Where are monetary and fiscal policy today?

The major phases of macro-policy since 1945, according to Claude (24 September 2026)

- Bretton Woods & the Keynesian Consensus (1945–early 1970s)
- Stagflation and the Breakdown of the Old Order (early–late 1970s)
- The Monetarist/Volcker Shock and Disinflation (late 1970s–early 1980s)
- Neoliberal Turn: Reagan/Thatcher Era (1980s–1990s)
- The Great Moderation (mid-1990s–2007)
- Global Financial Crisis & Unconventional Monetary Policy (2008–2015)
- Secular Stagnation & Extended Low Rates (2010s)
- Covid Response and the Return of Big Fiscal Policy (2020–2022)
- Inflation Surge and Aggressive Tightening (2022–2024)
- Current Phase (2024–2026)

Four policy phases

1. **The Keynesian Post-War Consensus**
2. **Monetarism and the road to the “Jackson Hole Consensus”.**
3. **Ultra-permissive monetary policy – “The only game in town”**
4. **After Covid and the return of inflation**

1. The Keynesian Post-War Consensus

A word from the master himself



Keynes after the pound goes off gold in 1931.

Macroeconomic policy dominated by fiscal policy.

Using monetary policy was “like pushing a piece of string”.

Harold Macmillan compared running the economy to driving a car and using the accelerator and brake.

The post-War boom 1

- Bretton Woods system > monetary stability, based on US $ and gold
- GATT > trade liberalisation > to boost development and strengthen peace
- Good price/unemployment trade-off during post-war boom. (Macmillan: driving a car)
- Keynesian policy widely accepted
- Strong demand – helped by war (hot & Cold)
- Significant acceptance of high taxation
- Technology roll-out (Richard Gordon)
- Government “fought” poverty

Anti-poverty measures



UK – Macmillan – 300,000 homes per year (1950s)



US – Johnson – War on Poverty Launched 1964

The post-War boom 2

- The US protector/hegemon of the West
- Super-power rivalry – MAD!
- **Faith in government**
- Deference to political authority/militarised societies
- Middle class women in the West in the home (see *Mad Men*)
- Sexual stereotyping



The post-War boom 3

- Soviet Central planning and planned trade in Comecon countries
- Latin America – import substitution, economic nationalism (and populism)
- India – planning and “Licence Raj”
- People’s Republic of China – state control and self-sufficiency (*Great Leap Forward*)
- Japan – export-led growth

Standardised consumer behaviour

- JK Galbraith, *The New Industrial State*, 1967
- The technostructure – management bureaucracies
- Ensured markets due to advertising
- The countervailing power of unions

- Government organised socialised consumption
  - Welfare – social housing, etc.

Designed by Porsche – saved by the Brits after 1945, finally completely retired in Mexico in 2003 – 21 million built







Herbie the love Bug
1968

Fordism too La théorie de la Régulation

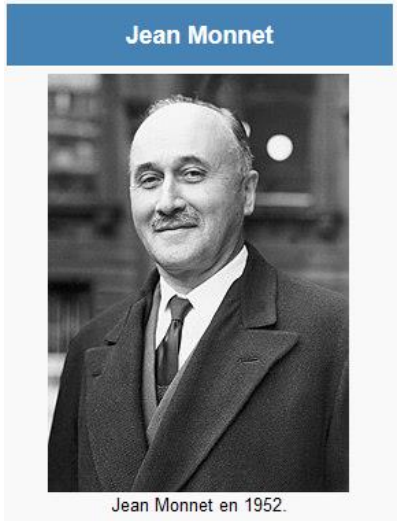
- Michel Aglietta: *Régulation et crises du capitalisme*, 1976 : examining the crisis
- Marx and Keynes > Fordism > compromise between labour and capital
- Long production lines > incredible economies of scale



Model T: “any colour as long as it is black”
Pay $5 a day

Workers as clients

French “Indicative Planning”



Jean Monnet en 1952.



- A rational organisation of the economy.
- Accompany restructuring of the economy, winding down old industries (mining) and nurturing new ones.
- Joint discussions with management and unions.
- Large public sector to implement *dirigiste* policies.

Some other sociological considerations

- Strong social solidarity – high top tax rates
- Limited choice in lifestyles and consumer products (far less complexity)
- Cultural homogeneity



The “shocks” of the 1970s

This system broke down in 1970s

- The emergence of the “Great Inflation”
- International trade – new exporters Germany and Japan
- Demand leakage > breakdown of Keynesian circuit
- Search for individuality > product diversity
- Civil rights and women’s rights
- Renewed social conflict opened up in capitalist societies
- Regulation theory (following Marx): crises are inherent to capitalism

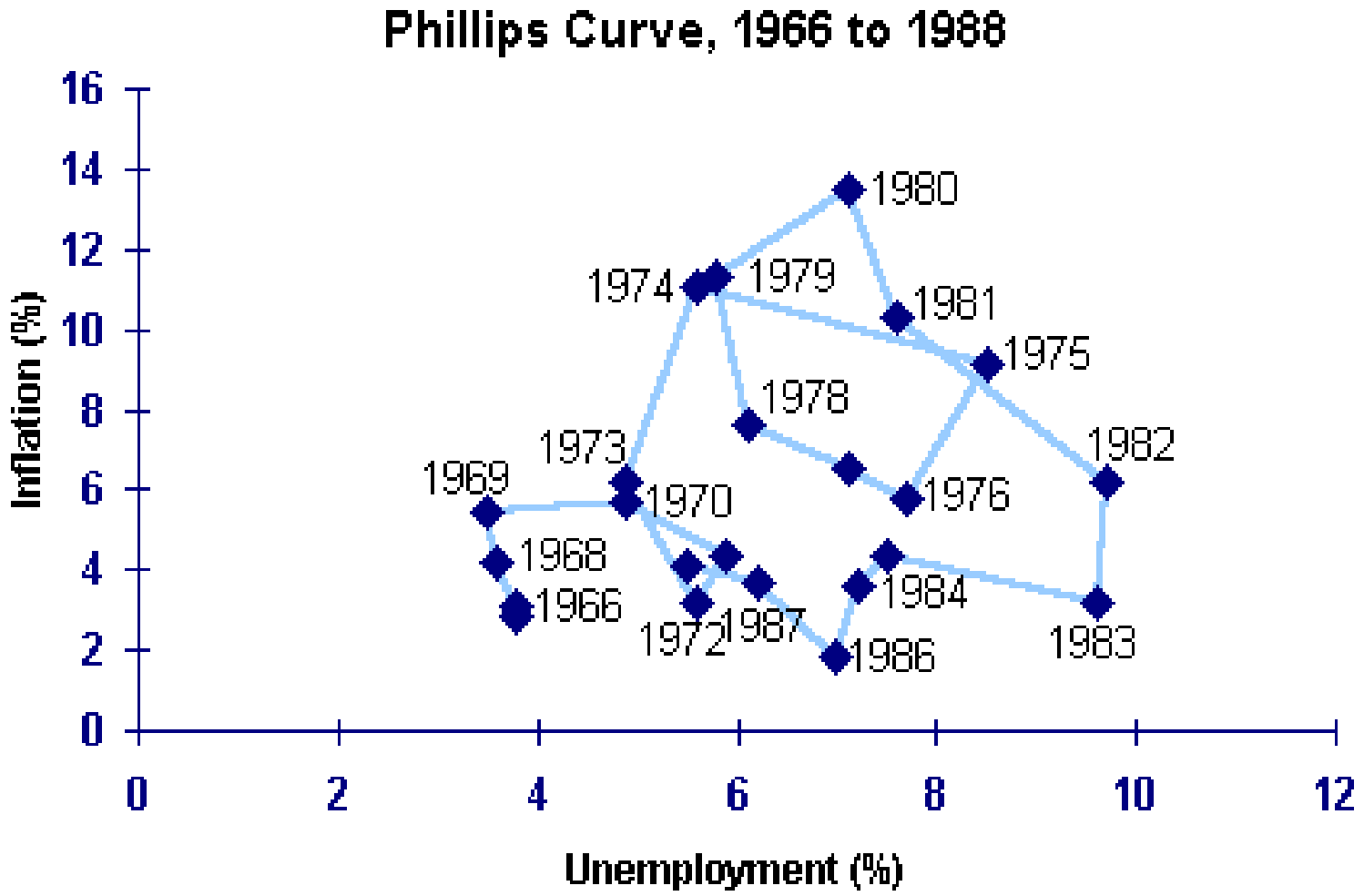
The rise of inflation: “Follow the Money”

- In 1960s: inflation started rising – too much demand: Vietnam war, Great Society, and space race.
- Demand push– cost pull
- Low unemployment > pay rises
- Challenge to authority
- Challenge to social norms
- Civil rights, greater freedom for women
- AND PERMISSIVE MONETARY POLICY (in US)
- 1971: Nixon announced suspension of Bretton Woods (https://www.youtube.com/watch?v=iRzr1QU6K1o)
- A fall in dollar, and a surge in global inflation.
- Compounded by first oil price shock 1973-4
- Recession and inflation (demand leakage, higher energy and raw material prices) > STAGFLATION (*The Economist*).
- The first oil shock to Elton John and *Benny and the Jets*: https://www.youtube.com/watch?v=Qb-sRuGiGFY
- Club of Rome: *The Limits of Growth* (1972)



Richard Nixon (“Tricky Dicky”)
US president 1969 – 1974
Impeached due to Watergate

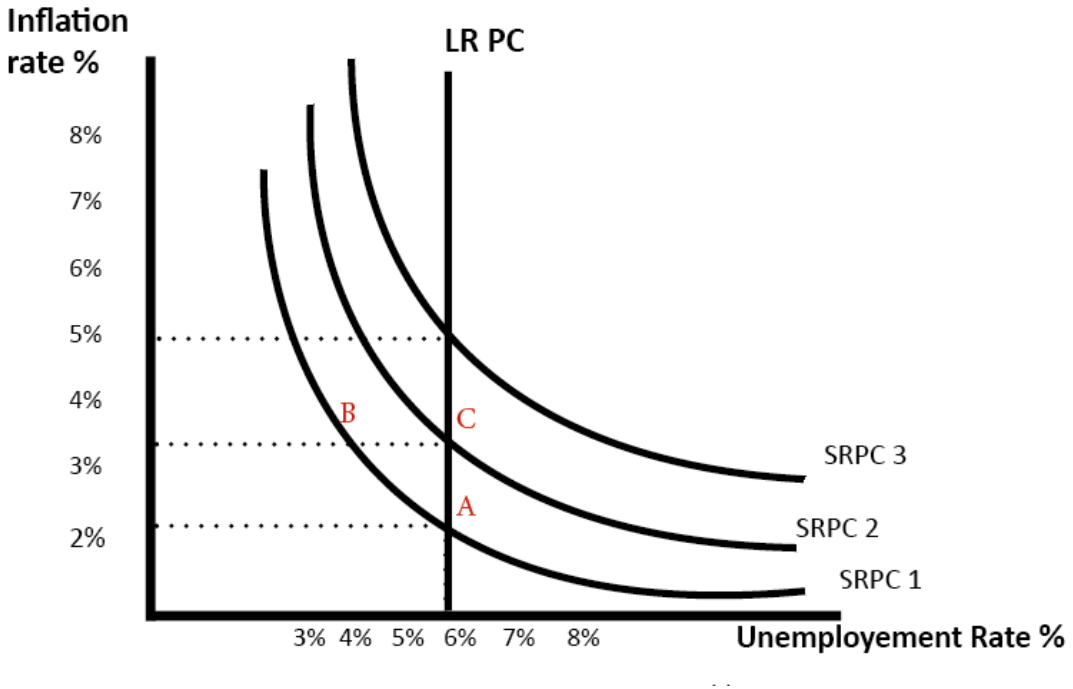
For “the West”: a world of crisis



http://www.econweb.com/macro/phillips/notes.html

2. Monetarism and the road to the "Jackson Hole Consensus"

Natural rate of unemployment



- Rational expectations hypothesis: policy experts cannot fool people (morally wrong)
- Fine-tuning of demand does not work, because of time lags (political business cycle)
- MV =PT

The Federal Funds Effective Rate (Fred, 17 September 2026)



Application: a mixed success

- **Volcker Shock (1979)**
- Fed funds rate: 20% in 1980 (inflation 10-12%)
- Unemployment rose to 10.8% in 1982
- Inflation came down relative quickly
- Reagan (1981) fiscal policy boom (tax cuts and defence spending)
- Labour market more flexible, unions weakened quickly

- **UK: MTFS**
- Surge in interest rates, and pound (oil backed)
- Magical monetarism
- Financial market deregulation (end capital controls 1979, end of credit controls 1980) > rise in V
- 1981: fiscal contraction during recession
- European countries 1980s > DM peg

“It’s all very difficult”

Goodhart’s law: “When a measure becomes a target, it ceases to be a good measure.“

Lucas critique: "Given that the structure of an econometric model consists of optimal decision rules of economic agents, and that optimal decision rules vary systematically with changes in the structure of series relevant to the decision maker, it follows that any change in policy will systematically alter the structure of econometric models.“

Alan Budd: “When we set off with various Barber-like experiments [fiscal expansion 1972] in the early and mid-70s, I did not think the effect would be inflation. The monetarists said it would be. They were right. I was wrong. Obviously, it was good Popperian stuff… And of course politicians like simplicity…

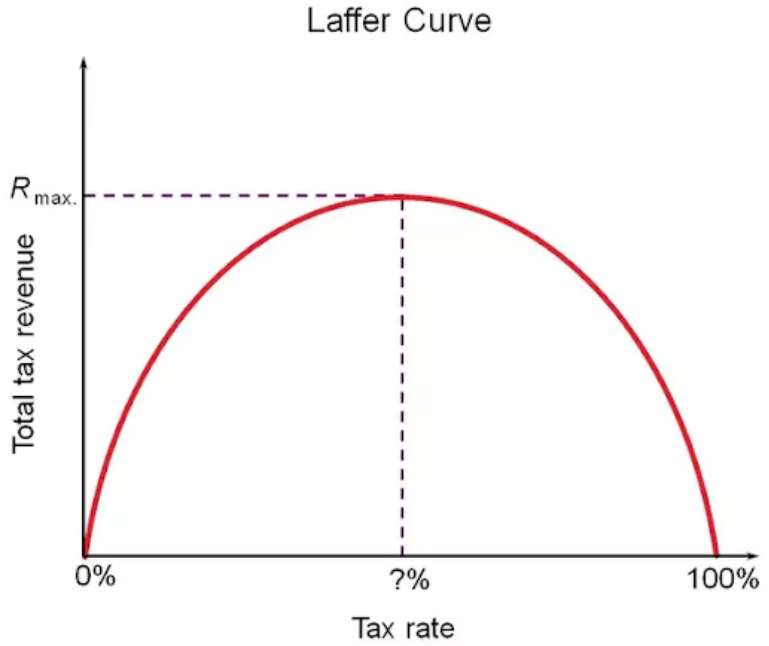
There were a few of us… who normally say “it is all very difficult”, who became converted to a rather simpler idea… it was peculiar in a way, I agree.”

The Tax Revolt > Supply-Side Economics

California (1978)
Proposition 13

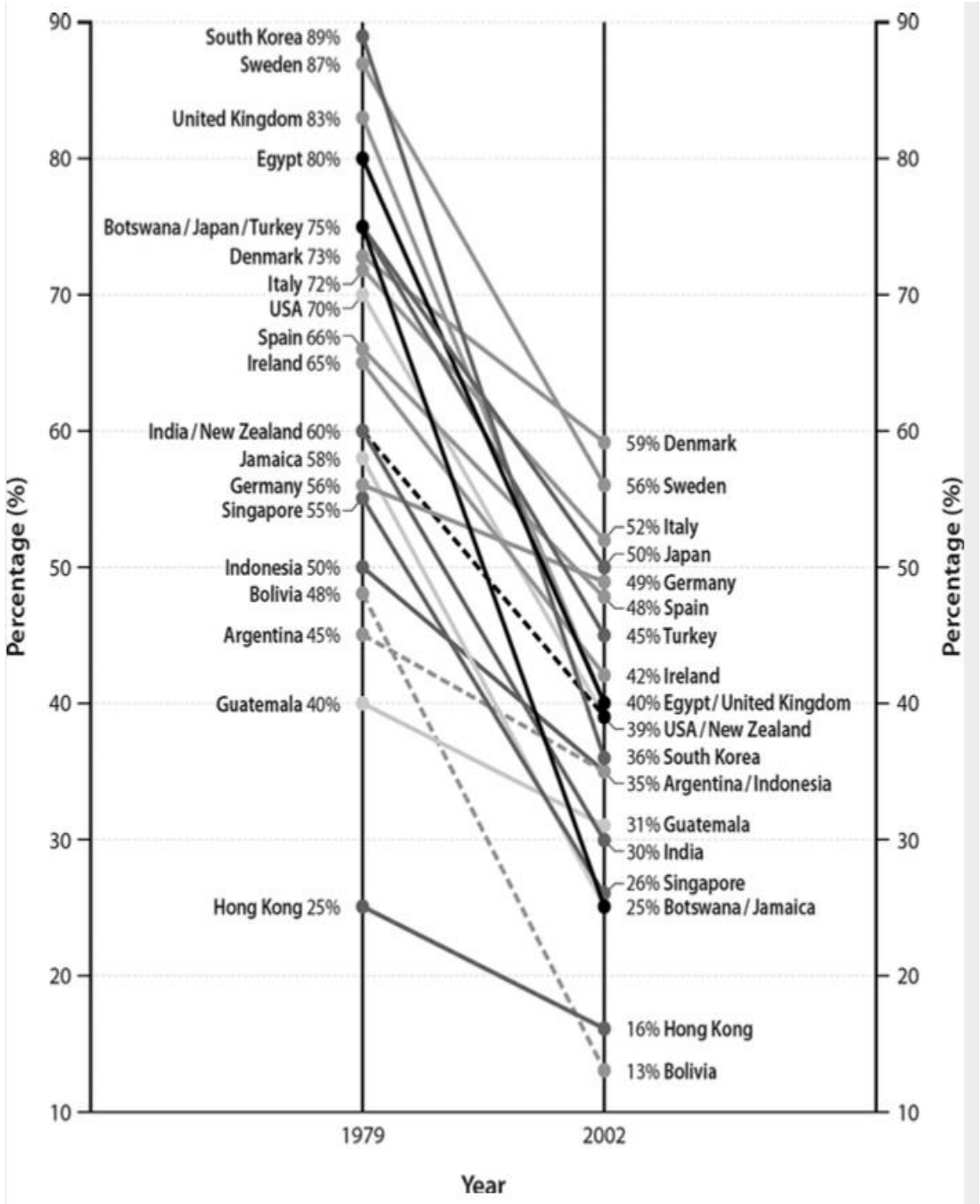
Thatcher elected May 1979: top tax rate cut from 83% to 60% (higher VAT)

Reagan elected 1980: tax cuts – top rate cut from 70% to 50%; to 28% in 1986 - 3% of GDP



The new Republican narrative: tax cuts pay for themselves and deficits do not matter.

Rober Shiller: Narrative economics 2017



Cuts in top tax rates: a truly global phenomenon

Minouche Shafik, *What We Owe Each Other: A New Social Contract*, London, Vintage, 2021.

3. The “Jackson Hole Consensus” and the Taylor Rule



The Jackson Hole Consensus: 1990s onwards

- Monetary policy > inflation targeting (New Zealand 1990 – NZ laboratory of neoliberlism)
- One instrument > one target (Tinbergen's rule)
- Policy should be forward looking (lags)
- Policy should be consistent, clearly communicated to agents and markets > credible
- Central banks independent > policy set by committees of experts and not politicians

Taylor Rule , The Great Moderation & economic problems solved

$$i_t = \pi_t + r_t^* + a_\pi(\pi_t - \pi_t^*) + a_y(y_t - \bar{y}_t).$$

i_t target short-term nominal interest rate
π_t rate of inflation (GDP deflator)
π_t^* the desired rate of inflation
r_t^* the assumed equilibrium real interest rate
y_t log of real GDP
$\bar{y}_t$ Log of potential output

The Great Moderation: mid-1980s until GFC (2007-2008) – especially from early 1990s onwards.

Robert Lucas January 2003: "My thesis in this lecture is that macroeconomics in this original sense has succeeded: Its central problem of depression prevention has been solved, for all practical purposes, and has in fact been solved for many decades."

Simplified Taylor Rule (Investopedia)

$$r = p + 0.5(p - 2) + 0.5y + 2$$

r = nominal fed funds rate

p = rate of inflation

y = percent deviation between current real GDP and long-term linear trend in GDP (the Fed has sometimes used the “unemployment gap”)

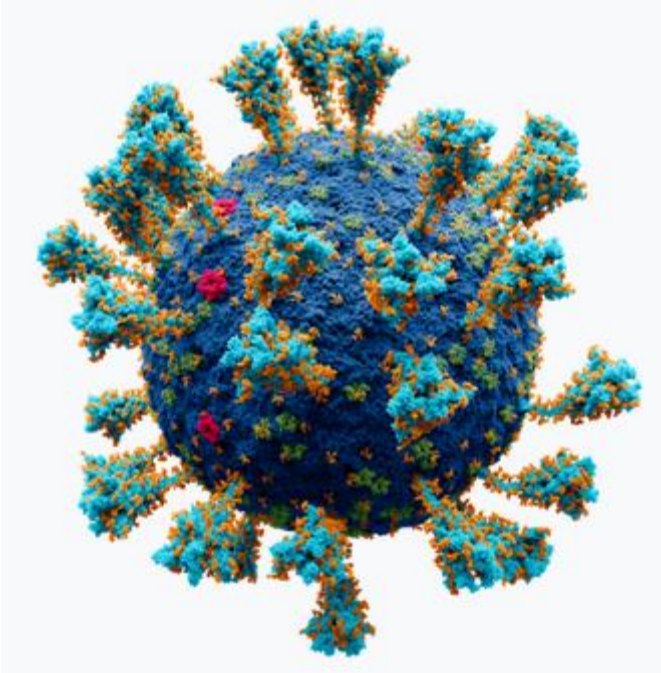
The equation assumes the equilibrium federal funds rate of 2% above inflation, represented by the sum of *p* (inflation rate) and the "2" on the far right.

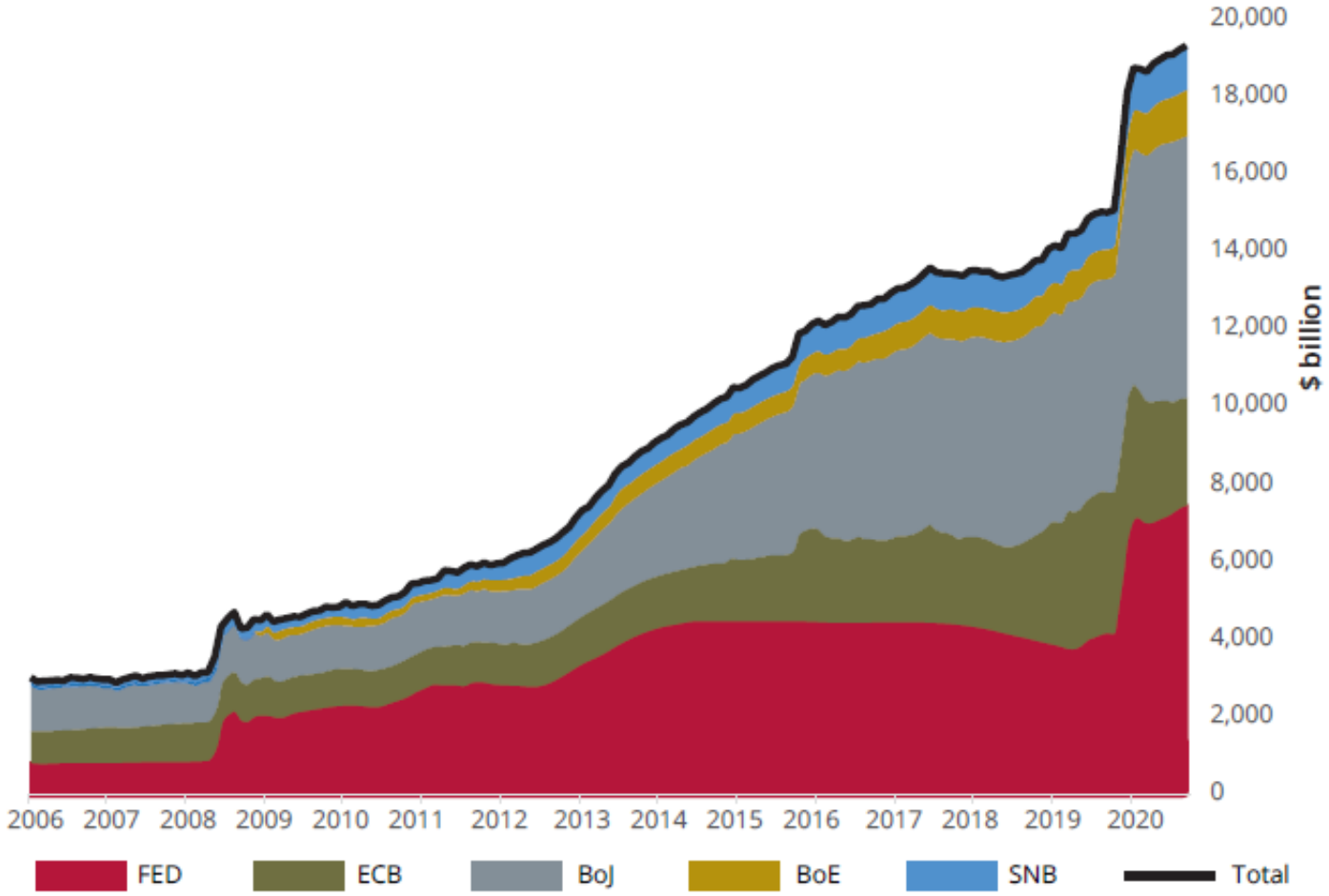
Ultra-permissive monetary policy after the Global Financial Crisis => “The only game in town”

- “Lower-bound” interest rates
- Quantitative easing: purchase of assets (government bonds (and MBS in the US) by central banks
- “Unemployment targeting” by US and UK in early 2010s
- Forward guidance – about likely future path of monetary policy
- (macroprudential regulation)

Central bank balance sheets

And then came Covid -

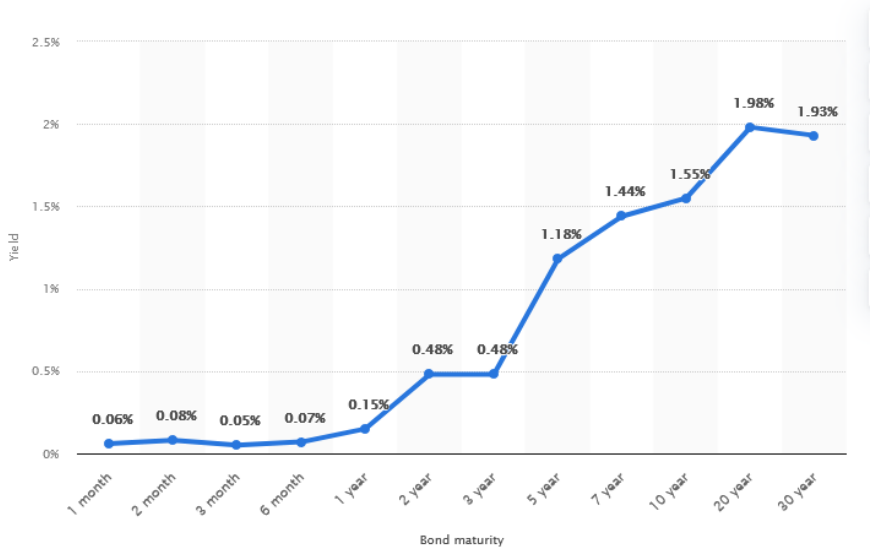




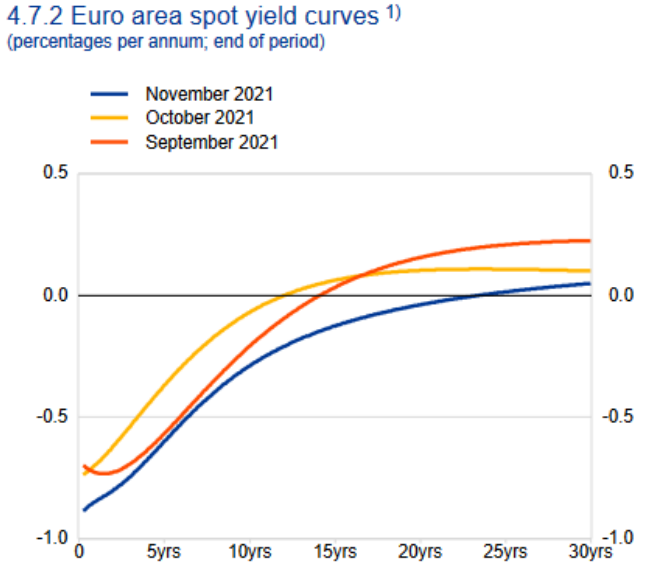
Source: Andy Haldane, speech on Inflation: A Tiger by the Tail?, 26 February 2021, p 9: https://www.bankofengland.co.uk/-/media/boe/files/speech/2021/february/inflation-a-tiger-by-the-tail-speech-by-andy-haldane.pdf [accessed 5 July 2021]

Flat yield curves

Treasury yield curve in the United States as of October 2021

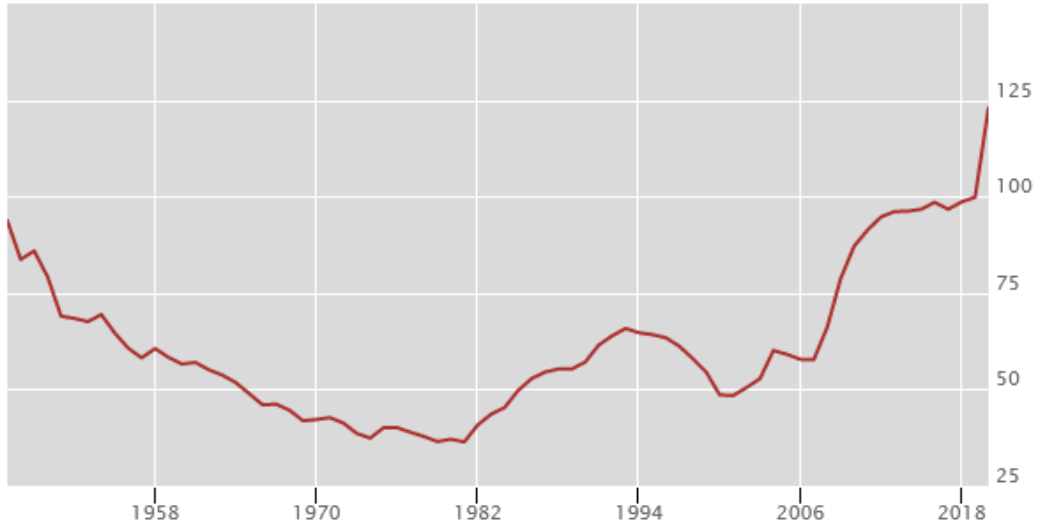


Euro area spot yield curves (for AAA-related euro area central government bonds)

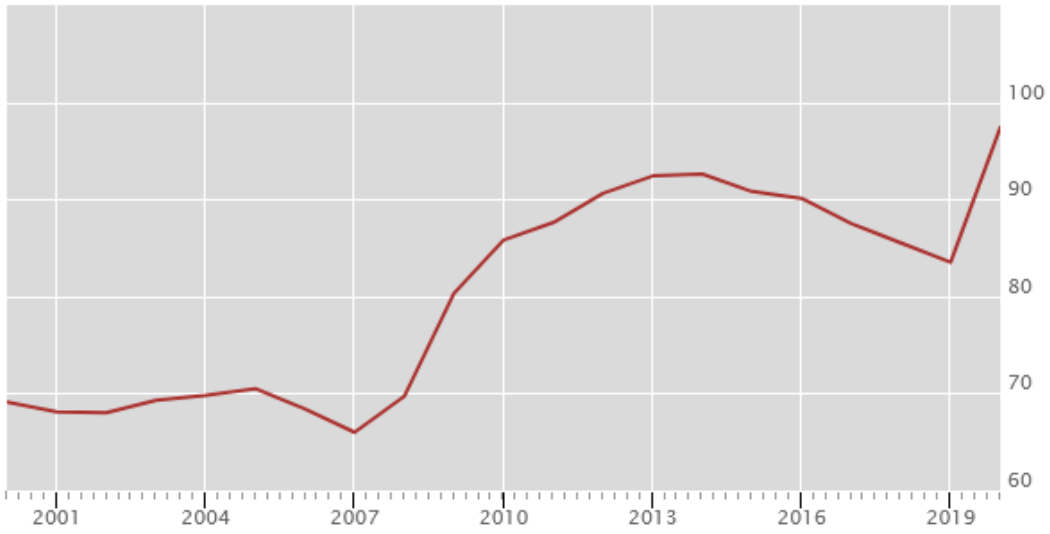


Total credit to government sector at nominal value (core debt), as a percentage of GDP: Source BIS

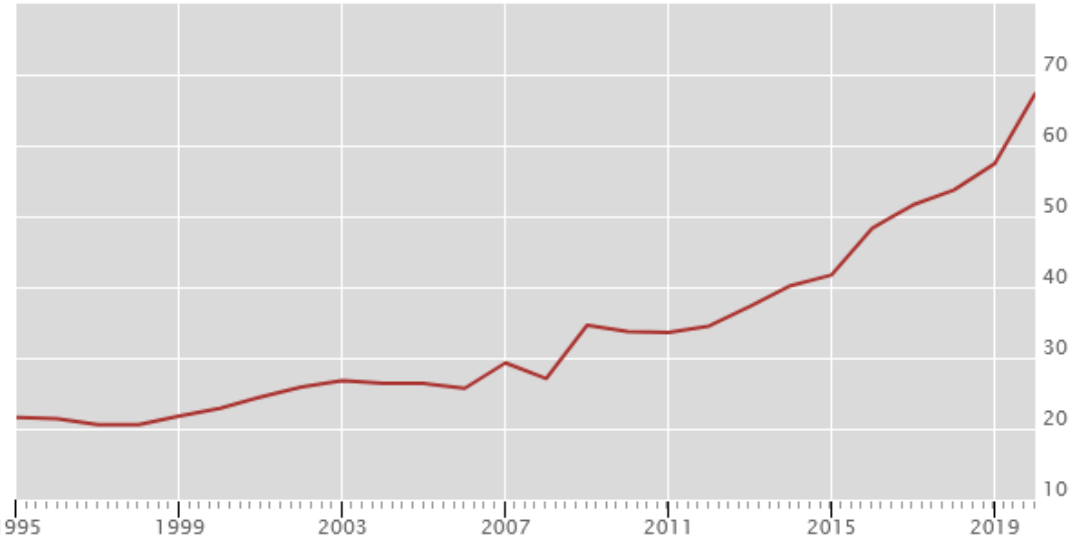
USA



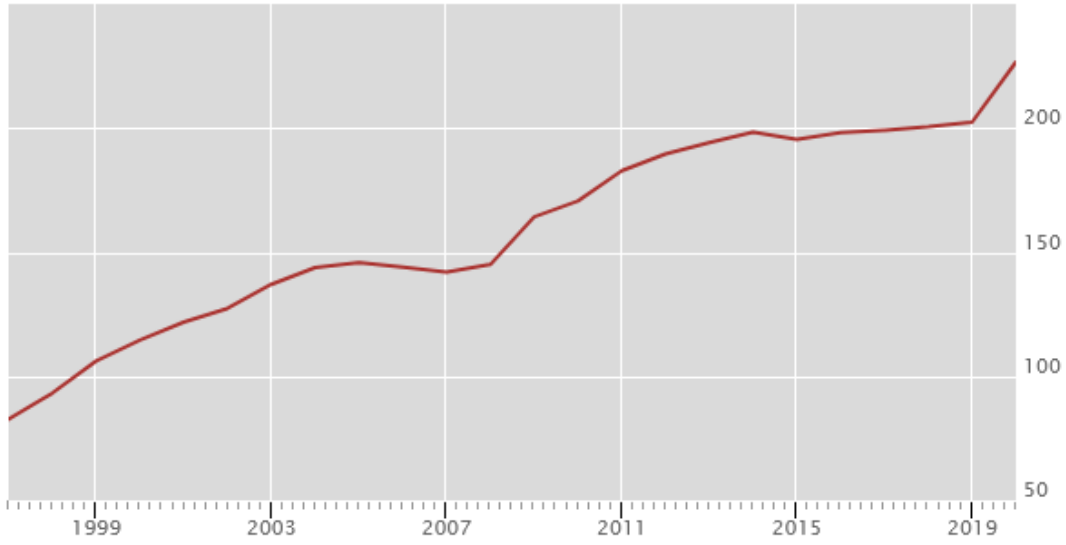
Eurozone



China



Japan



NEW YORK TIMES BESTSELLER

"The one economics book you must read now ... If you want to understand this bifurcated world and where it's headed, there is no better interpreter than Mohamed El-Erian." *TIME*

MOHAMED A. EL-ERIAN

With a new Introduction by the author

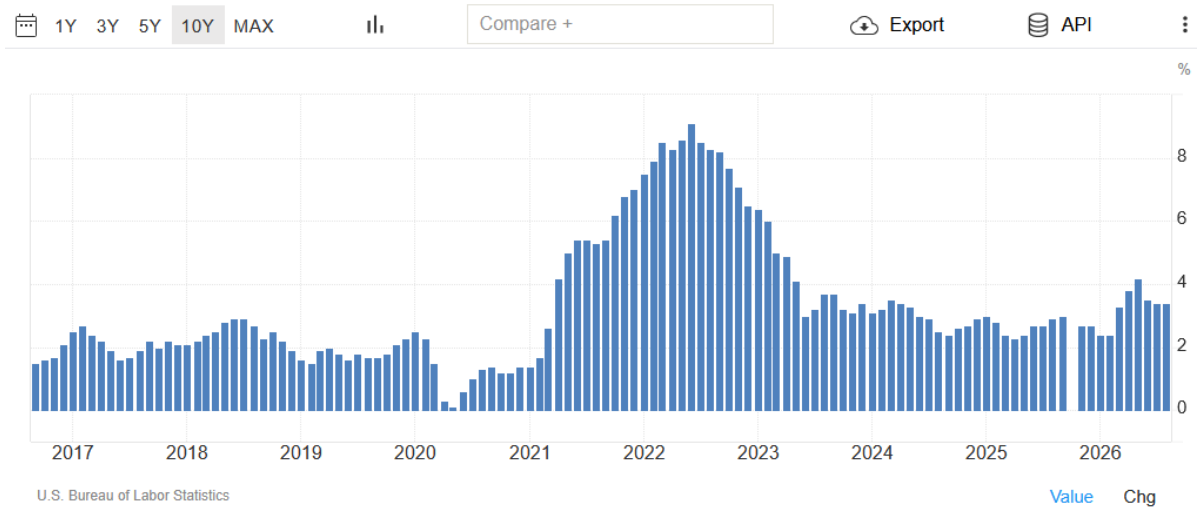


THE ONLY GAME IN TOWN

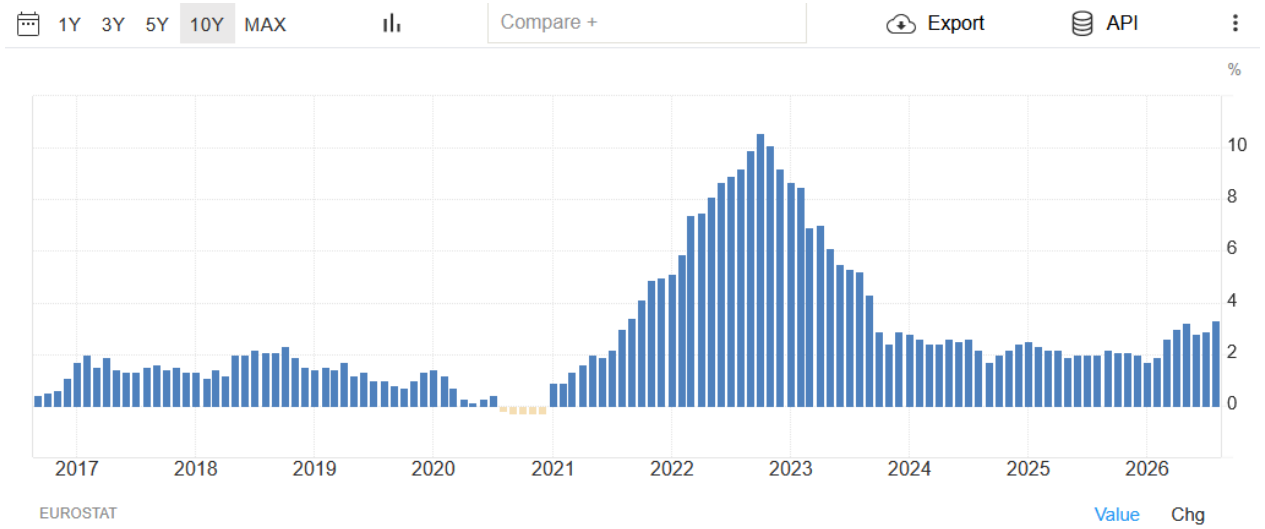
CENTRAL BANKS, INSTABILITY, *AND* AVOIDING THE NEXT COLLAPSE

4. After Covid and the return of inflation

United States



Euro area



Source: Trading Economics, retrieved 17 September 2026.

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)

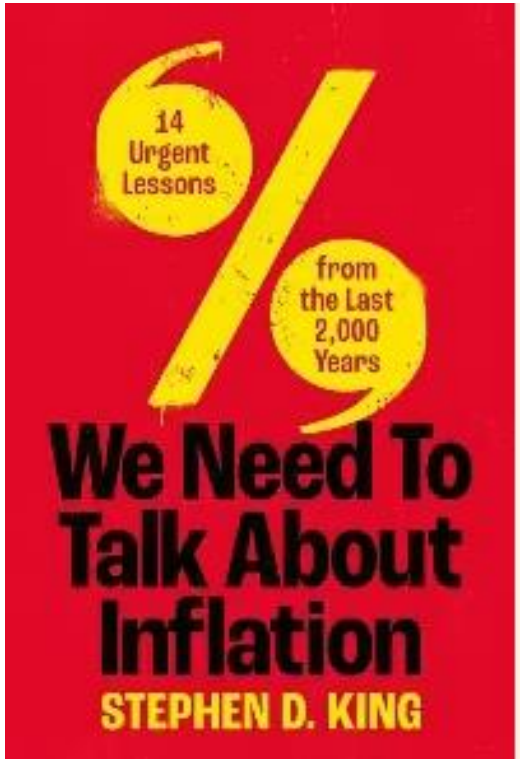
Inflation, higher interest rates…

… especially with spending on elderly

… but greater equality as labour has more power

Policy-makers are slow to see change!

THE FEARS OF STEPHEN KING (HSBC ☹)



- We don't know how long inflation will last
- It creates winners and losers
- Economic inefficiency as price mechanism weakens
- Governments are always tempted to print money
- Governments and central banks are like Liz Taylor and Richard Burton…

...they try to separate

but always come together

Or for younger folk, "Benifer"





The Trump Shock – “Liberation Day"



Tariff hikes announced

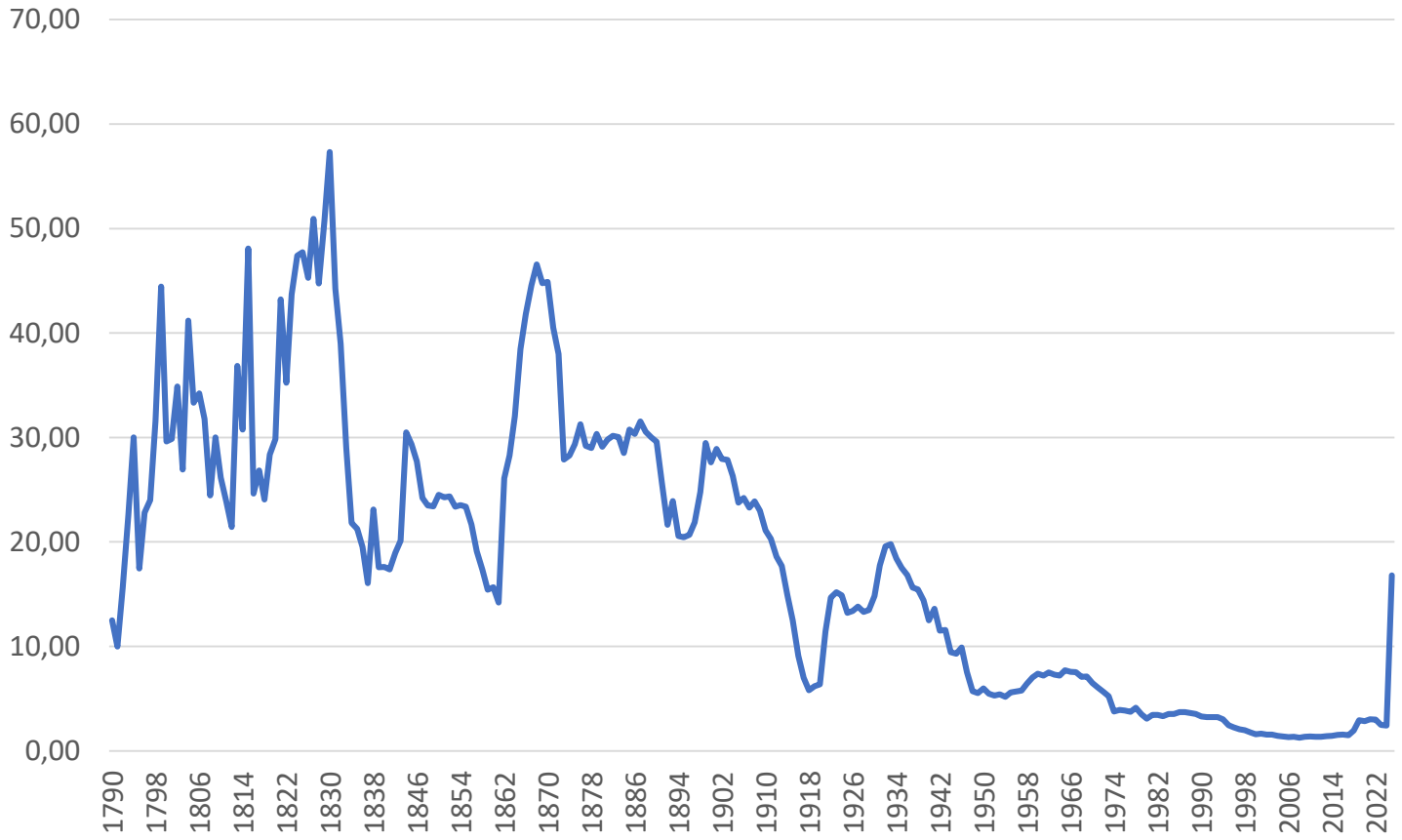
2 April 2025

Implemented 9 April 2025

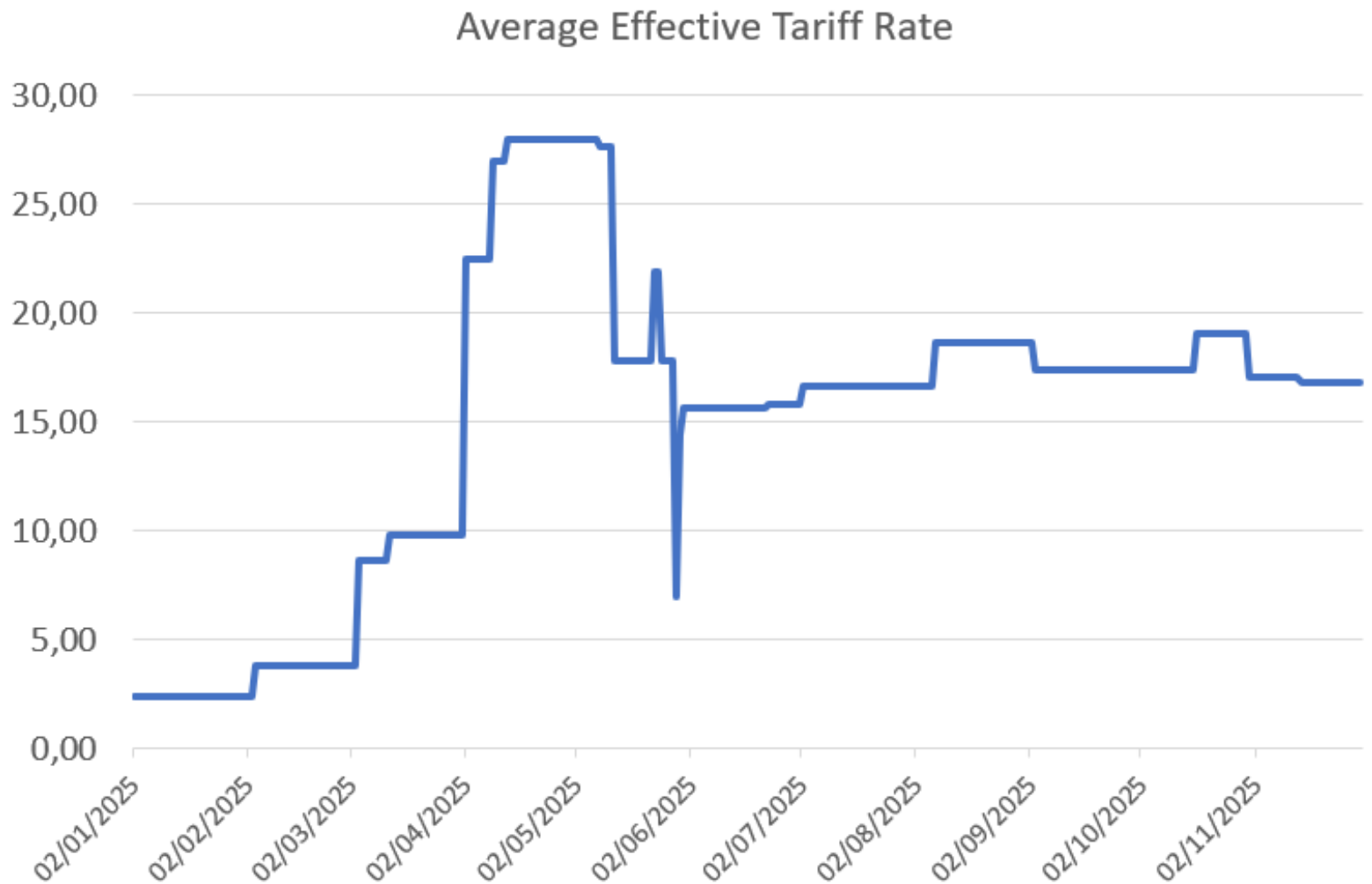
104% tariffs on Chinese goods.

20% on EU, etc.

Effective US Tariff Rate

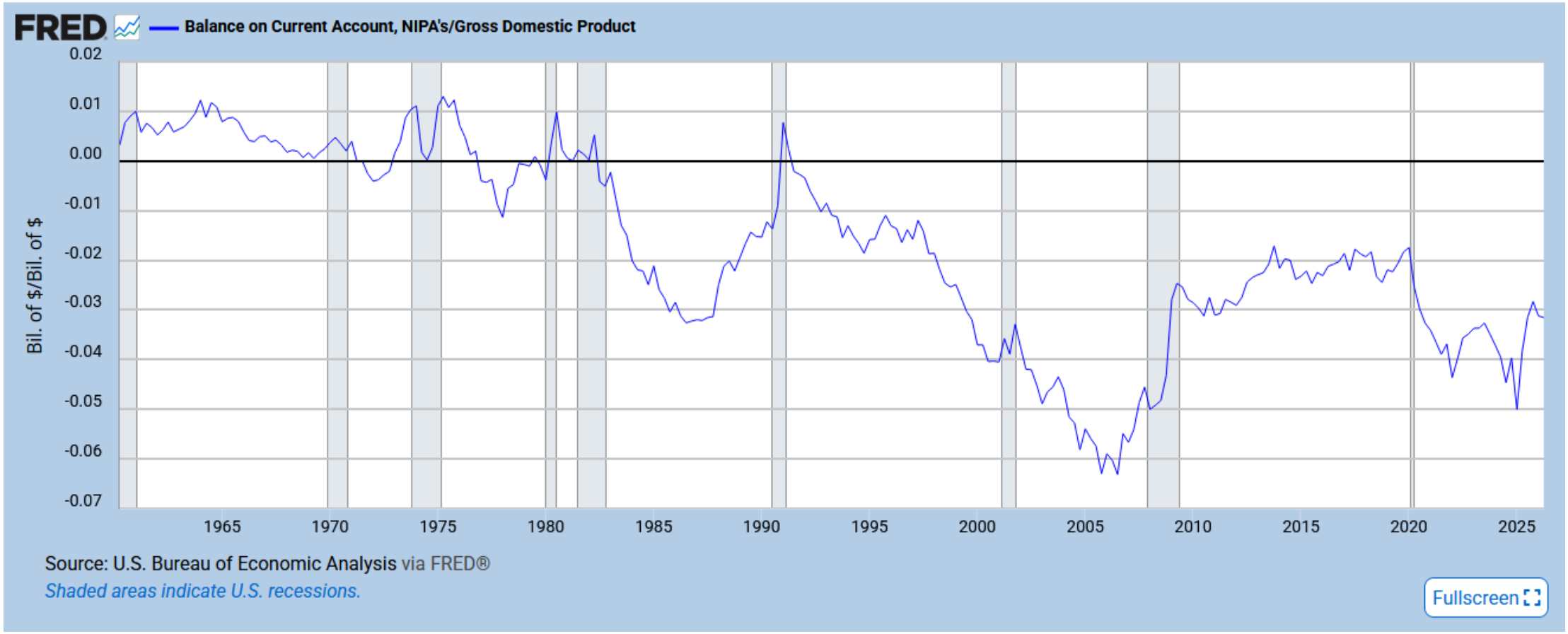


Presentation by N. Sowels, based on Yale Budget Lab Data, late February 2026. See:
https://www.globalpolicyjournal.com/blog/21/01/2026/economic-challenges-european-union-trumpism


Average Effective Tariff Rate
30,00
25,00
20,00
15,00
10,00
5,00
0,00
02/01/2025
02/02/2025
02/03/2025
02/04/2025
02/05/2025
02/06/2025
02/07/2025
02/08/2025
02/09/2025
02/10/2025
02/11/2025

Ibid

The US as “consumer of last resort”

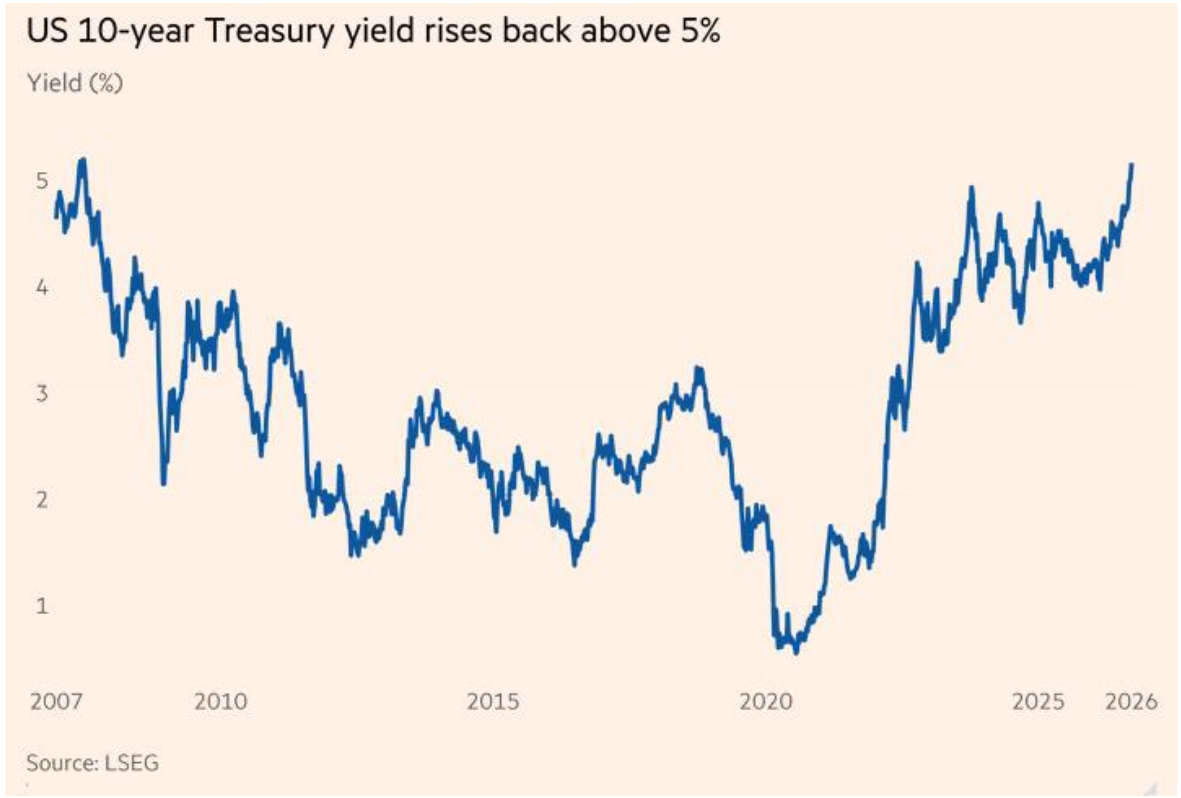


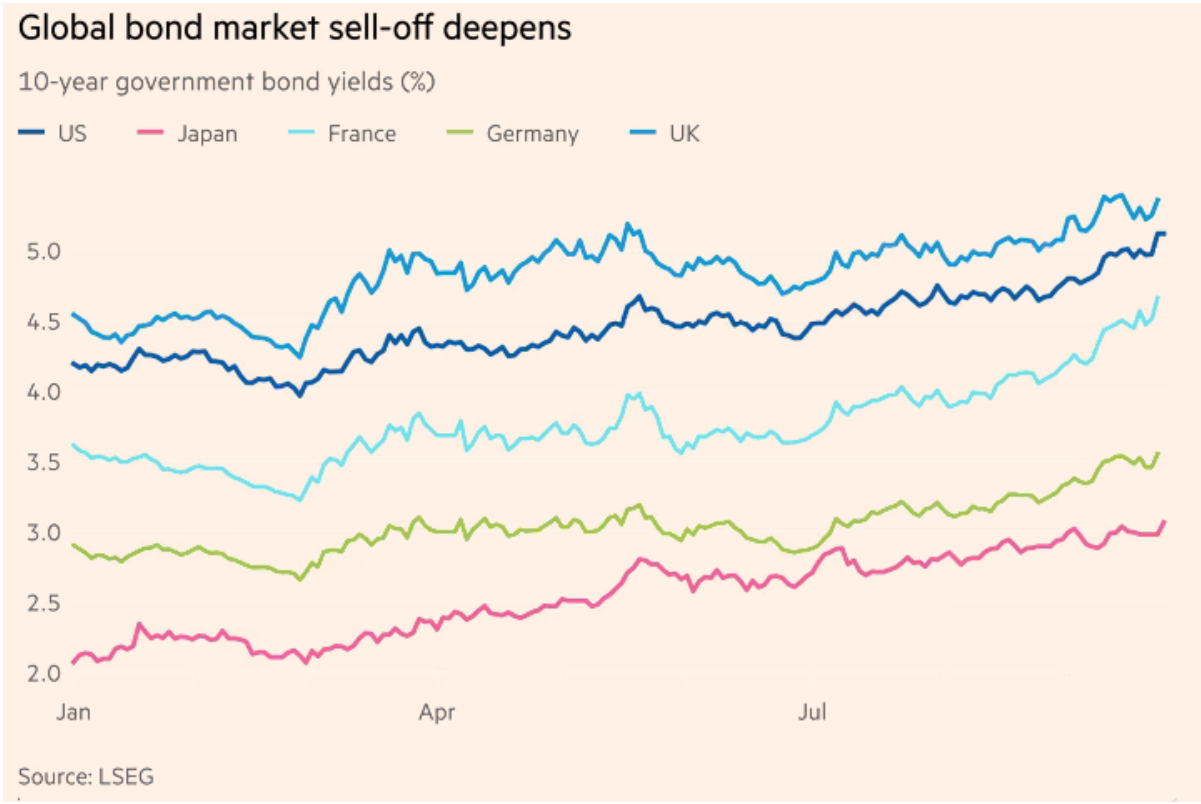
US Federal Debt



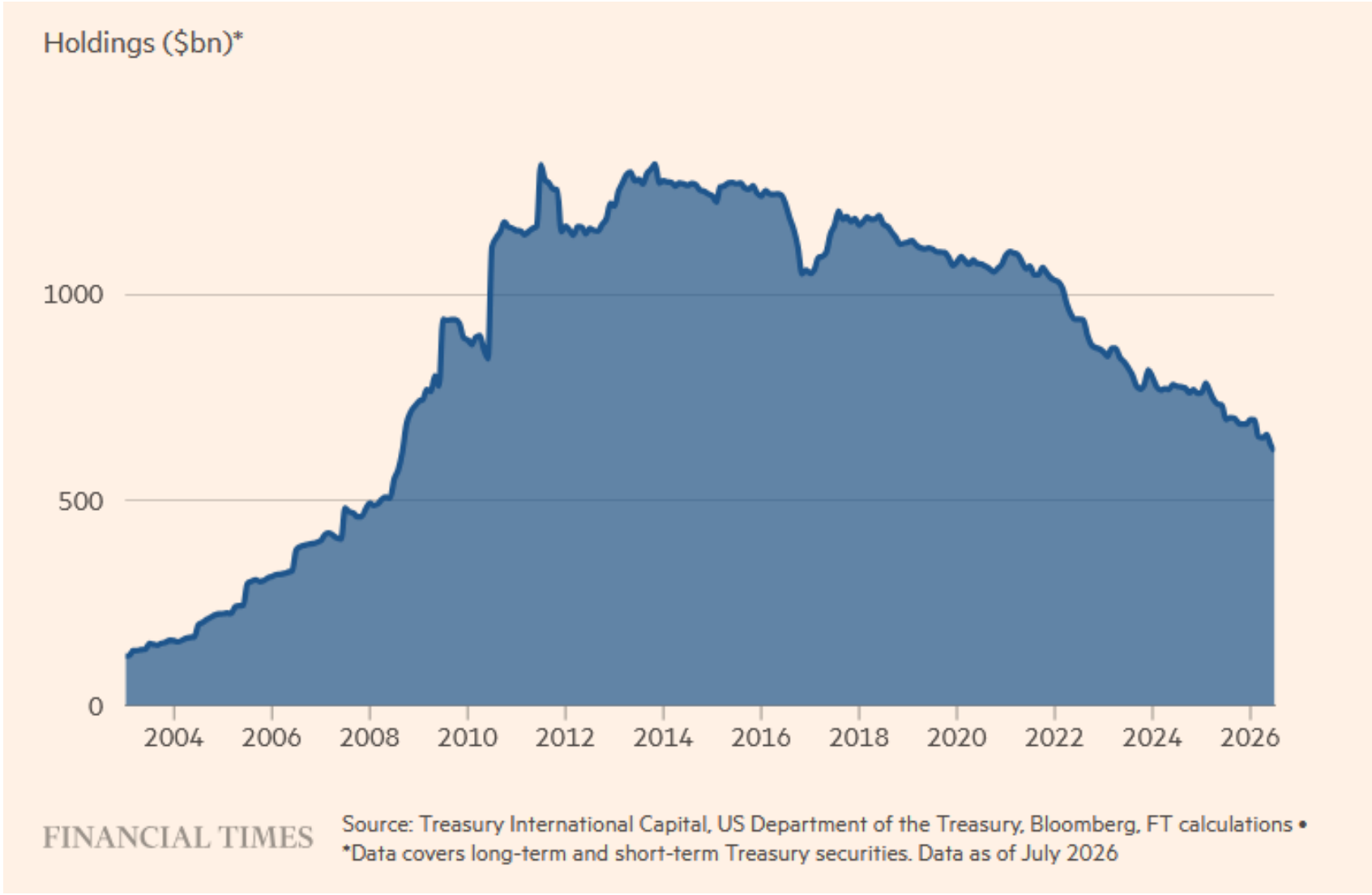
Source: [FRED, 24 September 2026]

Global bond sell-off deepens as oil climbs back to $105, Financial Times, 24 September 2026





China’s holdings of US Treasuries fall to the lowest since 2008



Source: Financial Times, 17 September 2026

Economic pressures and policy challenges are much compounded by Gaza and the war of aggression against Iran







The great dollar debasement???

