Intelligence MEMOS

From: Laurent Desbois

To: Canadians Concerned about the Next Recession

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Re: **Going to Print: One Recession Away from the Inevitable**

Eleven years after the 2008 financial crisis, interest rates remain historically low – we even have negative interest rates in Europe and Japan. Despite this huge monetary stimulus, advanced economies are struggling to reach the 2 percent inflation target, due in part to high debt levels, aging populations and globalization.

What happens, then, when the next global recession arrives and inflation has not budged and interest rates remain low?

Global private and public debt levels are at an unprecedented peacetime high. Our indebted economies cannot afford a drop in inflation (or, worse, price deflation) during the next recession. We must maintain price levels – in other words, incomes for corporations and wages for workers – so that they can continue to pay interest on their debts.

With global debt reaching US$185 trillion in 2017 according to the IMF, compared to a global GDP of $80 trillion, declining incomes and wages would cause debt restructurings and defaults. This would bring soaring unemployment.

In this context, the traditional toolkit used by central banks no longer suffices. They already went all-in during the last recession.

Central banks dealt with the 2008 crisis, which was caused by excessive debt, by encouraging more borrowing. They kicked the proverbial can down the road, and we have now reached a dead end. A change of course is required, and central banks are well aware of this.

Some help from the printing press

How can the 2 percent inflation target be maintained during the next recession without primarily resorting to lower interest rates?

Central banks will need to be creative, and printing money is one likely path. A specific amount of money could be printed on an exceptional basis and injected into the economy in a way that would keep the inflation target at 2 percent. This will need to be done properly to avoid the hyper-inflationary disasters we have seen in Zimbabwe or Argentina, whose history demonstrates why any move would need to be exceptional and for a limited duration.

Such a strategy is currently viewed as economic heresy. However, as it stands, it is ultimately inevitable. Interest rates are already low, public debts are already high, potential economic growth will remain low for a very long time, and the deflationary option would be disastrous.

Technically, central banks can print as much money as they need by crediting the government account at the central bank. In order to preserve central bank independence and send a clear and resolute message about achieving the 2 percent inflation target, some leaders in the monetary policy community are specifying that a strict new framework should be used during the next recession.

In a recent landmark publication, three former senior central bankers, including Jean Boivin, the former deputy governor of the Bank of Canada, describe the framework in this way: when the next recession comes, central banks in the United States, Europe and Japan would provide governments with a sum of money through a standing emergency fiscal facility, that would be strictly compatible with achieving the 2 percent inflation target. It would then be up to governments to decide how these sums should be spent. For example, they could decide to transfer money directly to households to stimulate the economy.

The technical aspect is simple, but the political challenge is huge. Once you cross the Rubicon by printing money – as opposed to quantitative easing, which was meant to be temporary in nature – where will it stop? Will central banks be able to maintain their independence and determine how much should be printed without outside interference? Governments will always be tempted to ask for more.

Currently, monetary and fiscal authorities are one recession away from significantly changing their policy tools and trying a delicate experiment with inflation-targeting through money printing. The alternatives, debt defaults and high unemployment, are economically and politically unacceptable.

At the same time, however, if new tools are not used sparingly, the resulting high inflation will be detrimental to all, while redistributing wealth from savers to those who are in debt.

Laurent Desbois, Economist and former Managing Director, Caisse de Dépôt et Placement du Québec.

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