FINANCIAL TIMES

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

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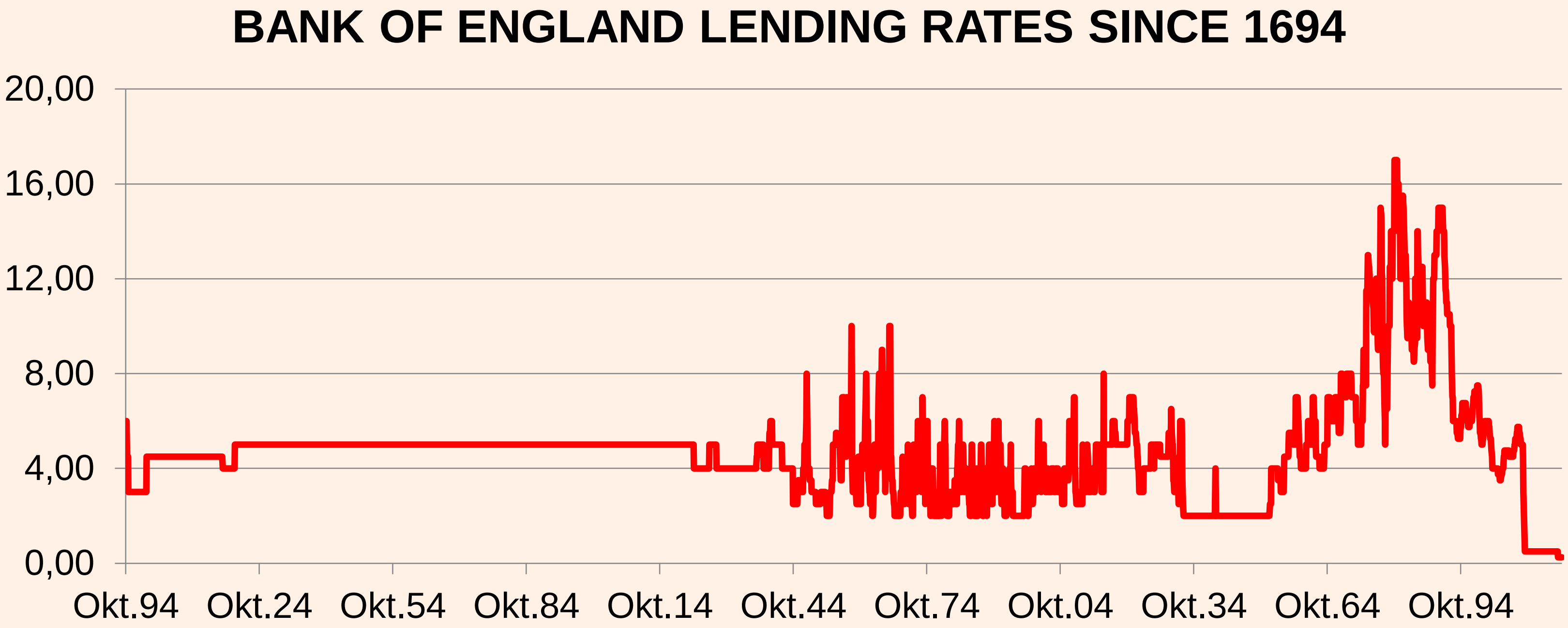
1. Escaping the trap

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



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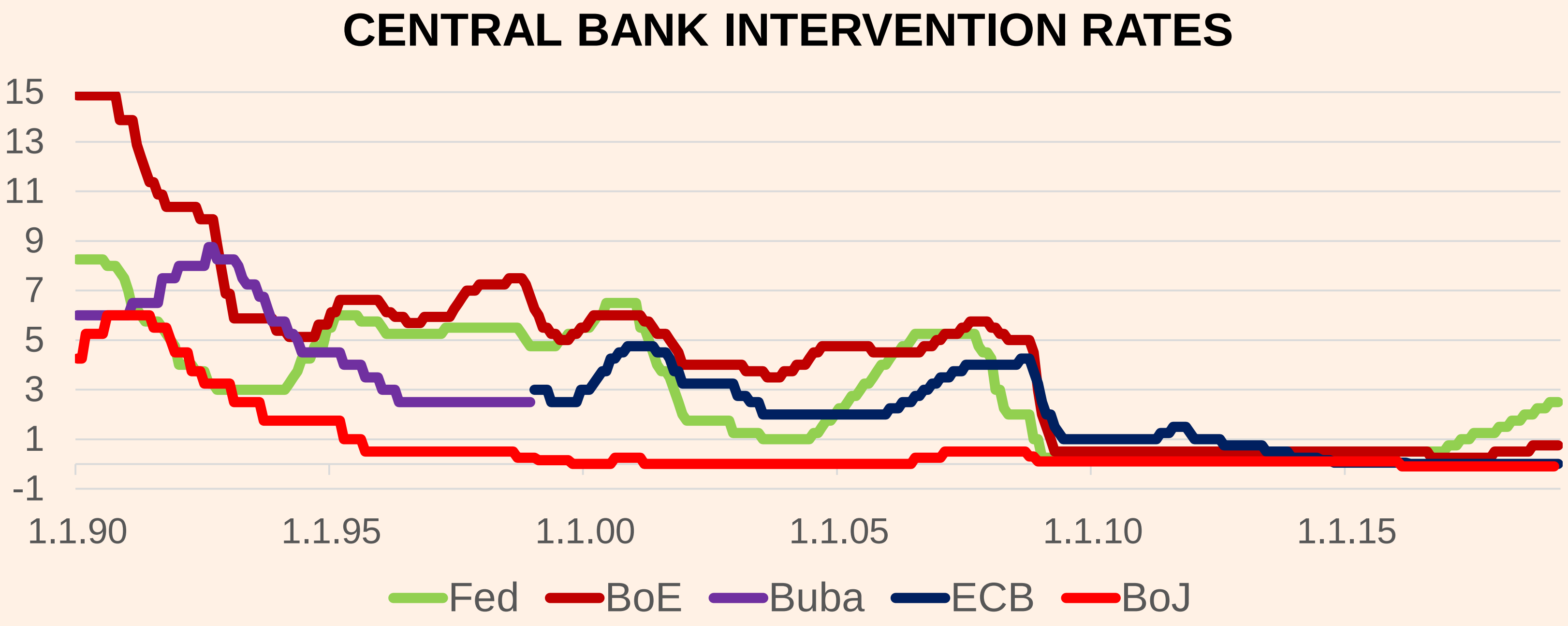

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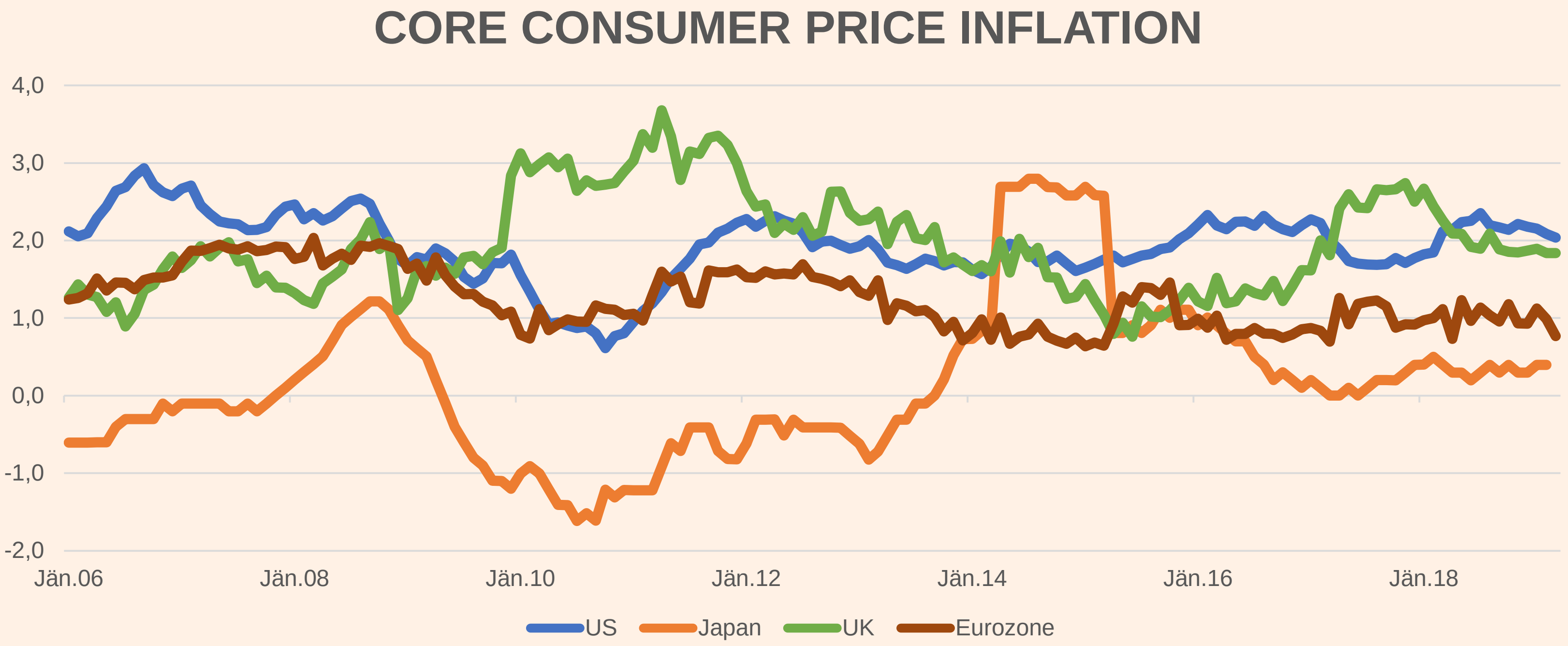

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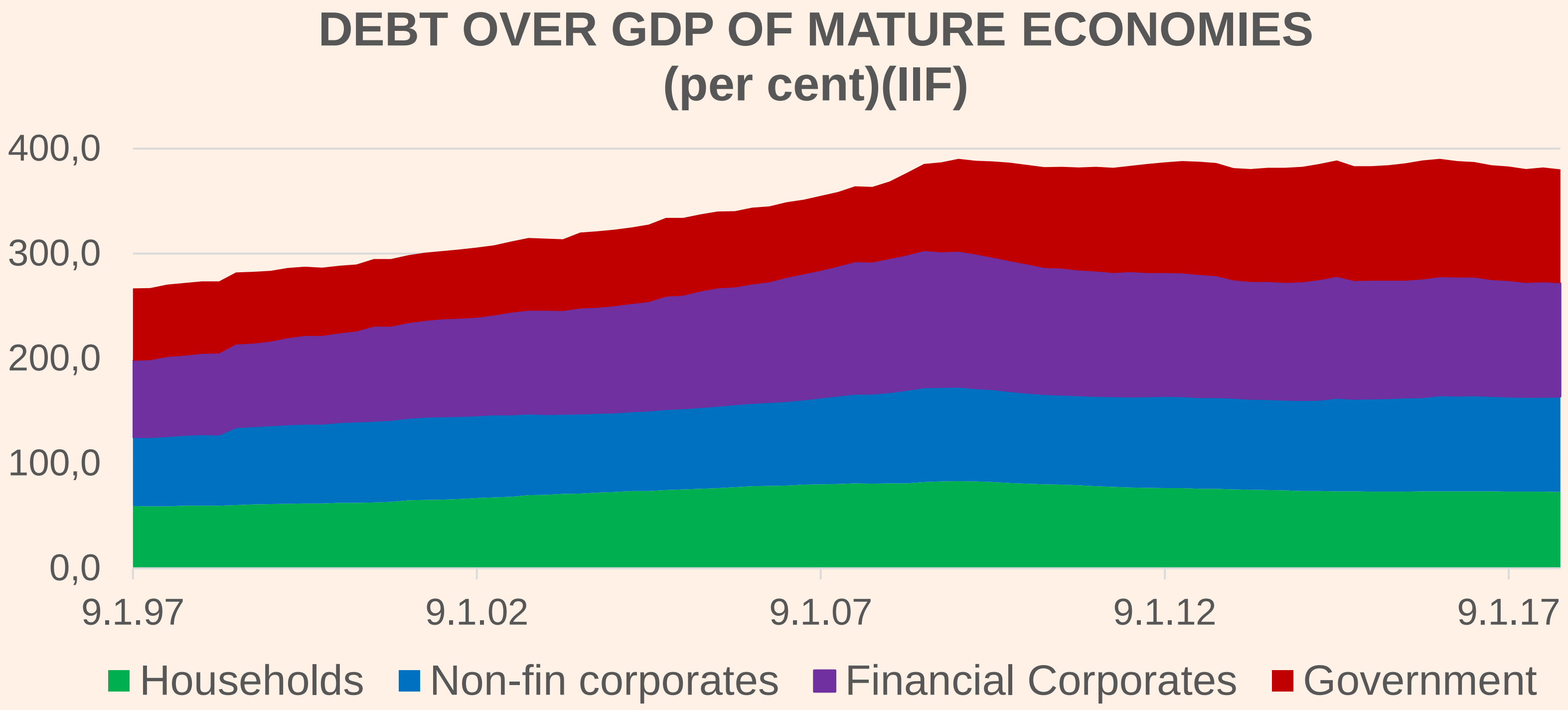

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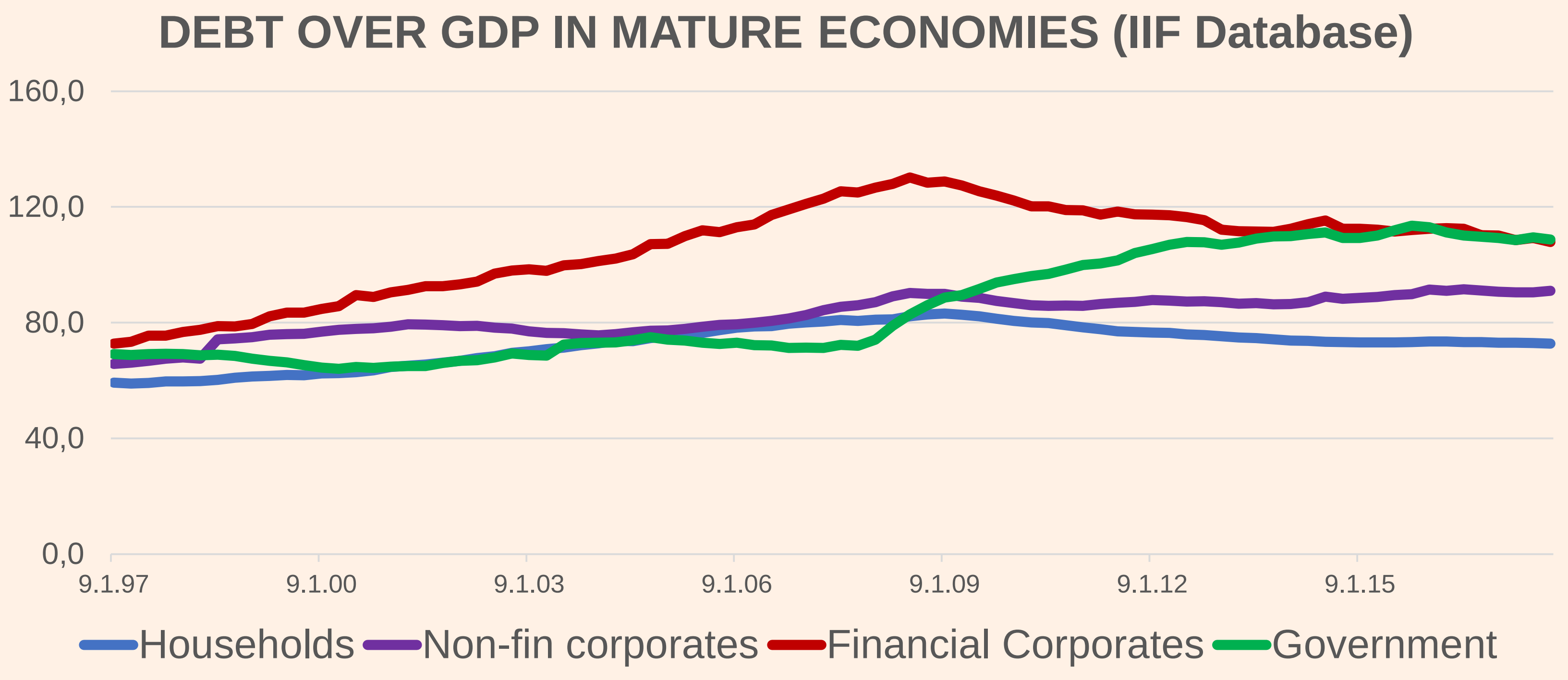
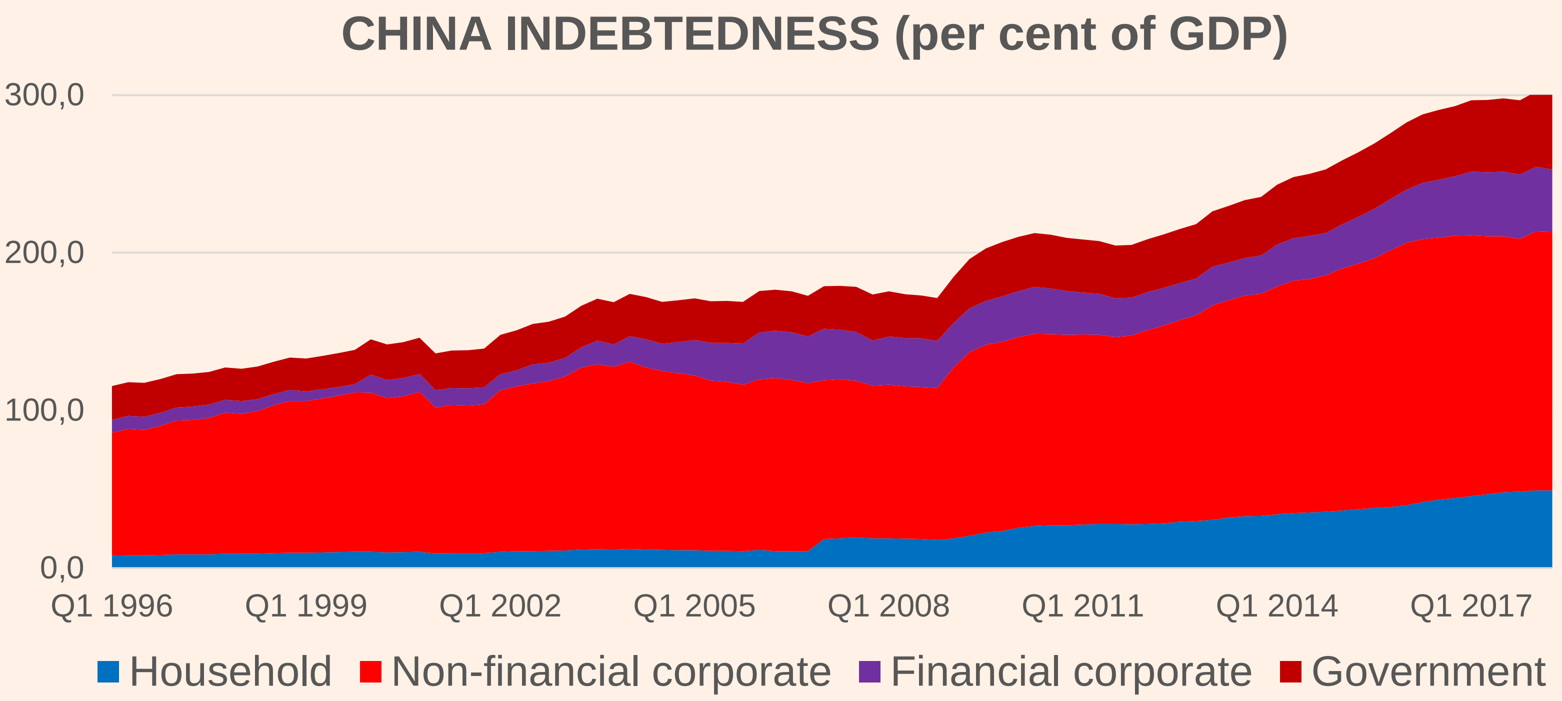


2. Explaining the strange world



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 Exceptional monetary (and fiscal) policies are withdrawn.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.