Uncharted Waters:

When Economic Policy Solutions Exacerbate or Become the Problem

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Economic policy premised on a fundamental ontological error

"It ain't the things you don't know what gets you. It's the things you know for sure what ain't so"

Mark Twain

Modern macroeconomic theory is fundamentally flawed

The economy is a complex adaptive system (CAS) with no equilibrium

The economic system is nested in other CAS and is vulnerable to their failings

CAS have multiple indicators of stress and "tipping points"

Economic policy solutions have become the problem

Expansionary monetary policy has encouraged private sector debt

Government debt buildup is unsustainable

Financial regulation has significant shortcomings

Ever widening safety nets create longer term problems

"We have seen the enemy, and them is us"

Pogo, an American comic strip

Current indicators of economic and financial stress

"If I were you, I wouldn't start from here"

Old Irish joke

Slow growth of investment and productivity

Record high debt levels of decreasing quality

Stability of some financial institutions questionable

Many asset prices historically high but volatility rising

Markets functioning badly, including US Treasuries

Resurgence of fraud and outright delusion

Uncertainties arising from the Russian invasion and financial sanctions

Current indicators of stress in related systems

Environmental systems stressed by population growth

Political systems threatened by growing inequality and polarisation

Public health systems threatened by covid

An economic or financial crisis would threaten these other systems

"If something cannot go on forever, it will stop"

Herb Stein

Reasons to fear stagflation – negative supply side shocks

“When you come to a crossroad, take it”
Yogi Berra

Pre pandemic resource misallocations

Post pandemic hysteresis

Population ageing in both advanced and developing economies

Climate change and costs of mitigation and adaptation

Energy shocks aggravated by Russian invasion of Ukraine

Deglobalization and the need for “resilience”

Both Depression and High Inflation are plausible outcomes

In CAS cumulative processes (positive feedback) are common

High debt levels increase vulnerability in good times and bad

The Debt-Deflation process described by Irving Fisher

The High Inflation process described by Sargent/Wallace and Bernholz

Both private and public debt pose problems. And we have both

"Some say the world will end in fire, some say in ice"
Robert Frost

Central banks likely to focus first on slower growth

"Take therefore no thought for the morrow. Tomorrow will look after itself. Sufficient unto the day is the evil thereof"
Matthew 6:34

A repeat of the 1970's? First support growth, then resist inflation?

Central banks remarkably accommodating given inflation forecasts

Fed's new framework is more pro growth

Belief that inflation shock is "transitory" and expectations "anchored"

Uncertainty about effects of tightening (the "debt trap")

Amid geopolitical concerns and fears central banks will be blamed

"Financial repression" in another guise?

A later pivot to tighter policy but….?

Gap between real rates and restrictive real rates potentially wider

And “debt trap” deeper and tightening likely more dangerous

Indebted governments face environmental and military expenditures

Implying a growing tolerance for higher inflation?

And overt “financial repression”?

GOOD LUCK – YOU JUST MIGHT NEED IT

“ Politics is not the art of the possible. It is choosing between the unpalatable and the disastrous”

J K Galbraith