&P500 and 10 Year US Treasury Index. Data as of 31 March 2023.

About the authors

Monica Defend is the Head of the Amundi Institute, which was created in February 2022. Embedded at the heart of the global investment process, the Amundi Institute provides thought leadership, advice and training for all its clients. Monica's team offers geopolitical expertise, quantitative research, macro and market strategy, and asset allocation advisory activities. She leads the creation of engaging and accessible proprietary research that delivers cross-asset thought leadership and investment strategy ideas to internal and external clients. A distinctive feature of her approach is the close collaboration that she has forged with the investment division to generate actionable investment ideas. She is also a Director of the Board of Amundi Japan, a member of Amundi Japan and Amundi SGR Advisory Boards.

Monica has led research strategy functions since 2001. Before becoming the Head of the Amundi Institute, Monica was Global Head of Research and a member of the Global Investment Committee and the Advisory Board at Amundi. She was appointed Deputy Head of Group Research and a member of Amundi's Global Investment Committee in 2017 and was responsible for defining Amundi's investment strategy for financial markets. Prior to that, she was Global Head of Asset Allocation Research and previously Head of Quantitative Research at Pioneer Investments. Monica started her career in the investment industry in 1997 following a role as a university teaching assistant for the Advanced Econometrics department at Bocconi University.

Monica graduated from Bocconi University (DES). She holds a Master's degree in Economics (Bocconi University) and a Master's degree in Financial Economics from the London Business School and Bocconi University. She was selected for the UniCredit Young Talents Programme and the Management and Banking Academy, obtaining an MBA award at the London Business School.

Vincent Mortier has been the Group Chief Investment Officer of Amundi since February 2022. Previous to that, he was the Group Deputy CIO of Amundi since 2015. He is a member of the Global Management Committee, the Executive Management Committee and of several supervisory boards.

In his capacity as Deputy CIO, Vincent was notably instrumental in anchoring ESG at the heart of the investment process across the different active investment platforms of Amundi and the establishment of a strong risk management framework. Playing also the role of Supervisor of the Group's activities in Asia ex-Japan, he is also very much involved in developing Amundi's businesses in this region, and played a key role in setting up the joint venture with Bank of China in particular.

He joined from Société Générale CIB where he held several positions within Equity derivatives, most recently as Chief Financial Officer of the Global Banking and Investor Solutions division since 2012. He joined the Société Générale Group strategy department in 2004 where he was in charge of overseeing SG CIB and several Central and Eastern European countries. In 2007 he became Chief of Staff to the CEO of SG CIB. He started his career at Société Générale in 1996 in internal audit.

Vincent holds an MBA from ESCP Europe Business School.

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