

# Class 3 – 2023-202

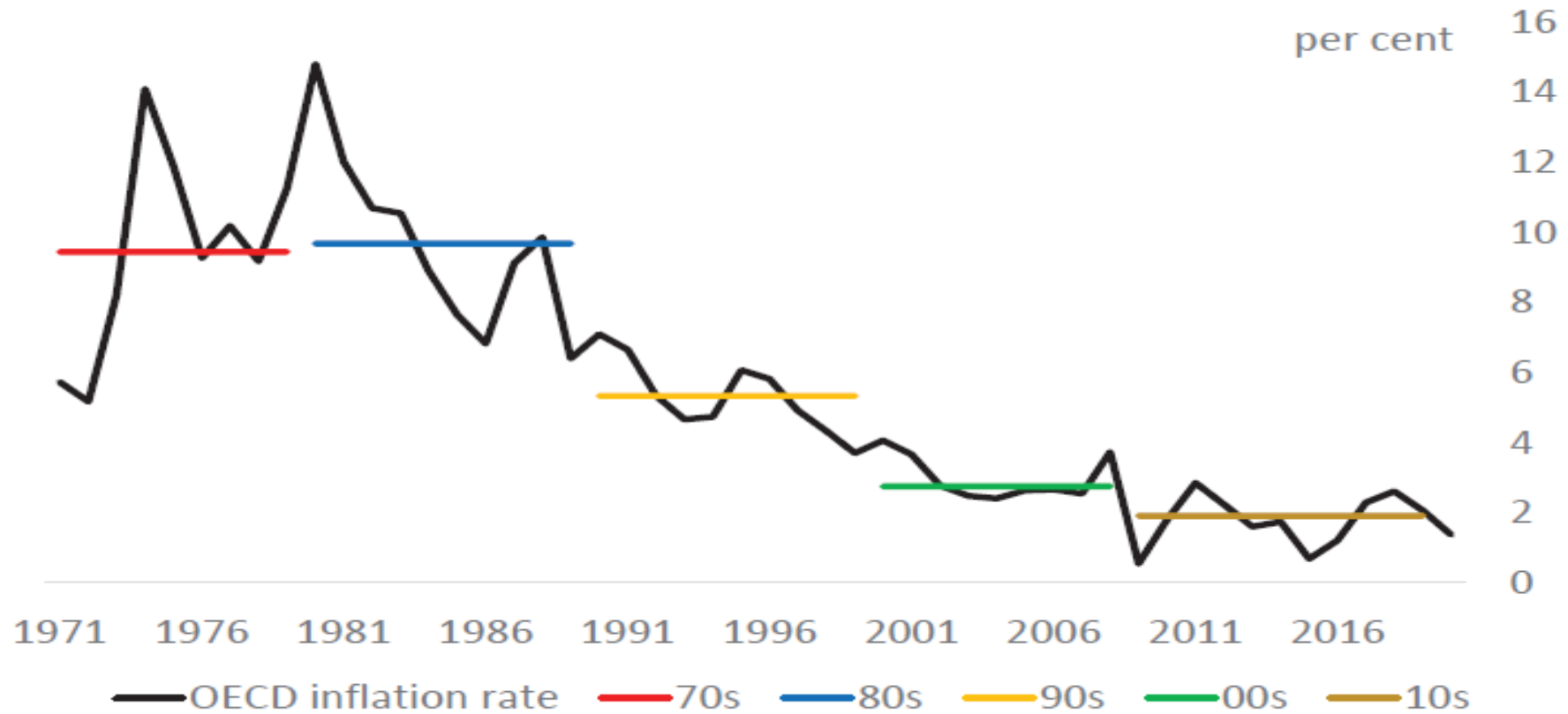
**COVID 19 and the return of inflation**

**The “Magic Money Tree” and Cryptos: currencies or assets? CBDCs**

# Recall – secular stagnation after the GFC

- Despite very low interest rates and QE > slow growth
- Low inflation
- Low long term interests
- Low investment in “non-productive” assets (cash hoarding, financial speculation by companies and investors)
- Poor income growth for households

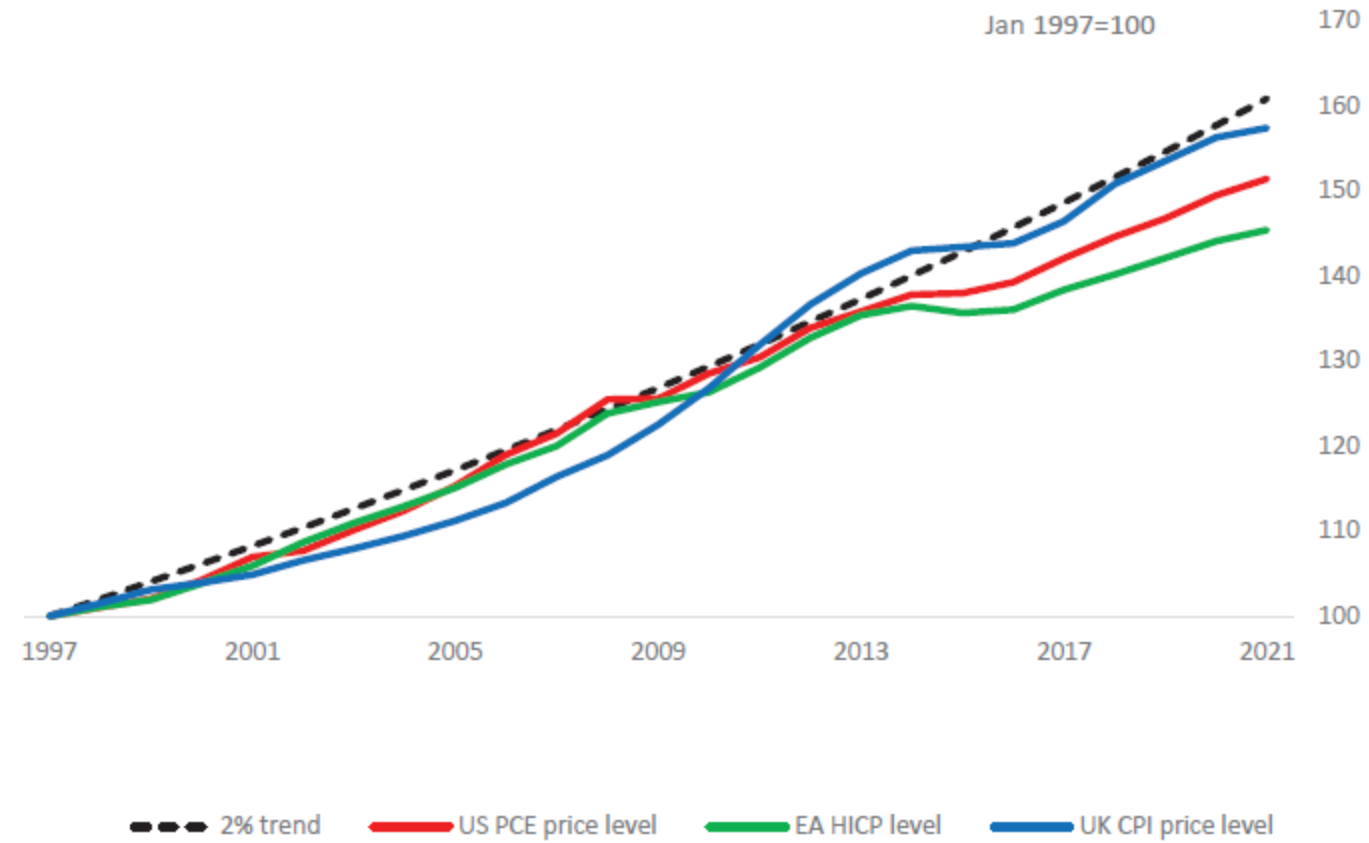
Chart 2: Global Inflation



Source: OECD and Bank calculations.

Source: Andy Haldane, "Inflation: A Tiger by the Tail?", Speech, Bank of England, 26 February 2021.

Chart 3: Price level in US, EA and UK<sup>5</sup>

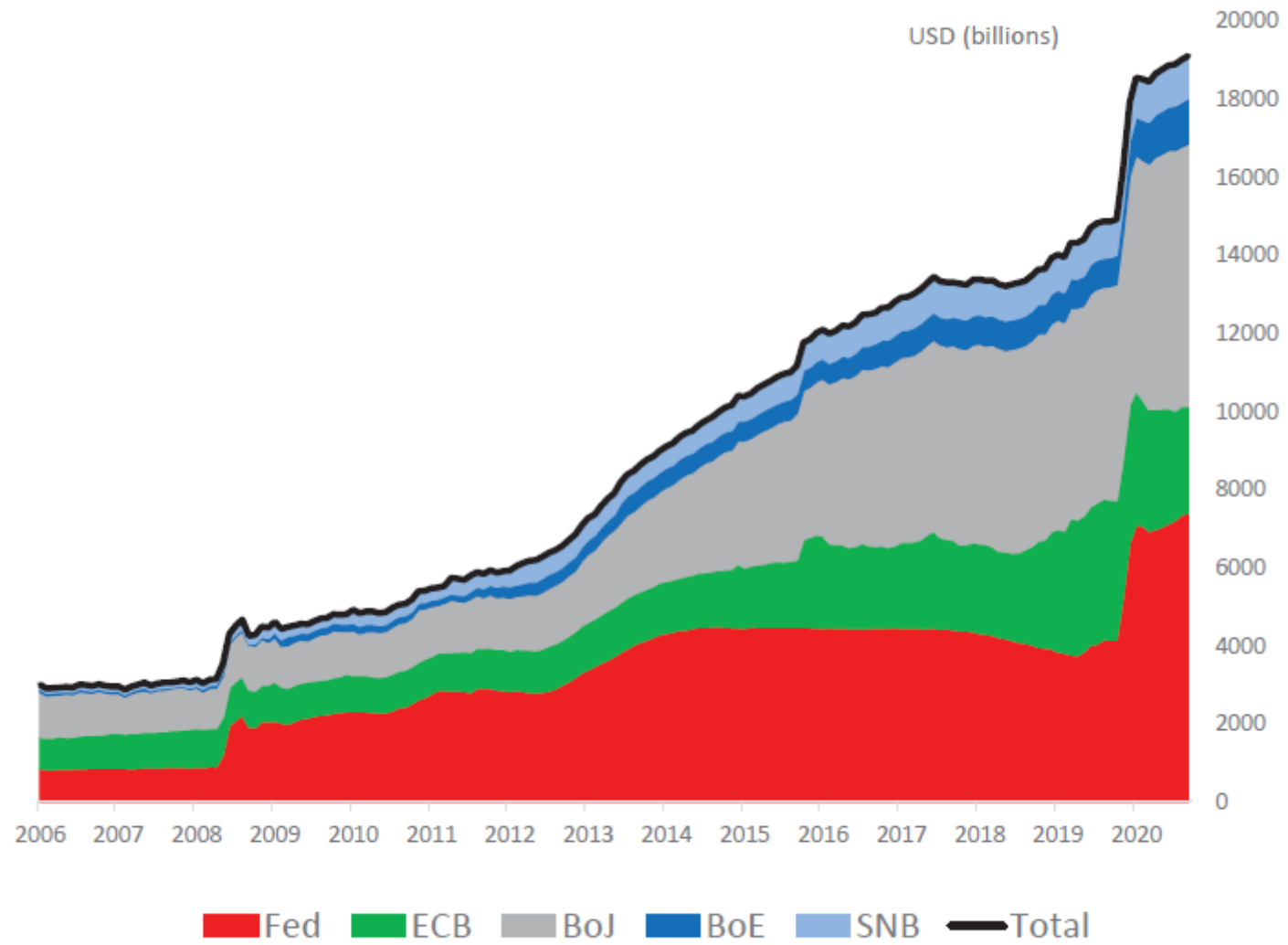


Sources: ONS, FRED, ECB Statistical Data Warehouse and Bank calculations.

# Then along comes Covid-19 in early 2020

- Widespread lockdowns
- Market collapses, followed by massive intervention by central banks: QE, Fed “swap lines” – to prevent financial instability
- Massive government spending to support household incomes and businesses (US direct payments to households and unemployment pay: UK “furlough” scheme – as in France)

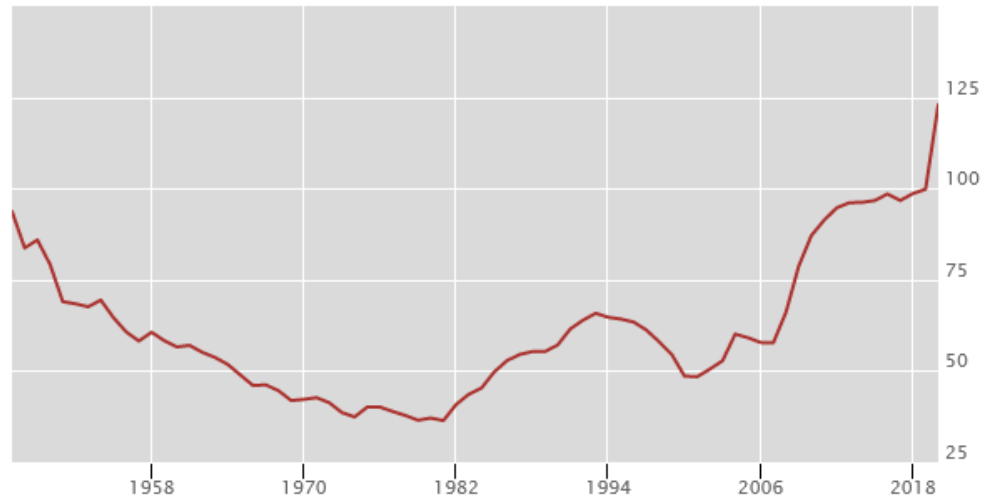
Chart 8: Central Bank Balance Sheets



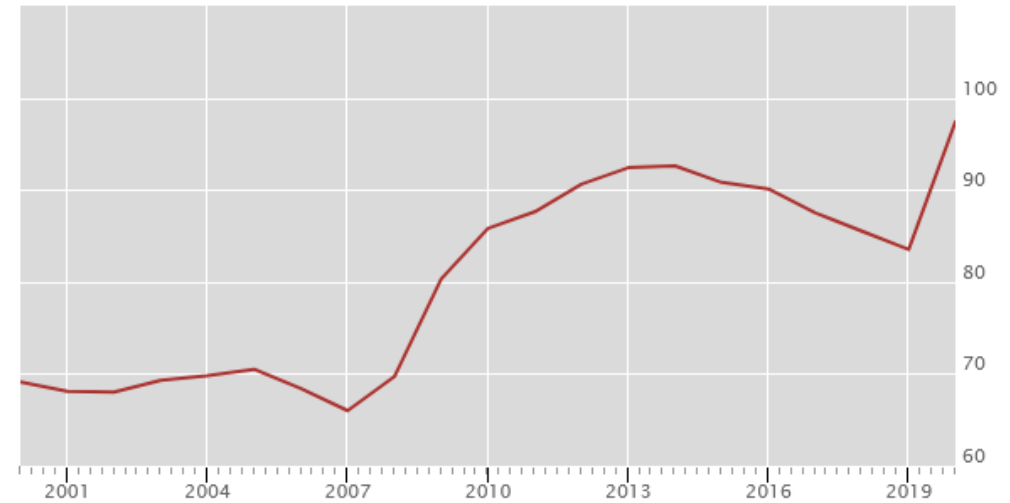
Source: Respective central banks and Bank calculations.

# Total credit to government sector at nominal value (core debt), as a percentage of GDP: Source BIS

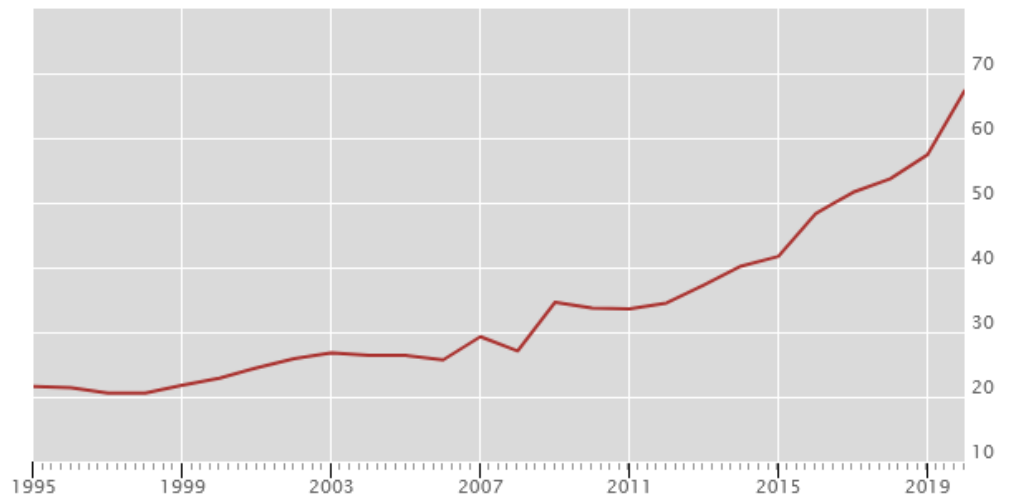
## USA



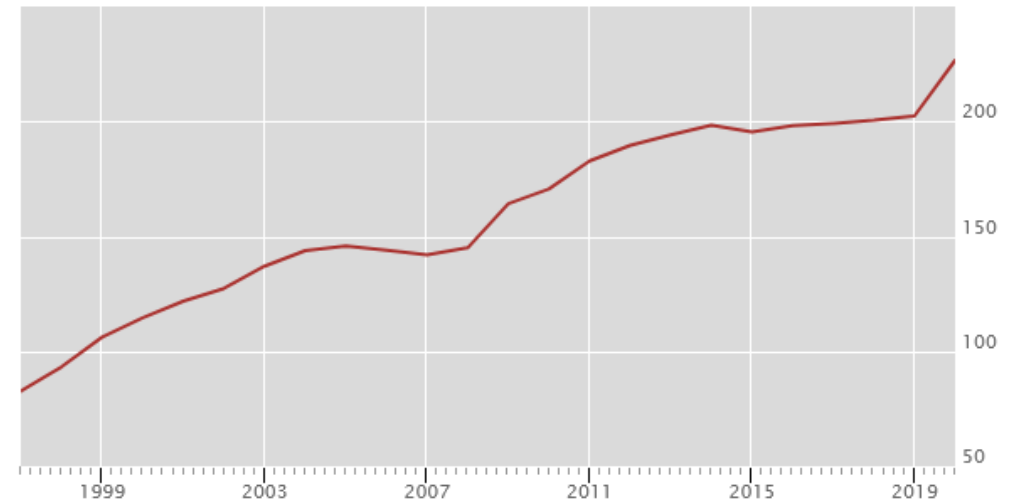
## Eurozone



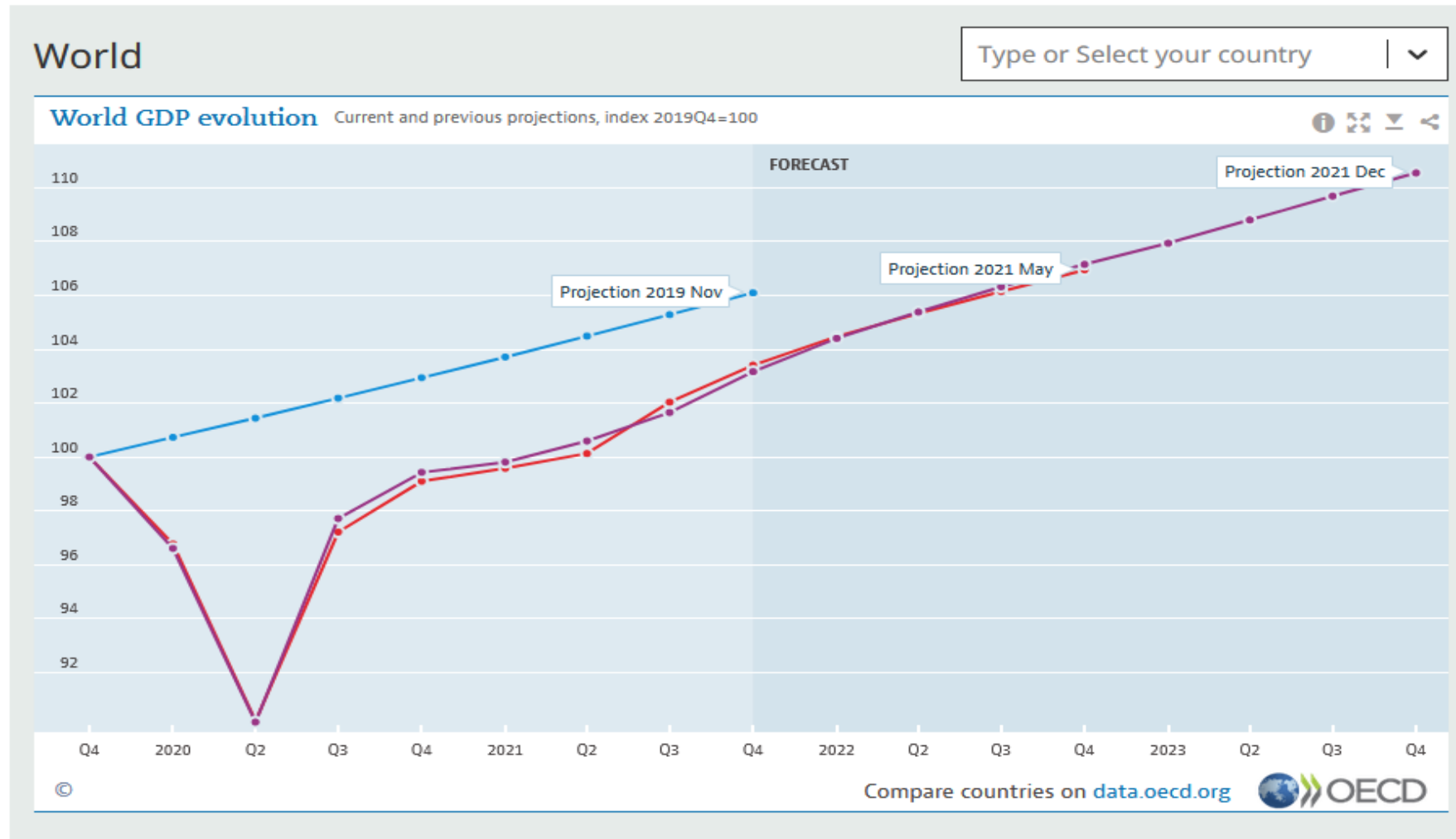
## China



## Japan



# Covid 19 second major shock after GFC – and it is not finished



Central scenario:  
Monetary & fiscal policies  
remain supportive.

Global recovery - growth  
2021 5.6%  
2022 4.5%  
2023 3.2%

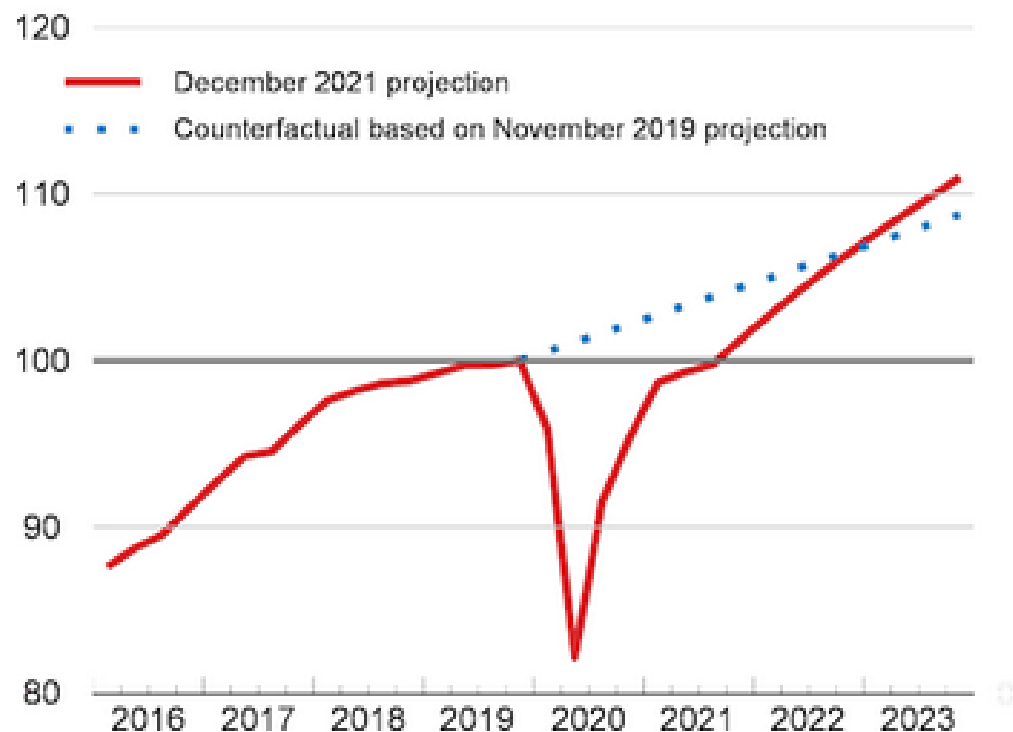
But imbalances!  
Polarity in caseloads  
Hospital capacity  
Vaccination rates



Figure 1.19. **World trade is rebounding quickly, helped by strong growth in Asian trade**

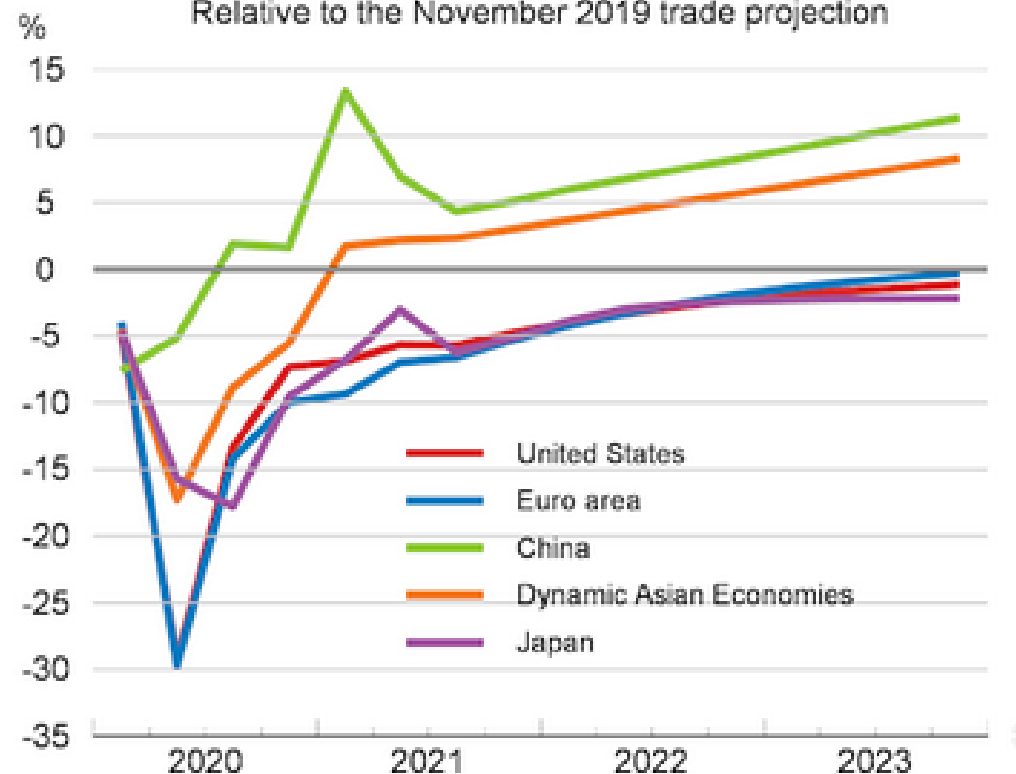
**A. World trade volume**

Index 2019Q4 = 100



**B. Shortfall in trade volumes**

Relative to the November 2019 trade projection



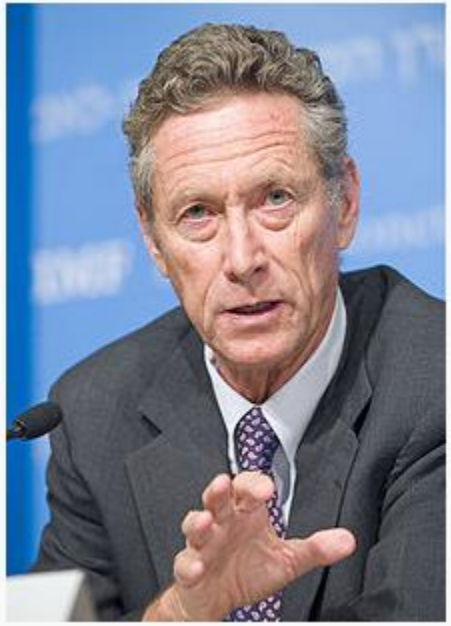
Note: The Dynamic Asian economies are Chinese Taipei, Hong Kong, China, Malaysia, Philippines, Singapore, Thailand and Vietnam.

Source: OECD Economic Outlook 110 database; and OECD calculations.



StatLink <https://stat.link/m84ne9>

# Government debt – the new thinking



Olivier Blanchard, Jan 2019

Long term real interest rates on government debt tend to be less than growth rate.

NOT a call to profligacy!

BUT public debts maybe more sustainable than previously thought.



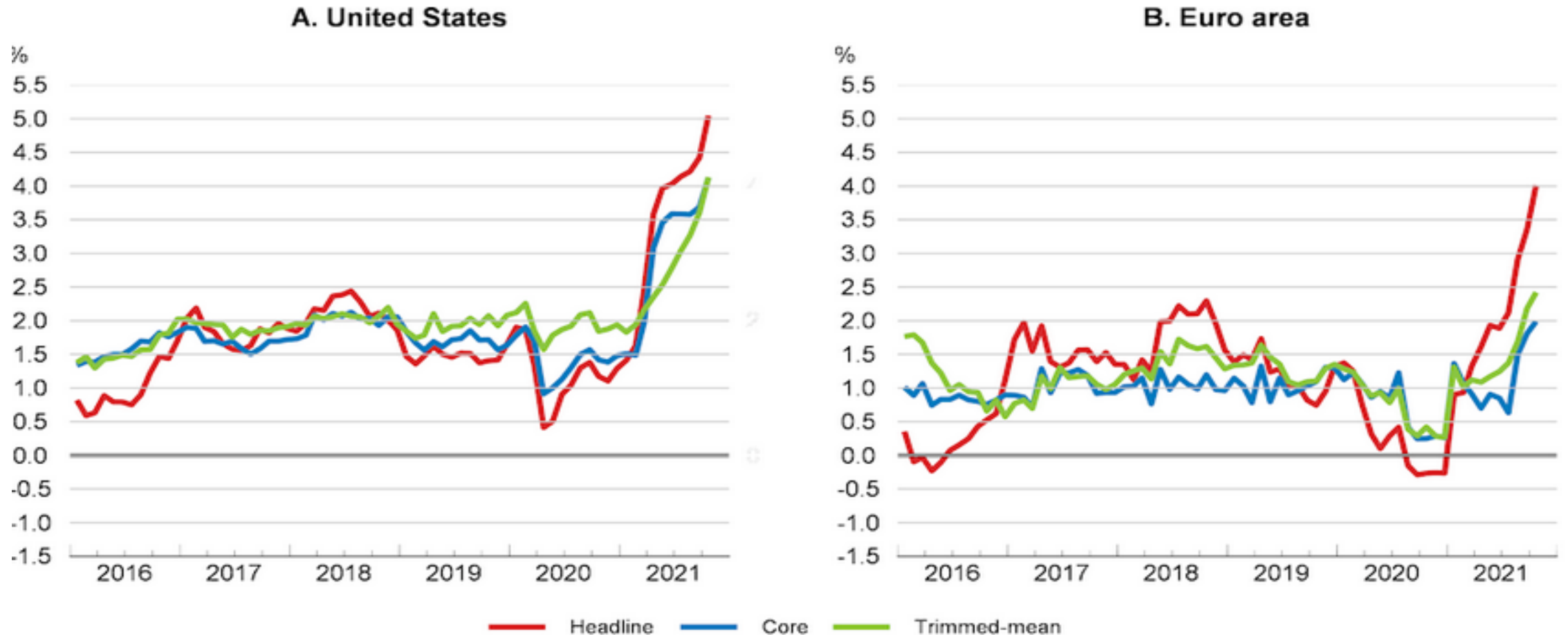
Adam Tooze, August 2020

1/ democratic politics no longer inflationary as labour lost the class war

2/ bond markets have been weaker than thought, in the face of a proactive central bank aligned with government

3/ EME inject huge savings into US bond market

# But now inflation is rising... rapidly?

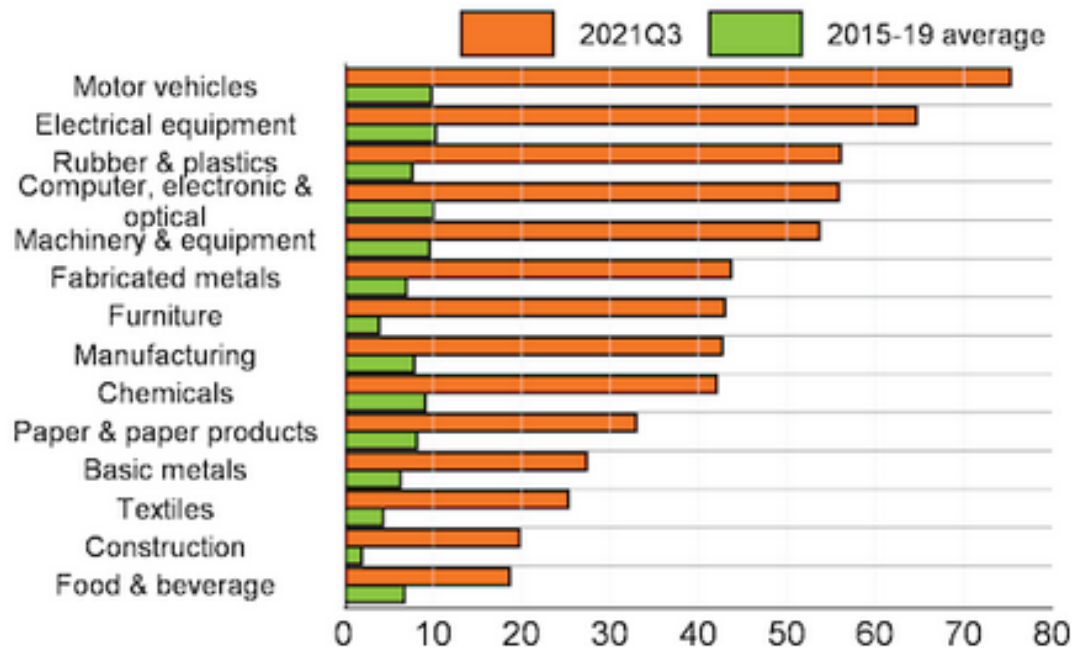


Headline = normal consumer price index; Core = excludes energy and food-related products; Trimmed-mean inflation trims 10% in terms of weights at the top and bottom of the distribution of the year-on-year growth of prices. Ibid OECD.

# Bottlenecks: supply chain problems and labour market shifts

B. Euro area firms with production constraints from material and equipment shortages

%, s.a.



## The “Great Resignation”?

A. Job openings in US small businesses with few or no qualified applicants

% of firms



Source: ibid OECD.

# *The Great Demographic Reversal: Ageing Societies, Waning Inequality, and an Inflation Revival, 2020*



Charles  
Goodhart

*"When a measure becomes a target, it ceases to be a good measure."*



Manoj Pradhan

The great rise of global labour is over:  
Women – China – Eastern Europe

(Recalls Immanuel Wallerstein (1983):  
capitalism goes global not for markets, but  
for labour)

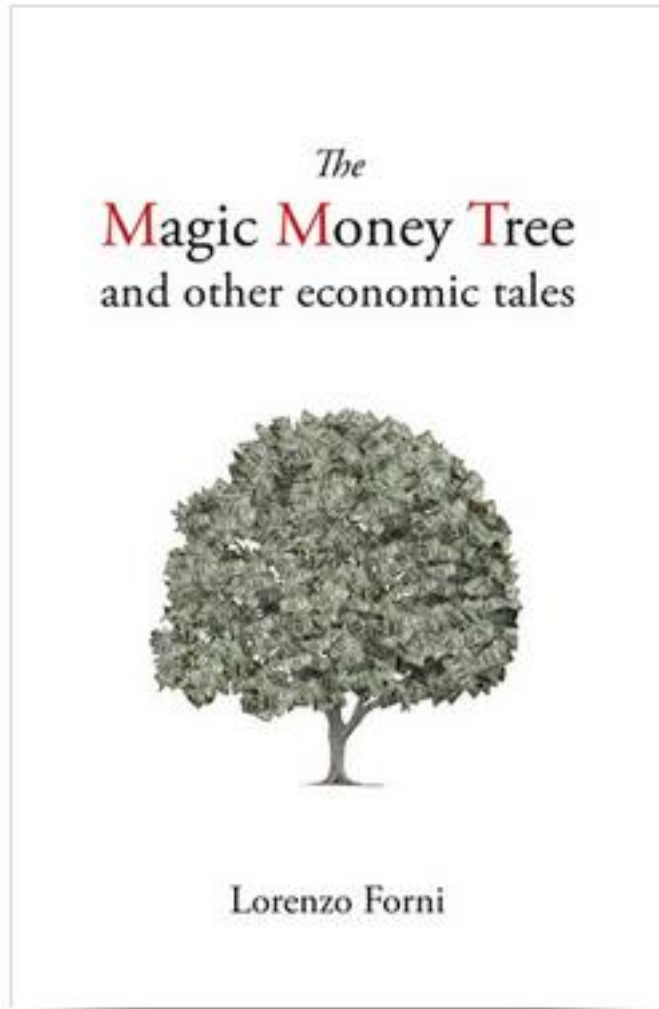
Inflation, higher interest rates...

... especially with spending on elderly

... but greater equality as labour has more  
power

***Policy-makers are slow to see change!***

# There are always budget constraints



There are always budget constraints! (Forni, July 2021)

Ultimately growth is determined by constraints in the real economy.

Pushing these back involves education, R&D, infrastructure – microeconomic improvements

# Debt Overhang (Barry Eichengreen at Jackson Hole – August 2023)

## Barry Eichengreen on the New Era of High Government Debt

What it means for policymakers around the world.



Barry Eichengreen Photographer: David Paul Morris/Bloomberg

By [Joe Weisenthal](#) and [Tracy Alloway](#)  
29 août 2023 at 10:00 UTC+2

The [Arslanalp and Eichengreen Paper](#) from the [2023 Jackson Hole symposium](#).

Bloomberg interview, "[Barry Eichengreen on the New Era of High Government Debt](#)", 29/08/2023

Arslanalp and Eichengreen wrote.

"High public debts are here to stay," they wrote. "Like it or not, then, governments are going to have to live with high inherited debts."

Doing so will require limits on spending, consideration of tax hikes, and improved regulation of banks to avoid costly blow-ups, they wrote.

"This modest medicine does not make for a happy diagnosis," they wrote. "But it makes for a realistic one."

Source: Ann Saphir, "[No real fix to the sharp rise in public Debt loads, economists say](#)", *Reuters*, August 26, 2023

# Some takeouts - higher inflation & higher interest rates?

- The G20 authorities managed to prevent a major depression after the GFC, and have also avoided the worst so far concerning Covid-19, although international coordination has been more limited than after the GFC.
- But, we could be heading for another monetary shock, like in the 1970s and the move to fiat money.
- Inflation could well upset asset markets (shares, bonds and other assets).
- Government finances face real, long-run pressures from demographics, and should the age of cheap money end.
- Investors face losses: already lower-bound, negative real interest rates make traditional saving impossible; elsewhere, the 'reach of yield' is increasing risks.



# Cryptos – currencies and / or assets?

- What defines a currency?
- What defines an asset?
  
- Cryptos exist on decentralized networks, largely based on blockchain – a distributed ledger.
- Virtual “tokens” – first Bitcoin – now thousands of “altcoins” (9,000 as of March 2021)
- Many resemble stocks

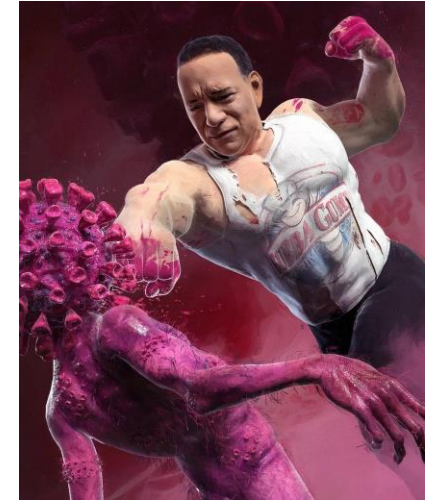
# Bitcoin

- Launched in 2009
- As of August 2021 – 18.8 million in circulation (out of 21 mn max): total market value of \$858.9 billion.
- Transactions monitored by computer “nodes” or “miners”, who run Bitcoin’s code and store its blockchain – they are paid with new Bitcoin.
- New Bitcoin released to miners is halved every 210,000 blocks (now 6.25 Btc). Mining will continue to 2140.
- Transactions are visible
- Around 11,300 nodes in September 2021
- Peer-to-peer technology and payment
- Bitcoin is deflationary?

# Etherium – a platform

- A platform to build and publish “smart contracts” (self-executing contract with terms of agreement written directly into the code)
- for decentralized applications
- A programmable platform – using blockchain
- An associated cryptocurrency: Ether or ETH
  
- Ether market cap in May 2021: \$500 billion

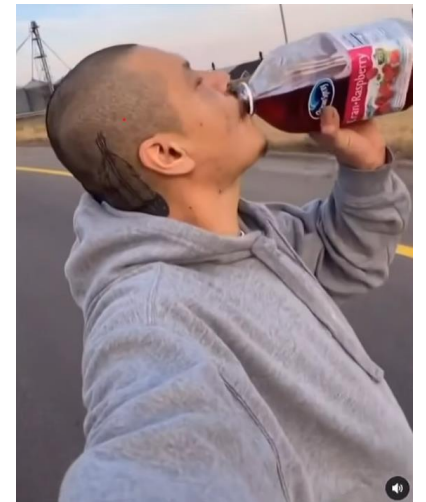
# Beeple: Everydays: the First 5000 Days: sold by Christies for \$69.3 million (March 2021)



**A non-fungible token: NFT**



⇒



# Related phenomena

- Cryptos are high-risk assets
- Illicit transactions
- Fraud - Ponzi schemes
  
- But also a vector for financial inclusion in emerging countries
- A way of escaping control by main “Western” authorities – especially the US
  
- Stable coins – backed by a traditional fiat currency (Tether-USDT)
  
- Regulation – especially of security type cryptos

# Cryptos and the return of inflation?

Market Summary > Bitcoin

25,147.09 EUR

+24,840.07 (8,090.69%) ↑ all time

Sep 28, 05:26 UTC · [Disclaimer](#)

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1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



1

BTC ▾

25147.09

EUR ▾

Feedback

More about Bitcoin →

- Spectacular collapses – FTX November 2022

[Sam Bankman-Fried](#)



- Will cryptos (and gold) resist the return of higher interest rates?

Investopedia published on TradingView.com, May 17, 2023 09:51 UTC-4



TradingView

TradingView

Source: Investopedia, [Gold Price History: Highs and Lows](#), June 22, 2023

# The payments revolution and its impact on the financial sector

- Digital technologies are changing the way economic agents coordinate with each other and disrupt globalization. New financial centres of gravity are emerging around private platforms (fintech, social media, e-commerce). These initiatives undermine the traditional form of money.
- The fundamental criterion that defines the currency is the final nature of the payment, recognized by the whole society. *Payment creates makes a fundamental social bond.* So the question is: Can cryptocurrencies be the next generation of currencies?
- The payment recording technology is blockchain which is a distributed payment register. *Bitcoin* is the most famous example. But it is a speculative asset, not a currency, because it does not respect the characteristic No1 of monetary sovereignty, which is being *the official and constitutionalized unit of account.*
- *Stable coins* claim to be attached to baskets of official units of account, but their extreme volatility has been demonstrated since the pandemic crisis and the war in Ukraine. Decentralized finance based on digital private currencies lacks the ultimate liquidity provided by the central bank digital currency (CBDC).

Source: Slide presented by Michel Aglietta in his presentation “The environmental emergency and entry into the digital age: the twofold challenge for societies and central banks”, at the conference on [The History of Regulation Theory and its Contributions to the Analysis of Global Capitalism](#), 8 & 9 September 2022. Michel Aglietta is Professor Emeritus Université Paris and Scientific Advisor to CEPPII.

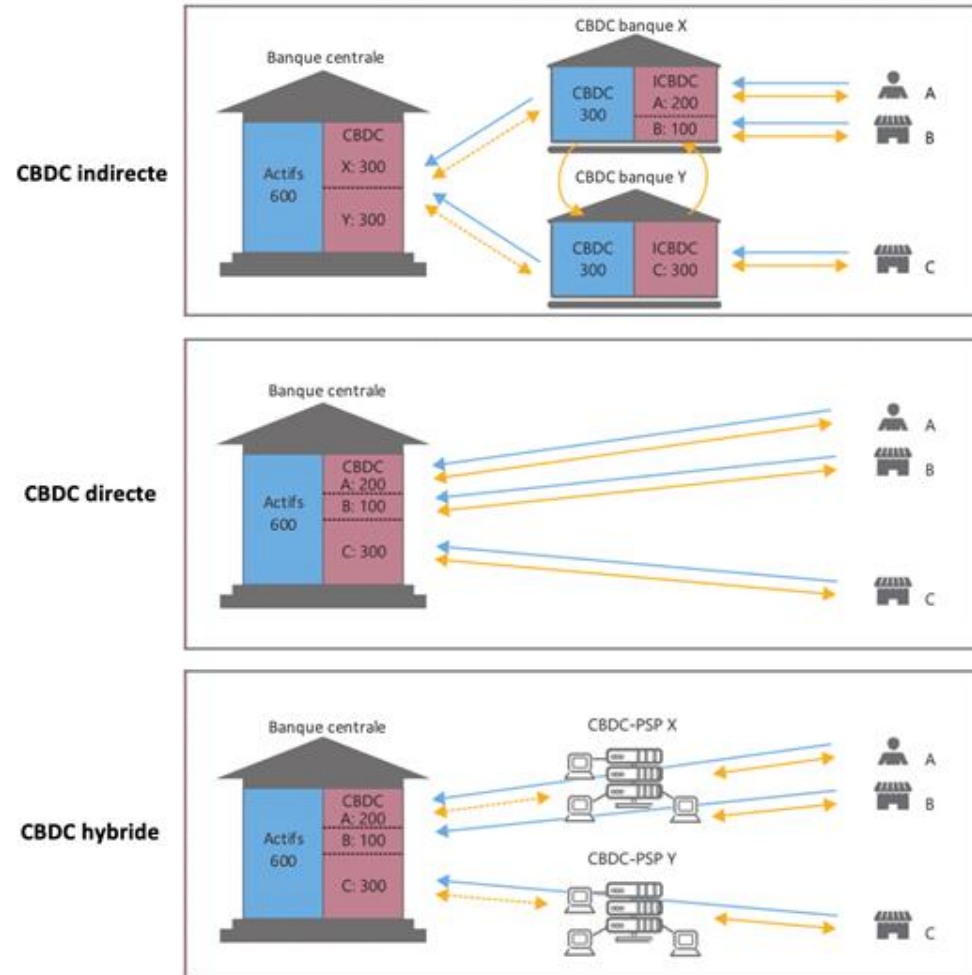
## Characteristics of central bank digital currency (CBDC)

- According to the BIS, central bank digital currencies refer to digital currencies issued and regulated by wholesale and retail monetary authorities.
- Any central bank digital currency respects the fundamental characteristics of money as a public good: the unit of account as an expression of monetary sovereignty, the universally available means of payment and a stable and protected system of value storage (*ultimate liquidity*). The central bank digital currency therefore presupposes the three principles of public order that must be respected: *financial integrity, financial stability and the effectiveness of monetary policy*.
- CBDCs based on digital identification have the potential to improve cross-border payments by limiting disorderly currency substitutions, provided that international cooperation is established through compatibility of protocols incorporated in digital codes.
- There are different possible architectures and technical designs of the CBDC that guarantee security while offering the benefit of instant settlement.

Source: Michel Aglietta, *ibid*.



# Different possible architectures of a CBDC



Source: Michel Aglietta, *ibid.*