Markets Equities

Summers on bubbles and secular stagnation forever

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NOVEMBER 18, 2013 11:27 AM
By: **Izabella Kaminska**

One of the most talked about things in economic circles this weekend?

Larry Summers' speech to the IMF Research Conference on November 8, the video of which started circulating at old fashioned money multiplier rates this Sunday.

Some key extracts:

> "Even a great bubble wasn't enough to produce any excess of aggregate demand… Even with artificial stimulus to demand, coming from all this financial imprudence, you wouldn't see any excess."
>
> "The underlying problem may be there forever"
>
> "We may well need in the years ahead to think about how to manage an economy where the zero nominal interest rate is a chronic and systemic inhibitor of economic activity, holding our economies back below their potential."

Kit Juckes at SocGen notes that big name economists have seized upon the secular stagnation themes referred to by Summers, and are now mutually legitimising the idea that something significant — beyond the banking crisis — is changing the way our economy works. Notably that even bubbles aren't enough to offset the forces at play.

From Juckes on Sunday:

> There's been a Larry Summers love-in this weekend, as both Paul Krugman and Gavyn Davies have picked up on the theme of his speech on secular stagnation at the recent IMF research conference. Mr Davies' piece (http://blogs.ft.com/gavynda

> vies/2013/11/17/the-implications-of-secular-stagnation) in the FT provides links to Mr Summer's speech and to Mr Krugman's response and is here. (http://www.nytimes.com/2013/11/18/opinion/krugman-a-permanent-slump.html?_r=0) **All of these pieces are worth a read but in essence they argue for continued super-easy monetary policy for a very extended period, an idea which seems to be greeted with enthusiasm by central bankers.** There is widespread agreement that after the 2008 recession, there was considerable slack in the major economies, but real interest rates could not be cut enough to fill that gap and major central banks had to respond with unorthodox policy measures, which in turn caused asset price inflation.
>
> **The new thinking though is that merely returning to potential output (which has been reduced as a result of such a long period of below-trend growth) would still leave demand too weak,** and would not eradicate deflationary pressures. In order to tackle that, policy would need to be kept super-easy for much longer in order to nudge potential output back up. I'm struck that booming equity markets (US), housing markets (UK) and art or wine markets (everywhere) do not bother policy-makers. But if the focus is on CPI inflation and wage growth, then the more the idea of secular stagnation takes hole, the longer the bias for really easy monetary policy will remain in place. Risk-lovers are cheering…

So, while even the wealth effect of bubbles is not enough to compensate for many of these secular forces, it's potentially unwise to make the Greenspan mistake (http://ftalphaville.ft.com/2013/11/15/1695922/greenspans-dilemma-becomes-yellens-dilemma/)of popping them too early.

Krugman summed up (http://krugman.blogs.nytimes.com/2013/11/16/secular-stagnation-coalmines-bubbles-and-larry-summers/?_r=0)the situation nicely:

> So how can you reconcile repeated bubbles with an economy showing no sign of inflationary pressures? Summers's answer is that we may be an economy that needs bubbles just to achieve something near full employment – that in the absence of bubbles the economy has a negative natural rate of interest. And this hasn't just been true since the 2008 financial crisis; it has arguably been true, although perhaps with increasing severity, since the 1980s.
>
> So you might be tempted to say that monetary policy has consistently been too loose. After all, haven't low interest rates been encouraging repeated bubbles? But as Larry emphasizes, there's a big problem with the claim that monetary policy has been too loose: **where's the inflation? Where has the overheated economy been visible?**

Which is kind of the point we were making here (http://ftalphaville.ft.com/2012/08/31/1135531/time-to-resurrect-the-missing-variable/), here (http://ftalphaville.ft.com/2013/04/26/1477242/counterintuitive-insights-that-are-only-now-making-the-mainstream-now/)and here. (http://ftalphaville.ft.com/2013/03/06/1412822/the-age-of-infinite-equity/)

Speaking of the economy's desire to blow ever more arbitrary bubbles to keep the wealth effect going… (http://bitcoincharts.com/charts/mtgoxUSD#rg60ztgSzm1g10zm2g25zv) perhaps it's time to consider Bitcoin as the market's own organic way of satisfying Keynes's hypothetical policy of burying currency in coalmines and letting the private sector dig it up? (Though obviously in a way that currently distributes the wealth effect of that policy completely unequally.)

Related links:
Larry Summers just confirmed that he is still a heavyweight on economic policy (http://qz.com/147861/larry-summers-just-confirmed-that-the-world-still-has-to-pay-attention-to-him/) – Quartz
A Permanent Slump? (http://www.nytimes.com/2013/11/18/opinion/krugman-a-permanent-slump.html?_r=0)- New York Times
Greenspan's dilemma revived (http://ftalphaville.ft.com/2013/11/11/1692272/greenspans-dilemma-revived/)- FT Alphaville
How I learned to stop worrying and love the bubble (http://ftalphaville.ft.com/2013/09/27/1649682/how-i-learned-to-stop-worrying-and-love-the-bubble/) – FT Alphaville
The age of infinite equity (http://ftalphaville.ft.com/2013/03/06/1412822/the-age-of-infinite-equity/) – FT Alphaville
An economy that needs bubbles (http://dizzynomics.wordpress.com/2013/11/18/an-economy-that-needs-bubbles/) – Dizzynomics

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Thought for the weekend

Wazza and Greta

AUGUST 16, 2019 By: FT Alphaville

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PEguy

Nov 24, 2013

Take a bow The Onion. They said this much in 2008

http://www.theonion.com/articles/recessionplagued-nation-demands-new-bubble-to-inve,2486/

"America needs another bubble," said Chicago investor Bob Taiken. "At this point, bubbles are the only thing keeping us afloat."

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Tom_

Nov 20, 2013

@rlin - This is not a recession, this is a prolonged period of slow growth, and one of the reasons is low savings and investment. When the central bank suppresses real rates it encourages borrowing but discourages saving; the result overall is higher total spending but less investment. On a national level, investment = savings - current account. The theory of real rates being above equilibrium is not mine, it's standard New Keynesian, and I disagree with it. I don't see Summers or Krugman arguing that bubbles increased long-term growth, but that would be a very dumb thing to believe. The "confidence fairy" hasn't been refuted, US business investment is up in the wake of fiscal consolidation, and that is not an uncommon outcome for fiscal consolidations especially in emerging markets.

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Economistadebancada Nov 19, 2013

The main cause of the "Secular stagnation" is the population decline as explained for Portugal and Europe in the following blog posts:
Is Portugal Facing a “Shortage Of Japanese"? **http://sidelinecon...e-of-japanese.html**
Can demography explain Portugal's slump before the crash? Is the Eurozone suffering from a “Shortage of Japanese”?**http://sidelineconomics.blogspot.com/**

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Felix2012 Nov 19, 2013

I am starting to imagine an afterlife where all siners are bailed out via Christianity version of QE (hell fire at the lowest setting?) until they redeemed them self

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Felix2012 Nov 19, 2013

Asset speculation and lending without (kindof) losers/bankruptcy is like Christianity without hell ??

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rlindsl Nov 19, 2013

" If you want more investment, you need more savings, not less." & " US savings is simply too low to generate investment.", What I think you are stating is that this is not a demand based recession, it is instead related to a lack of...savings? And then further it is your opinion that real rates are currently above "equilibrium" even though at near zero, so you agree with an idea to penalize savings above a negative net carry rate currently enjoyed by holders of US treasuries... ? Remarkable.

I would like to see any evidence of counter cyclical fiscal policy employed by the US or any other nation. Federal spending as a percentage of GDP ex .mil is at the lowest level since 1947. The last fiscal stimulus was the census bump, a thing that worked for a quarter proving the value of direct stimulus spending.

Summers's point was that US GDP would have been in constant decline if not for the serial capital bubbles of the last 3 decades, and this squares with the decline in middle class wealth over the same time span related to advances in automation and technology that divert the benefits of (drastically) increased productivity from labor to the capital side of the balance sheet. Both Krugman and Summers are advocating counter cyclical fiscal policy, instead every economy on Earth has engaged in austerity at the same time consumers are deleveraging, leaving demand spiraling downward.

So they are proposing something yet not used, fiscal spending during a contraction. It is a better proposal based on actual data compared to the austerity/confidence fairy advocates so thoroughly refuted even by the IMF, early advocates of austerity in the beginning of the crisis.

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Tom_ Nov 19, 2013

What's most pathetic is that while admitting stagnation is secular these guys have no other proposal than to prolong counter-cyclical measures indefinitely.

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Tom_ Nov 19, 2013

The condition is real, the prescription misguided.

The first problem is the theory that depressed investment results from real rates being above the "equilibrium" rate, where, theoretically, investment is sufficient to generate full employment without (above target) inflation. It follows that the top item on our agenda should be to somehow lower real rates, which with rates near zero means to depress term and risk premiums and/or generate inflation.

Actually, lowering real rates has two effects: stimulating spending, and increasing the proportion of spending that goes towards consumption, while reducing the portion that goes towards investment. Low rates suppress savings, and savings equals investment. If you want more investment, you need more savings, not less. Emerging market governments and central banks still know this, and developed-world economists remember it when they're dealing with EM governments and central banks. Granted the US can and does rely heavily on foreign savings, without anywhere near the risk that an EM would take. But that only goes so far. US savings is simply too low to generate investment.

The theory makes a little bit of sense if restated: lower real rates stimulate more consumption, which results in higher near-term employment. That makes some sense as a short-term response to a crisis. But it shouldn't surprise anyone that an economy with manipulated low rates has low investment and low long-term growth. That should be expected.

What's so hard to reconcile about repeated bubbles and limited inflation? Bubbles are crazes for investment in particular assets beyond reasonable expectations of sustainable demand for them. They direct savings towards unproductive assets or an excess of a particular kind of normally productive assets and thus destroy wealth. Should we be surprised if a new tulip craze doesn't raise the average wage rate? Besides, there was significant general overheating in both the last US bubbles, especially in the late 1990s.

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rlindsl Nov 19, 2013

This is a highly defined problem if you have been reading the FT's blogs. Technology decreases middle class labor and skilled positions, technology is property owned by capital, technology is creating ever greater efficiency.... rinse repeat ad infinitum. This inevitable artifact of the information age is being exploited by the holders of capital, the owners of the technology via the political system and tax code. Any number of gimmicks and hacks are being employed to purchase political power and promote the continued inequalities of wealth distribution. It is another simple fact that the more concentrated the wealth, the lower the number of consumers with discretionary income. This becomes a self reinforcing feedback mechanism until it is interrupted by a change in fiscal policy, and that must be predicated on campaign finance reform- God only knows what precipitates campaign finance reform...

I wish @IzabellaKaminska would do a series on "What is Wealth?". Expand on creating scarcity in in an abundant world. Why on Earth would the work week not be shortened, minimum wages increased, taxes on capital gains increased (a lot) and basic access to food, housing, medical care become assured as this drives demand and increases social stability.

The largest problem with inequality seems to be a disconnection from the ability to empathize with your fellow citizens, if the wealthiest of our populace understood how odious it is to deny food aid to children seemingly on a vindictive whim, if they understood the danger to social stability this incurs, then they would see "civil capitalism" as a good investment. I fear that the current suppression of the majority will see a future transition in a non-stochastic manner instead.

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Economistadebancada Nov 19, 2013

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Can demography explain Portugal's slump before the crash? Is the Eurozone suffering from a “Shortage of Japanese”?**http://sidelineconomics.blogspot.com/**

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The Dork of Cork. Nov 18, 2013

Its in the very nature of the compound interest system which causes a extreme concentration of capital over time. This results in a breakdown of the local production /distribution / consumption system.

They as keepers of the gate must invent bubbles that the people cannot consume if they are to preserve the relative wealth of those whom they serve.

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Is it that easy Nov 18, 2013

Summers and Krugman deal in absurd aggregates..

They care not where capital is spent (unproductive housing on a vast scale) nor to whom it is allocated (the wealthy whilst taking form the middle and the poor.

If they gave a single moments thought to fiat money, credit expansion, unproductive asset price appreciation and the consequent distribution of income and wealth, we may actually get somewhere.

Instead we just get yet more of the extreme absurdity.. sick and shameful in this supposed advanced and sophisticated economy of ours.

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balakris Nov 18, 2013

Anyone for zero growth being a good thing?
Might just address the quality and distribution of growth.
Disappointing that 'brilliant' summers and krugman don't or can't comprehend the real issues.

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Nobby Nov 18, 2013

I continue to believe that ideas such as negative rates and other monetary efforts to rebalance the economy by shifting wealth from one group to another should in fact be done by fiscal means. Targeted spending, tax cuts and tax raises could be more effective in making sure you achieve your aims and more importantly, are decisions taken by democratically elected governments, rather than unelected central bankers.

Overall, I believe that QE did achieve some useful goals, but the real failure has been on the fiscal side which is even more pernicious in redistributing wealth to the top 1%.

In simple terms, poor people's money has a higher velocity than rich peoples.

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Barry May 15, 2019

@Nobby

Nice to see a mention of money velocity as this is the key to the whole problem. As rich people take more and more of the share there is less and less overall velocity. The rich are breaking the system and no amount of capital injection can resolve that in the long run.

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Pastaneta Nov 18, 2013

If almost everything is "bubbles" and "irrational exuberance" and "animal spirits" and "random pessimism" - what's the point of "economics" and "economists"? These terms all suggest that prices have little if any meaning, that you cannot trust the unpredictable, irrational, thoughtless "hoi-polloi" - and only - now hold your breath - smart politicians, economists, dictators, "genetic accidents" (monarchs with powers, that is), central bankers, bureaucracies - whatever centralized authorities are called - are the solution to problems. If prices are no longer reliable signals to match talent and capital, or correct mismatches faster - some central authority must make them - based on - what? And based on what will the mismatches be corrected? Relying on central authorities under one label or other seem the only logical conclusion of all these arguments. So why don't these economists make them explicit?

And then have a discussion whether or not it was possible that these "bubbles," and "bouts of pessimism" are consequences of policies passed - perhaps - with good intentions, and perceived - blinded perhaps - through the prisms of bad ideas (which are today viewed as "good economic theories"?). It would not be the first time bad ideas dominated policies. Astrology was perceived as science for one hundred years monarchs and courts relied on astrologers), communism was thought to do better matching of people and resources for decades - and now some economists rationalize central planning by seeing bubbles right and left - and argue for more central planning (be it by governments or central banks).

Reuven Brenner

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grumpy Nov 18, 2013

From Kruggy:

“Any such suggestions are, of course, met with outrage. How dare anyone suggest that virtuous individuals, people who are prudent and save for the future, face expropriation? How can you suggest steadily eroding their savings either through inflation or through negative interest rates? It’s tyranny!

But in a liquidity trap saving may be a personal virtue, but it’s a social vice. And in an economy facing secular stagnation, this isn’t just a temporary state of affairs, it’s the norm. Assuring people that they can get a positive rate of return on safe assets means promising them something the market doesn’t want to deliver – it’s like farm price supports, except for rentiers.

Oh, and one last point. If we’re going to have persistently negative real interest rates along with at least somewhat positive overall economic growth…..”

It appears to me that this repeated throwing-of- the-hands-in-the-air about the supposed outrage of the self-defined ‘virtuous’ rich seems to miss the point that the real targets being hit by a future of low interest rates are those who have not already amassed wealth or savings and haven’t followed advice to invest it in a non-cash or non-near-cash form.

A future with near zero interest rates everywhere fabulously boosts the value of anything with a yield (property, bonds, shares etc) - things which the rich have already. That drawbridge is on its way up guys! (to save the world though - all in a good cause). Its a sort of crystal-meth version of ‘haves’ and ‘have-nots’ .

Meanwhile those attempting to “save” (the cheap bastards!) can have negative interest rates on their unsophisticated little bank accounts undermining their accumulation of enough cash to buy some of those super-assets that are held, at officially protected bubble valuations, by the rich.

Are we to have a new Nobility - for the public good?

Is it possible that there is a point beyond which, determination to outwit and do away with the concept of “the business cycle” becomes, a game not worth the candle?

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JulN Nov 18, 2013

Summers and Krugman are wrong. They use a wrong definition of inflation and therefore gets to the wrong conclusions. Let's list some of the reasons:
1. CPI/RPI don't accurately reflect inflation
2. There can be 0% CPI increase and still be inflation: productivity growth produces deflation. So 0% CPI could well hide inflation.
3. Most asset prices aren't reflected in inflation figures. But our economy has changed over the last 50 years: investment/speculation, rather than consumption, is where most newly-created money flow towards. So inflation can remain low and asset bubbles appear. This would eventually lead to higher consumption and prices if only the bubbles didn't burst all the time (and the artificial wealth disappearing with them)...

At least Scott Sumner and the market monetarists have a more consistent (though arguable) approach: they admit that inflation figures are pretty much worthless and only focus on NGDP trend.

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Nobby Nov 18, 2013

One of the reasons why the surpluses of the Clinton years so quickly switched to deficits in the Bush years is the ability under the US tax code to take back capital losses.

In a bubble market, tax receipts are boosted by the large gains of investors, but if and when this pops and losses are generated, you not only lose the "expected" tax revenue, you end up losing what you collected in prior years.

In many ways, a centrally planned bubble give a false impression of government cash flows because they merely "borrow" from the future.

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Heleen Mees Nov 18, 2013

@Izabella Bubbles also ruin the tradable sector - at least the recent housing bubbles did - because of Dutch disease like effects. So, I think this love for bubbles will get us nowhere.

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Izabella Kaminska FT Nov 18, 2013

@helen - i agree! I think that's the key problem with it. There has to be some sort of distribution mechanism to counter that.

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Heleen Mees Nov 18, 2013

@Bonnemort That may be true for Summers, but I doubt it is for Krugman.

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Bonnemort Nov 18, 2013

Heleen Mees - "like trickle-down economics, (asset bubble) increases inequality .."

Maybe as far as some people are concerned that's a feature, not a bug.

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Worldly Wiseman Nov 18, 2013

"The economy's desire"... anthropomorphic fallacy, non? More broadly, isn't stigmatising developments as bubbles a cop-out, in that it implies a lack of predictability about when they will burst which saves the effort of bothering predicting what exactly might deflate them. So for example if one believes that London property is a bubble rather (say) a revaluation in line with other international prime markets, then one might argue that a change of government in 2015 with a clear intention to introduce, and clear budgetary need to make stringent, a "mansion tax" might reduce its attraction.

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Heleen Mees Nov 18, 2013

I don't get Krugman and Summers. Generating economic growth through asset bubbles is like trickle-down economics. It increases income inequality quite a bit.

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Iron I Cally Nov 18, 2013

Didn't these guys create the problem in the first place via banking deregulation, leading to excessive credit growth?

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Nihil1st Nov 18, 2013

"...wealth effect of bubbles..."?

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TL25 Nov 18, 2013

with Q&A here **http://www.imf.org/external/np/res/seminars/2013/arc/index.htm**

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