‘On fiscal expansion: government deficit and debt in an era of low interest rates’

Dr. Dirk Ehnts
Structure of this presentation

1. The statistical picture
2. HM Treasury’s operations
3. Policy conclusions
4. Discussion
Low interest rates (1753-2017)
Low interest rates (1950-2017)
Public debt and interest rates (1700-2017)
Public deficits and interest rates (1980-2017)
HM Treasury’s operations

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• Quantitative easing: reserves for financial assets.
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• Banks can swap excess reserves for t-bonds with the Debt Management Office on the primary market.
• BoE supplies banks with reserves as demanded, otherwise bank transfers will bounce, impairing the payment system.
Policy conclusions

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Fiscal expansion and unemployment

Source: Bank of England

fred.stlouisfed.org
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• In all other times, public spending should crowd-in private investment.
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[Graph showing economic indicators over time with shaded areas indicating U.S. recessions. Sources: BLS, OECD.]
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• Rising wages are caused by rising demand, causing increases in M3.
How should monetary policy be organized to deliver price stability?

Obviously, there must be a middle way, a rate of money growth consistent with low inflation/price stability. The challenge is to have a rigorous model that enables monetary policy-makers to monitor – among other things – developments in the banking industry as a means of delivering, with precision, the right rate of growth of the quantity of money.

We will discover that, in a limited sense, the MMT theorists are right.
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• “All that the state has to do, if it needs to stimulate a depressed economy, is to borrow from the banking system and thereby to create new balances, and to buy something/anything with the new balances from the non-bank private sector etc. (And – for those who still struggle with these points – there is no need to expand the budget deficit. The state can buy existing assets from the non-bank private sector, including the long-dated government debt that the private sector owns. Public debt and the budget deficit are then unchanged, but the composition of the debt has changed and the quantity of money has increased.)”
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  • QE.
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• Total expenditure can be and is influenced by government spending, which creates additional incomes by spending more.
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(M3 from Fed, not Shadowstats)

M3 growth of 4-4.5% would have been contractionary in all years outside of recessions except 91-96. Unemployment would have been significantly higher.
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• Unemployment can be reduced by reducing working hours, too.
• Targets: full employment, price stability & sustainable economy
• Thank you.