

Economy

Focus US

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On some heterodox economic ideas

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The economic policy debate in the US is drifting further and further away from the consensus that prevailed before the 2008 crisis. Until then, it was understood that monetary policy should prevent inflation from spiralling and fiscal policy from making deficits unbearable. Now, the Fed is concerned that inflation is durably too low, not too high. Deficits no longer frighten Republicans who voted for tax expansion at the top of the cycle, while some Democrats see them as the silver bullet for reducing inequality, eliminating unemployment and fighting climate change!

The week's focus

Modern Monetary Theory, Green New Deal, Price-Level Targeting... these expressions have been creating a buzz in the economic and political US blogosphere for some time. What is encompassed by these expressions is not always immediately clear (especially in the first two cases) but it is from the perspective of these concepts that it is now fashionable to examine economic policy choices. Let's try to get a clearer picture.

➤ **Modern Monetary Theory (MMT)** - This current of economic thought revives the old idea - which is not very "modern" - that a state can escape any budgetary constraint by appropriately using its monopoly on money issuance. The government could finance as much spending as it wants, for example, until full employment is established forever, by creating money. It would not need to worry about deficit or debt levels. The only constraint to its action would be a surge in inflation or a fall in the currency. Currently, inflation is too low and the dollar is rather strong, which reduces these risks. In any case, according to MMT supporters, it would still be possible to slow demand by raising taxes or substituting debt for monetary financing. The Fed's role in the MMT is not clear. This heterodox school of thought, which is very popular in part of the US left¹, has been criticised in recent days by the Fed chair and prominent Keynesian economists, such as Paul Krugman and Larry Summers.

➤ **Green New Deal** - As its name suggests, it's Roosevelt + the fight against climate problems. This plan provides for massive state intervention (creation of millions of guaranteed jobs), a drastic correction of inequalities (taxation of high incomes and wealth) and multiple actions to accelerate the energy transition (decarbonisation of economic activity, new infrastructure spending). The link with MMT is obvious since it is a question of massively increasing public spending. Alexandria Ocasio-Cortez, one of the most prominent young Democratic women elected, has proposed a resolution to this effect in the House. The debates of the Democratic primaries for 2020 will largely revolve around these ideas.

➤ **Price-Level Targeting** - Since the last crisis, this concept has become increasingly popular because it has become clear that central banks have been unable to return inflation to their targets. Rather than targeting inflation, the alternative would be to focus on the price level. To take a simplistic example, if inflation for five years was 1% instead of 2%, the Fed would tolerate inflation at 3% for five years to compensate for "lost" inflation. This would reinforce the idea that the inflation target is symmetric. This year, the Fed launched a comprehensive review of its monetary strategy, which could lead to changes in the first half of 2020. *Price-Level Targeting* is a serious concept. It is possible that it will be adopted by the Fed².

These are some examples of how the economic policy debate is evolving. The idea of adapting the monetary strategy is welcome. Casting aside all interest in government deficits and debt is a dangerous option, needless to say. But some might say that fiscal irresponsibility already reigns in the US...

¹ One of MMT's leading proponents, Stephanie Kelton, was Bernie Sanders' economic advisor in 2016.

² Clarida (2019), "The Fed's review of its monetary policy strategy, tools, and communication practices".

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- Around the world, confidence in the manufacturing sector has been on the wane for months, widening the gap with a more resilient service sector. The US is no exception to this general trend, but has a much better business climate than the rest of the world. In **February**, the ISM-manufacturing index was 54.2pts (-1.4), the US PMI index stood at 53pts (-0.7pt) whereas the worldwide index excluding the US was close to the expansion/contraction threshold at just 49.9pts. In the non-manufacturing sector, the ISM index rebounded strongly in February (+3pts to 59.7), probably reflecting relief after the end of the longest shutdown in US history (the index had lost 3.7pts over December and January). The strength of business confidence indicators bodes well for further expansion. However, **Q1 2019** has started with a poor "growth carryover". The Atlanta Fed's first GDPnow estimate stands at just +0.5% q-o-q annualised. The negative contributions of residential investment, inventories and foreign trade are barely offset by consumption spending. The Beige Book (with a closing date on **25 February**) notes a negative impact of the shutdown in many areas: retail, car sales (-5.5% over January-February), tourism, real estate, restaurants, industry, staffing services. The return to normal will only be complete in Q2.

Monetary, fiscal and trade policy

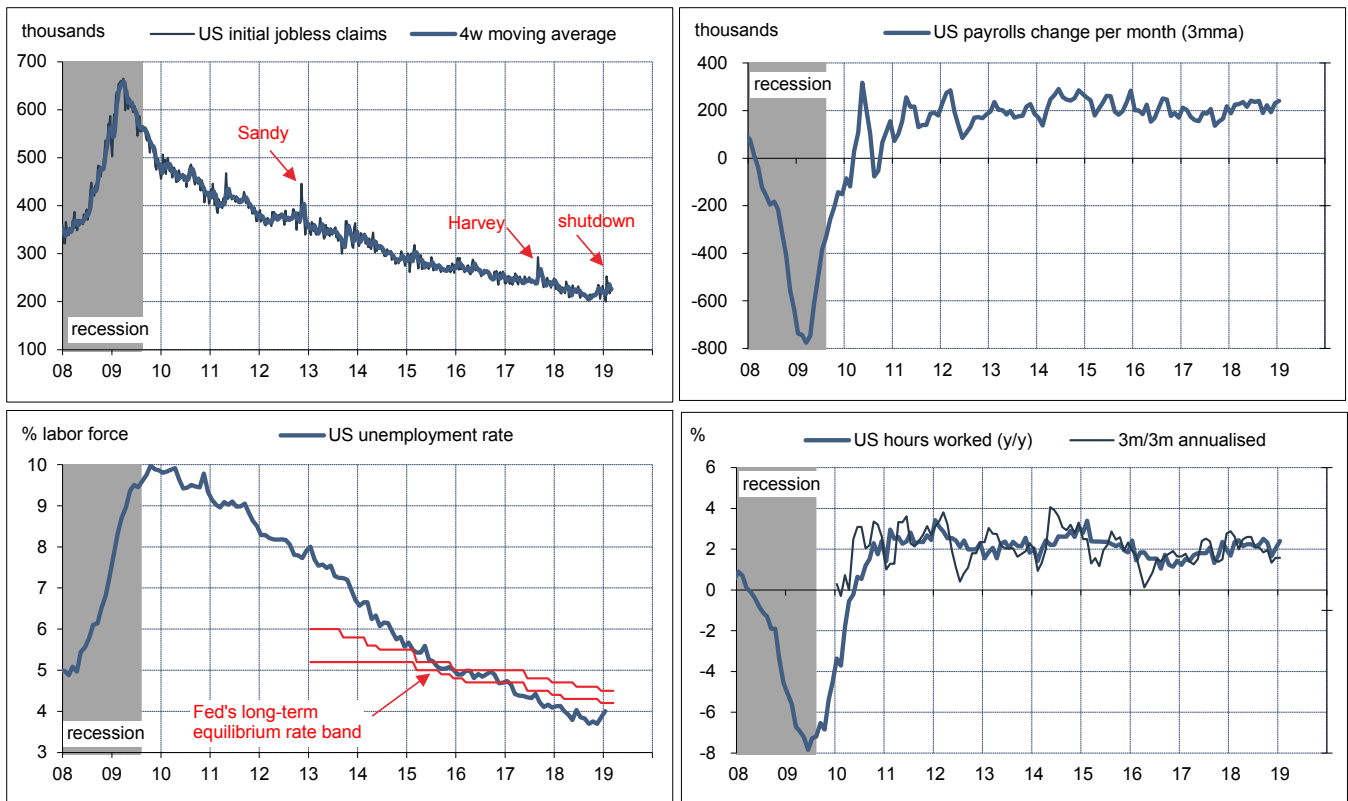
- Twin deficits / budgetary component - With the January data, the federal budget deficit stands at \$ 310bn for the first four months of the fiscal year, or +\$ 130bn compared to the same period a year earlier. The effects of the tax reform are fully felt as total tax revenues are down by 1.5% year-on-year (-34% for corporate income tax). The federal deficit is currently around 4.5% of GDP, a high level given the position in the cycle (growth > medium-term potential, full employment). The mood at the moment is one of indifference (see p.1). On **2 March**, the federal debt ceiling was restored to \$ 22tn, or 107% of GDP. Taking into account the intragovernmental holdings, the exchangeable public debt is 79% of GDP. In view of its cash reserves and the exceptional measures it can adopt, the Treasury can cover its expenses until the end of August, after which the Congress will have to suspend or raise the statutory debt ceiling again.
- Twin deficits / trade component - In **December**, the balance of trade in goods and services widened to -\$ 59.8bn. In 2018, the deficit reached \$ 621bn (vs \$ 552bn in 2017), a ten-year high. This increase is logical given the strength of US domestic demand, but the result is nevertheless barbed as Donald Trump's protectionist offensive targeted the opposite result. We remember last April, for example, he was tweeting: "*When you're already \$500bn DOWN, you can't lose!*" In fact, everything has combined to widen the trade deficit: 1) tax cuts (support for US demand); 2) Fed's policy rate increases (support for the dollar); 3) trade tensions (retaliation against US customs duties). All told, in 2018, US exports to China fell by 31% Q4/Q4. *So much winning...*
- On **5 March**, breaking with the monotony of the Fed's "patience" refrain, **Robert Kaplan** (Fed Dallas) expressed concern about the level of debt of non-financial companies (higher than at the three peaks in 1990, 2001 and 2009) and the decline in credit quality. He did not announce a sudden crisis but reminded us that this problem can accentuate an economic downturn. See also our *Focus-US* of 16 November 2018: "General warning on leveraged loans".

The week ahead

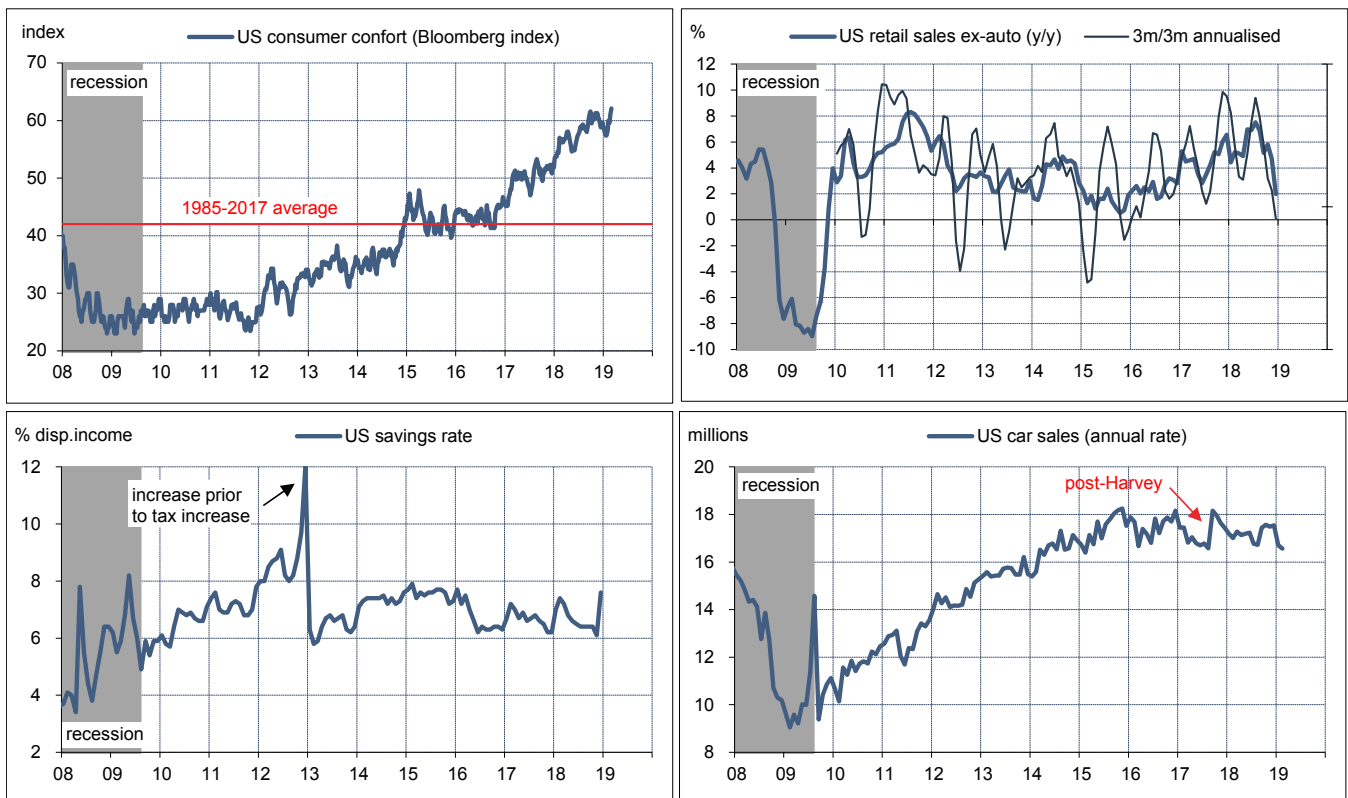
- The January retail sales report will be the highlight of the agenda (**March 11**). In December, retail sales had dropped dramatically (-1.8% m-o-m), unrelated to the usual fundamentals of household spending. The stock market crash and the approach of the shutdown were explanatory factors. Equity markets rebounded at the beginning of the year but the shutdown continued until 25 January. In addition, extreme weather conditions disrupted activity and spending in the Midwest for part of the month. Overall, there are few reasons why the rebound should be massive (+0.4% expected). The other important statistic is industrial production in February (on the **15**). In January, the 0.6% decline came from the collapse of automotive production (-8.8% m-o-m) following plant closures in the Midwest. This setback will be corrected. Overall, the US industry remains concerned, as noted in the last Beige Book, about the weakening of global demand, the impact of new tariffs, and uncertainty regarding trade policy. On the latter point, however, it is confirmed that an easing of the friction on the US-China front is in prospect.



Appendix 1 - Labour market



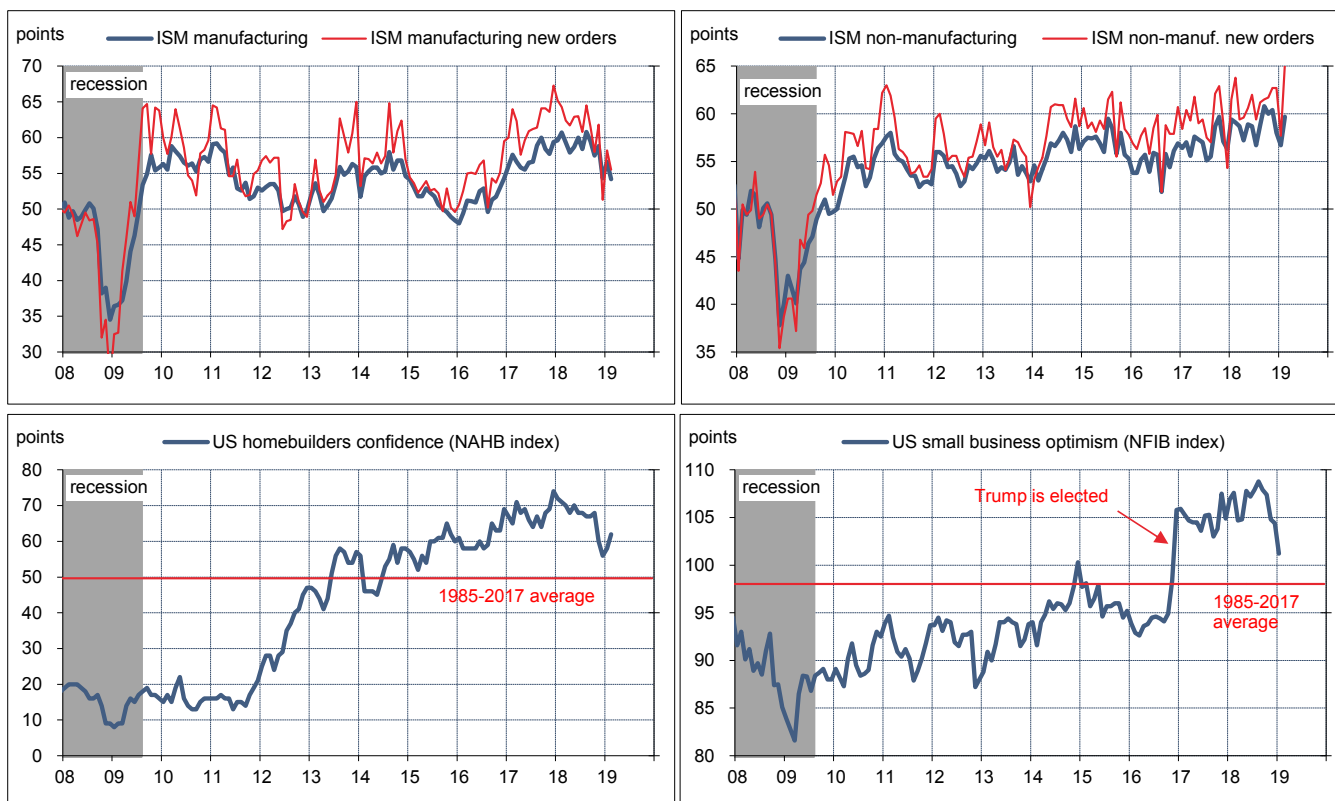
Appendix 2 - Consumer



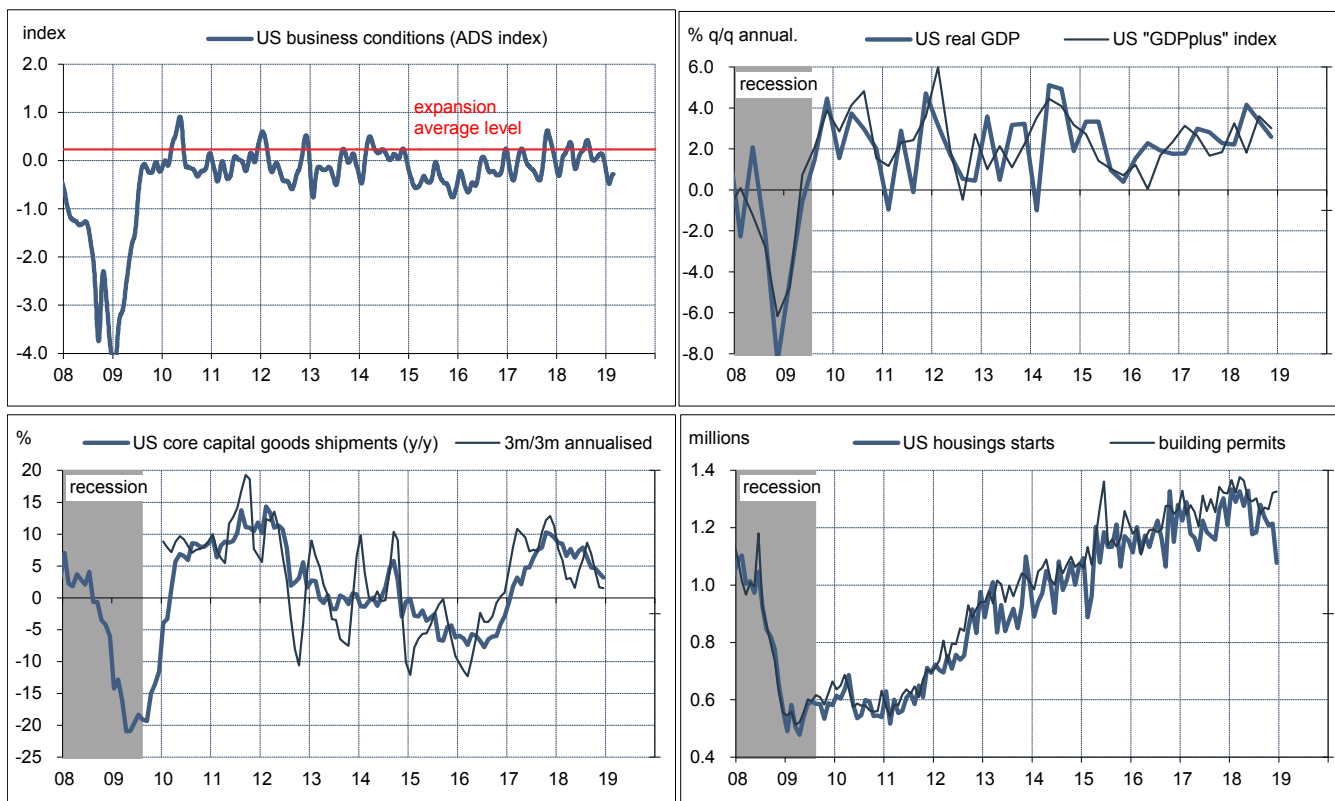
Sources : Thomson Reuters, Bloomberg, Oddo BHF Securities



Appendix 3 - Business climate



Appendix 4 - Conditions of economic activity



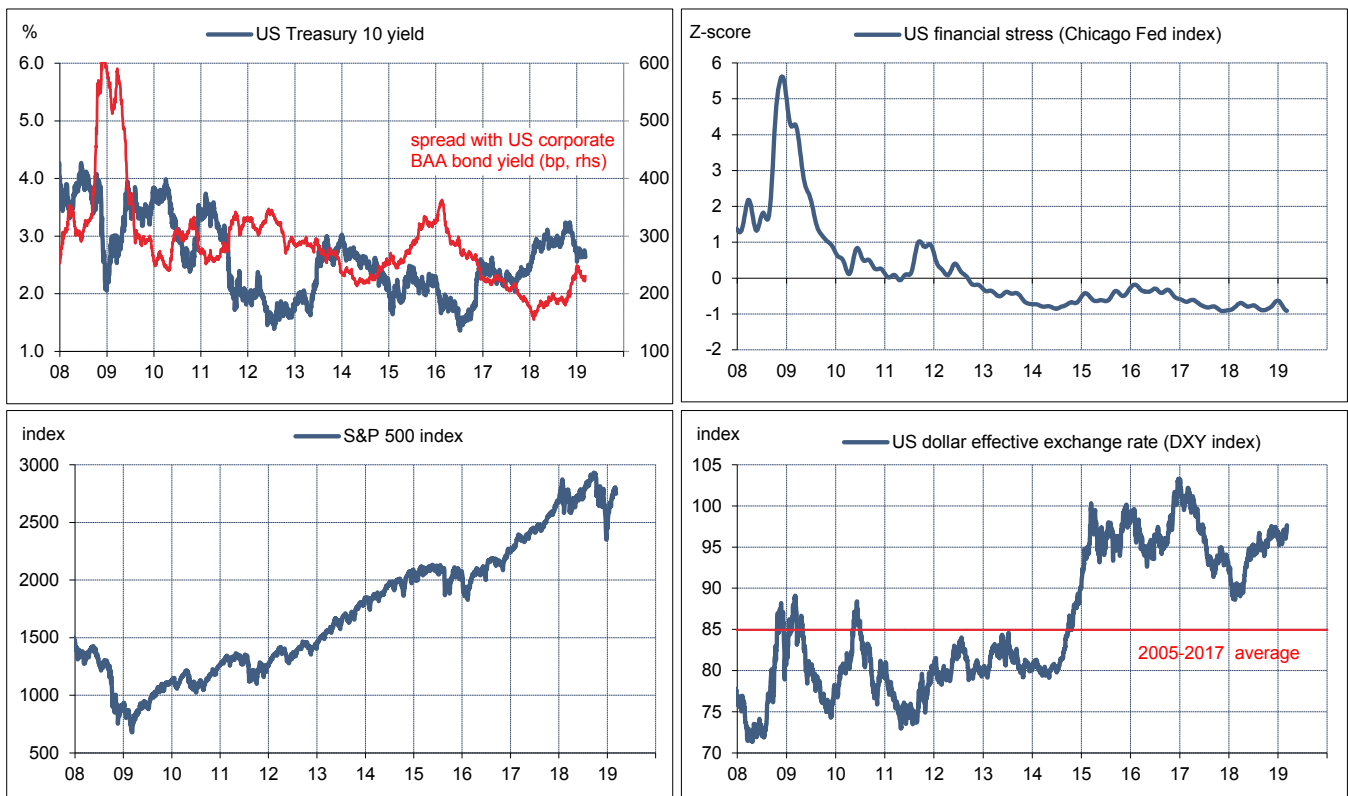
Sources : Thomson Reuters, Bloomberg, Oddo BHF Securities



Appendix 5 - Inflation and monetary policy



Appendix 6 - Financial markets



Sources : Thomson Reuters, Bloomberg, Oddo BHF Securities



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