# Growing perplexity as central bankers confront permanent stagnation

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This year's meeting of central bankers held at Jackson Hole, Wyoming last weekend represented something of a turning point in the response of financial authorities to the global financial crisis that erupted in 2008 and the resulting, ongoing stagnation of the world economy.

It was marked by ever-growing perplexity over monetary policy accompanied by the acknowledgement there is not going to be a recovery, after which there can be a return to "normal" central bank measures. This follows eight years of ultra-low and even negative interest rates and the pumping of trillions of dollars into the global financial system.

As the *Financial Times* put it: "The message from the meetings in Jackson Hole was clear: there is no winding back the clock to the pre-crisis world of central banking."

In her keynote address delivered last Friday, US Federal Reserve Chairwoman Janet Yellen explained that measures previously regarded as unconventional were now part of the Fed's "tool kit." She said she did not expect interest rates to return to the average level of 7 percent between 1965 and 2000 and forecast a rate of 3 percent in the long run.

Her assessment reflects the belief that the so-called neutral rate, which neither stimulates nor suppresses economic activity, is much lower than in the past because of the decline in the growth potential of the US economy.

Adam Posen, a former Bank of England policy advisor and president of the Peterson Institute for International Economics, said even this target was too optimistic. "The fact that we are nowhere near to the 300 let alone 400 basis points that you would normally need is disturbing," he said.

The concern over the Fed's base rate is motivated by the fear that in the event of a recession it will already be so low that it will not be possible to make a cut large enough to stimulate the economy.

Ethan Harris, head of global economics at Bank of America, warned that the current business cycle was "particularly dangerous." Economies were late in the cycle, meaning that another recession is due, yet the interest rates set by central banks "are all close to zero and they are starting to lose the expectations war with inflation."

The ongoing use of the measures adopted over the past eight years was a persistent theme in the reports and discussions at the meeting.

In her speech, Yellen offered the reassurance that, while additional tools may be needed, even if average interest rates remain lower than in the past, "I believe that monetary policy will, under most conditions, be able to respond effectively."

That assumption is increasingly being called into question. Benoit Coeuré, a member of the executive board of the European Central Bank, claimed that while unconventional measures had supported output and inflation, they had been taken on the assumption that they would be transient "because monetary stimulus would help counter the cyclical forces depressing the real equilibrium rate." But in the absence of other measures to stimulate the economy, "unconventional measures may have to be deployed more frequently." However, this would come with complications and "rising side effects, for instance on financial stability."

Coeuré wants European governments to undertake more intensive "structural reforms" aimed at attacking the social and employment conditions of the working class. "What we have seen since 2007 is half-baked and half-hearted structural reforms," he stated.

The failure of the measures adopted by central banks—investment levels, labour productivity, growth rates and inflation remain at historic lows—has prompted calls for governments to take action on the fiscal front, particularly through the development of infrastructure projects. While such measures were not on the agenda at

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the Jackson Hole meeting, they are under discussion both within banking and financial circles.

In its report on the meeting, Reuters noted that while fiscal policy was not formally discussed "it was a steady part of the dialogue as policymakers thought through policies for a post-crisis world." One of the "central worries" was that "households and businesses have become so cautious and set in their outlooks—expecting little growth and little inflation—that they do not respond in the expected ways to the efforts central banks have made."

In a lunchtime address, Princeton University economist Christopher Sims said fiscal policy could replace "ineffective monetary policy" at near zero rates. It required deficits aimed at generating inflation and should not be financed by taxes or spending cuts.

The governor of the Bank of Mexico, Agustin Carstens, said that coming out of the discussion was the sense that "monetary policy activism has run its course" and that other branches of government had to step forward.

Dallas Fed president Robert Kaplan said that central bankers were increasingly talking about "the need for fiscal policy and other economic tools beyond monetary policy."

The calls for fiscal action are being expressed more broadly. The London-based *Telegraph* carried a report at the weekend noting that "Keynes is in fashion once more." It cited remarks by Bank of America investment strategist Michael Hartnett calling for a "more strategic mix of fiscal and monetary policy." He said voters were demanding a more populist set of solutions after austerity.

However, there are a number of fundamental reasons why such stimulatory measures cannot and will not be carried out, at least not to any significant extent.

Keynesian measures, based on government spending initiatives aimed at countering economic stagnation in the US during the 1930s, were based on the relative strength of US capitalism and its industrial capacity. It was this, Leon Trotsky noted at the time, which permitted Roosevelt his "experiments." Moreover, they did not produce lasting growth, with the US economy plunging rapidly in 1937.

Eighty years on, the situation has markedly changed, with US capitalism no longer the overwhelming industrial power it once was and where profit accumulation is increasingly dependent on financial speculation and parasitism.

Stimulus measures would require cooperation and coordination between the major powers. Such agreements were made in 2009, in the immediate aftermath of the financial meltdown, but they largely went by the board in less than a year. All governments support stimulus measures in theory, so long as they are carried out by someone else. The US, for example, has for some years called on Germany to provide greater stimulus, not least in the hope that this will provide greater markets for American exports.

However, the German ruling economic and financial elites were hit hard by the 2008 crisis, which they see as being the responsibility of the US. As a result, they are not inclined to take measures they regard as weakening their financial position vis-a-vis the US and other economic rivals.

Then there is the question of the financial markets. The quantitative easing policies of the past eight years have created a speculative bubble where the price of sovereign bonds has risen so high that some $13 trillion worth are now trading at negative yields (the two move in an inverse relationship to each other). Any major boost to the real economy would bring a rise in inflation and interest rates, threatening major losses for financial speculators potentially running into trillions of dollars.

Moreover, austerity is not simply an economic program but a class policy. It is directed to ensuring the suppression of the working class through low wages and worsening conditions. Any real economic revival would certainly bring about a resurgence of struggles for higher wages and improved conditions as workers sought to recover the losses in income and living standards inflicted over the past decade. The return of such struggles would have a major impact on the financial system, since the record levels of share markets have been based, not least, on the ever-increasing suppression of living standards for the overwhelming majority of the working class.

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