

KNOW YOUR LIMITS !

A Simplified, No-Nonsense, 1-Page Summary Of The Economy

Sept. 2015 — by Benoit Herrmann

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		High Inflation	Low Inflation	Low Deflation	High Deflation
Likely Meaning		Disrupted supplies or wage bubble or loss of faith in currency/country outlook	Decent job market, growth, wages and prices rising accordingly	Unemployment or working poverty or debt weakening demand/weighing on growth	Sudden collapse of a debt-driven and/or foreign capital-funded asset bubble
Best Store Of Value	Gold	+	-	+	+
	Foreign currencies	+	-	+	+
	Cash	-	-	+	+
	Assets	-	+	-	-
Winners		Foreigners	Bulls	Savers	The prepared
Losers		Nationals	Bears	Investors	The unprepared
Risk	Economic	Economic seizure	Overoptimism	No investment	Fight for survival
	Financial	Capital flight	Financial bubble	Political meddling	Bankruptcies
	Social	Misery	Good times	Class war	Panic
	Political	Xenophobic dirigisme	Complacency	Unpopularity	Social dirigisme
Past Examples		Sanctioned Germany (1919-1933) Protectionist Argentina (post-1946) Embargoed Iran (post-1979)	The Western World (1981-2008)	2nd Industrial Revolution (post-1870)	U.S. Great Depression (post-1929) Japanese Financial Crisis (1990) Asian Crisis (1997)
Typical Remedies	Short-Term	Restore supply chains, clean up finances, prop up currency, impose capital controls	Maintain good governance, avoid accidents, deflate bubbles	Justify social order or redistribute wealth, increase public spending, devalue	Engage in nationalisations, big projects and social welfare, unpeg currency
	Long-Term	Diversified economy, sound finances, varied trade partners, market wages	Education, innovation, sensible investment, competitiveness	Innovation, export-driven growth, low inequality, job-rich economy	Honest governance, strong regulation, financial exuberance under control
What if the state is broke ?		Chaos, bail-out from IMF or "ally", political servitude, opened markets	Perfect time for reforms and public debt reduction	"Austerity" unavoidable although painful and depressing demand even further	Chaos, bail-out from IMF or "ally", political servitude, market purge
2015 Examples		Greece, Brazil	Iceland	G7 countries	None so far
Recent U.S. History		1968 - 1981	1981 - 2008	2008 - 2015	Coming up
		<ul style="list-style-type: none"> The costs and the extra-production incurred by the Vietnam War start to take their toll. Overheating economy, first inflation wave. 1971: the world loses faith in dollar's value. Nixon is forced to unpeg it from gold, causing overdue devaluation/more inflation. An OPEC-triggered oil shock rocks the world. 1970s: self-perpetuating inflation sets in as companies and trade unions grow used to raising prices and wages by anticipation. Fear of recession and obsolete doctrine convince leaders to mostly ignore problem. Country plagued by a crisis of confidence. 	<ul style="list-style-type: none"> 1981: the FED forcefully raises interest rates in the first strong move to tame inflation. Supply-side economics "finishes the job" as Reagan deregulates markets, making U.S. industry competitive again. Over the period global trade, internet and financial innovation transform the world. Deepening trade and public deficits. Until now the world seems unfazed as dollar remains strong. Main reasons: (a) U.S. economy is deemed dynamic/safe (b) deep financial market (c) petrodollars are "recycled" (d) from 1997, traumatized Asia starts accumulating FX reserves. 	<ul style="list-style-type: none"> 2008: debt crisis. True collapse is averted through public spending, nationalisations and unprecedented monetary support (zero interest rate, money printing). Weak investment, record share buybacks. Enfeebled workforce prevents any inflation, which materializes through asset bubbles. Hoped-for deleveraging doesn't happen. Inequality turns into major issue ("the 1%", "Wall Street vs. Main Street"). Rising anti-establishment sentiment. Polarized politics, bankrupt federal state. 2015: petrostates and China begin to resell U.S. debt to face their own domestic travails. 	<ul style="list-style-type: none"> New monetary stimuli in the cards ? War on cash, gold and deposits ? Collapse cannot be contained any further ? Sovereign default ? New job-creating innovations ? Redistributive taxation, leaner state and private deleveraging ? Subdued finance, pro-people revolution ?
		1971 - 1979	1979 - 2008	2008 - 2015	Coming up
		<ul style="list-style-type: none"> The post-war boom starts to wane. An OPEC-triggered oil shock rocks the world. As protected prices and wages fail to adjust, unemployment rises fast in rigid Europe. Disindustrialization, sluggish growth. Attempts to lift demand through spending only succeed in fanning inflation. 	<ul style="list-style-type: none"> Protected markets are opened to trade, which requires less safe/generous jobs. German reunification, euro launch. 2000s: the euro allows Southern states to enjoy a debt free ride while Germany reforms itself into an export machine. Different choices lead to diverging roads. 	<ul style="list-style-type: none"> 2008: debt crisis. True collapse is averted through public spending, nationalisations and unprecedented monetary support. Unemployment, "insiders vs. outsiders", widening North-South competitiveness gap. State insolvency becomes a major risk, forcing austerity. Popular discontent. 	<ul style="list-style-type: none"> Sovereign defaults ? Eurozone breakup ? Move to a federal transfer union ? Leaner states and fluid private sector ?
Recent Japanese History		Coming up	2013 - 2015	1991 - 2013	1990 - 1991
		<ul style="list-style-type: none"> Currency collapse and hyperinflation ? Sovereign default ? 	<ul style="list-style-type: none"> Abenomics goes all-in on money-printing to keep state afloat and devalue currency. Exports are lifted. Some inflation is imported, hurting wages amid persistent malaise. Stubborn stagnation, no obvious way out. 	<ul style="list-style-type: none"> "Lost decades": monetary/fiscal support and cosy ties allow minimal deleveraging at the price of a skyrocketing public debt and an economy under stationary regime. Rich/aging population, modern technology: room for growth becomes increasingly thin. 	<ul style="list-style-type: none"> 1985: asset prices start to quickly pick up in the real estate and stock markets. Overconfidence and lax monetary policy enable ever more debt accumulation. 1990: a colossal asset bubble explodes.
		Coming up	2013 - 2015	1991 - 2013	1990 - 1991
		<ul style="list-style-type: none"> Opening up to new entrants/immigrants ? Savings invested overseas to bring revenue ? 	<ul style="list-style-type: none"> Exports are lifted. Some inflation is imported, hurting wages amid persistent malaise. Stubborn stagnation, no obvious way out. 	<ul style="list-style-type: none"> "Lost decades": monetary/fiscal support and cosy ties allow minimal deleveraging at the price of a skyrocketing public debt and an economy under stationary regime. Rich/aging population, modern technology: room for growth becomes increasingly thin. 	<ul style="list-style-type: none"> 1985: asset prices start to quickly pick up in the real estate and stock markets. Overconfidence and lax monetary policy enable ever more debt accumulation. 1990: a colossal asset bubble explodes.
Main Stakes Of Our Time		Growth is fundamentally slowing due to a couple of big trends: population stabilization, lack of job-creating/materially productive innovation (which internet isn't fully), wealth concentration (when only the rich get richer, ever fewer people can afford to spend more). This is a major turning point for our debt-saturated modern economies. We may have wrongly associated unfunded welfare systems with progress: could it be an historical rarity that only the growth rates of the XXth century made possible ?			
		As growth stalls and deflation sets in, mountains of debts become unpayable. Deleveraging and restructuring are in order for the rich world: will it go smoothly or in a bang ? Central banks have tried to buy time through ultra-accommodative policies, but so far, perversely, these only helped to create even more debt. Stakes are at an all-time high. Barring spartan discipline and radical measures, a brutal collapse looks hard to avoid. It would start with any bank or sovereign default big enough to precipitate all the others.			
		China, by its size and its discipline, is an obvious competitor to U.S. dominance. As it launched its own IMF/World Bank in 2015 and started hoarding ever more gold, it is, with Russia, actively preparing the next world order. If the U.S., Europe and Japan were to go under, such global rebalancing could occur quicker than expected. In the process a new monetary system would emerge, based on gold and/or a basket of currencies. Hopefully Western misfortunes and Eastern revanchism won't degenerate into wars.			
		True growth comes from productivity gains, which mostly consist in inventions whereby capital replaces labor: tractors replace farmers, machines replace workers, etc. Today, computers and robots are replacing humans in a rising number of services: how then to employ people in the future ? How to ensure they still earn money to spend ? Perhaps future revenues will mainly come from personal assets (houses, equipments, stocks), useful jobs being limited to niche areas, human services and "creativity".			
		Human activity has remodeled Earth according to its needs. Sadly, we now reached a point where irreversible damage (resource depletion, climate change, biodiversity loss) could soon make our planet less inhabitable. Capitalism rests on "discovering" ever new needs. It isn't wired for self-restraint, however it is a great system for innovation: hopefully a series of transformative inventions will come soon enough. Even better if China leads the way: it may be its only chance to secure prosperity and soft power !			