

The Changing Landscape of Financial Markets

by

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I shall briefly review three successive periods, mainly from the viewpoint of a monetary economist:-

- 1) 1992/93 until 2007
- 2) 2008 until Now
- 3) The Future

1) 1992/93 → 2007

The best 15 years, from a macro-economic viewpoint in the history of mankind, by far! NICE years.

- Steady expansion.
- Low inflation.
- Declining and low unemployment.
- Global inequality declines for the first time since 1800, as poor Asia (China) grows faster than rich EU/North America.

NICE years caused by:-

Real factors:

- Demographic sweet spot.
- Globalization; China, E. Europe.
- Technology and productivity.

Policy:

- CBI and Monetary Targets
- But two serious *failings*; 'feet of clay'
- Over-optimism on *Financial Stability*. Minsky and macroeconomic stability breed financial instability.
- Worsening inequality *within* countries.

(N.B. Macroeconomics has exhibited exactly the same failings, e.g. the representative agent who never defaults in the common DSGE models.)

GFC → Today

- Super-expansionary monetary policy. Interest rates down to ELB; QE raises M0 manifold, but bank credit and broad money sluggish. Inflation below target.
- Better in USA than EU. Geithner force-feeds US banks with TARP money; with no equivalent pot of money, EU allows banks to raise CARs by deleveraging, largely via declines in cross-border lending.
- With fiscal policy constrained by politics, scary debt ratios and Maastricht, monetary policy facing continuing demographic/globalization headwinds.

- Did it matter that inflation remained slightly below target?
- Main problem has been fall in growth of productivity. Why? But beneficial side effect has been that labour markets have recovered more strongly than product markets.
- Revolt of the 'left-behind' working class. Immigration is seen by them as the most inimical aspect of globalization. Since left-wing politicians have idealistic views of the commonwealth of mankind, revolt has favoured right-wing nativist populists.

The Future

- Globalisation is in retreat
- Demographic factors are turning adverse. Growth of work force slowing; turning negative in Northern Europe.
- Fast rise in over 70s. Ratio of workers to old, dependency ratio, worsening rapidly. Old need care (dementia).
- Growth of real income staying low, or even falling.
- Equilibrium real rate, therefore, needs to stay low, but ex ante savings may fall relative to ex ante investment. (Politics again)

- Also, demographic/globalization changes will increase relative power of labour.
- Politics, demography and economics imply revival of inflation, not in next couple of years, but within the next decade.
- What happens to inflation target and CBI, once Central Bank governors cease being best friends of Ministers of Finance?