

Flash Economics

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The world is implementing expansionary fiscal and monetary policies in an unprecedented manner. Is this dangerous? Is the world in persistent deflation?

The world is now implementing expansionary fiscal policies and expansionary monetary policies. This choice will prove to be dangerous if inflation and real interest rates rise again in the future. This will happen if the world is in persistent deflation. Can we then see signs of persistent deflation in the global economy?

We can think of:

- Limited structural needs for investments since the world is becoming a service economy;
- An increase in private sector savings.

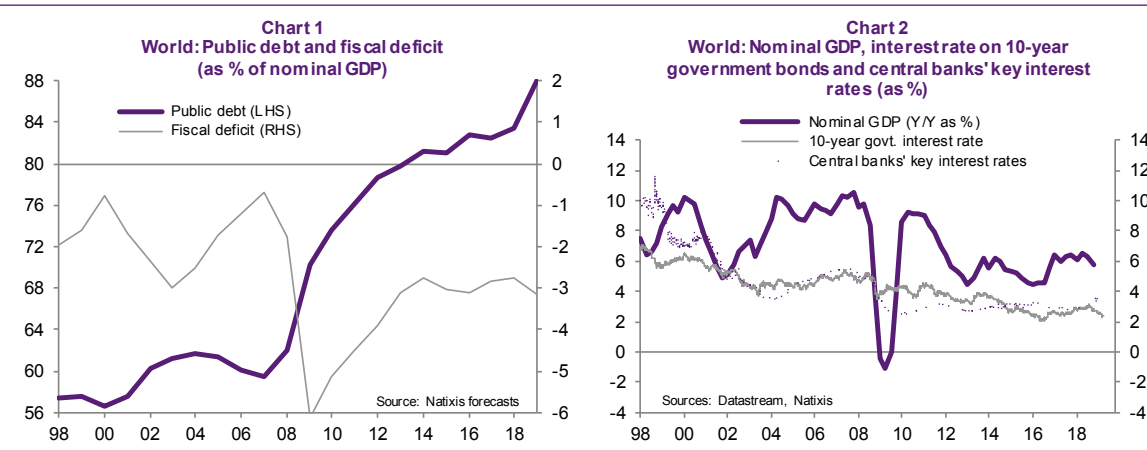
If the world has an enduring deflationary trend, which seems to be the case, it is not abnormal that both monetary and fiscal policies are expansionary.

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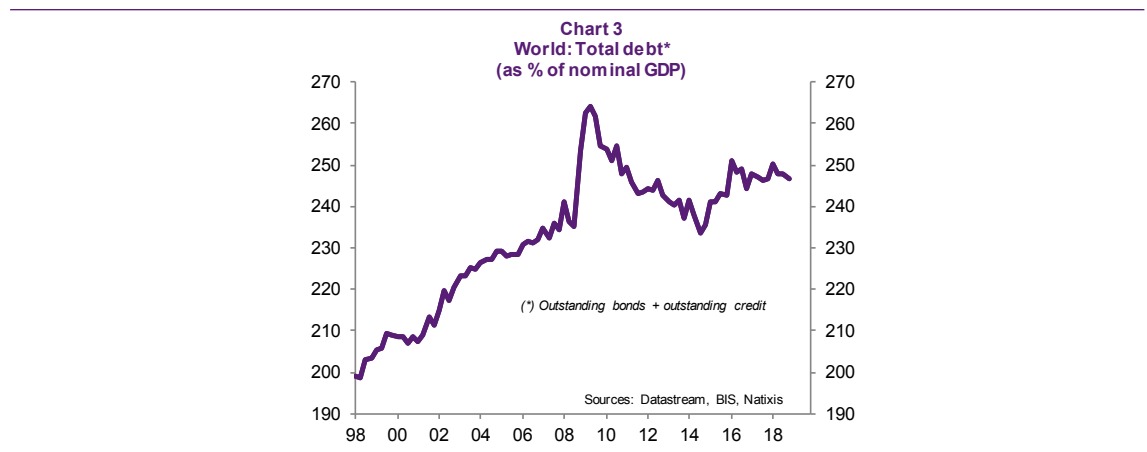
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Fiscal and monetary policies are expansionary at the same time

The world's fiscal policy is expansionary (Chart 1), and so is its monetary policy as shown by the abnormally low level of interest rates in relation to growth (Chart 2).



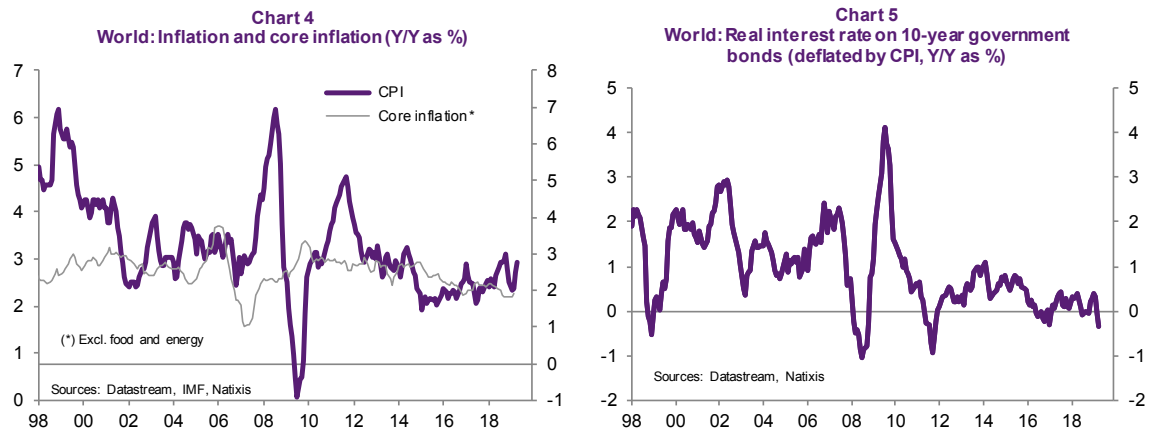
Global debt (Chart 3) is therefore increasingly being accumulated with very low interest rates.



The global choice to increase the public debt and to keep interest rates low by using an expansionary monetary policy will not trigger any crisis as long as monetary policies can remain expansionary and as long as central banks are not faced with a shock that forces them to conduct more restrictive monetary policies. **We are, in particular, talking about a return of inflation.**

The question of global deflation

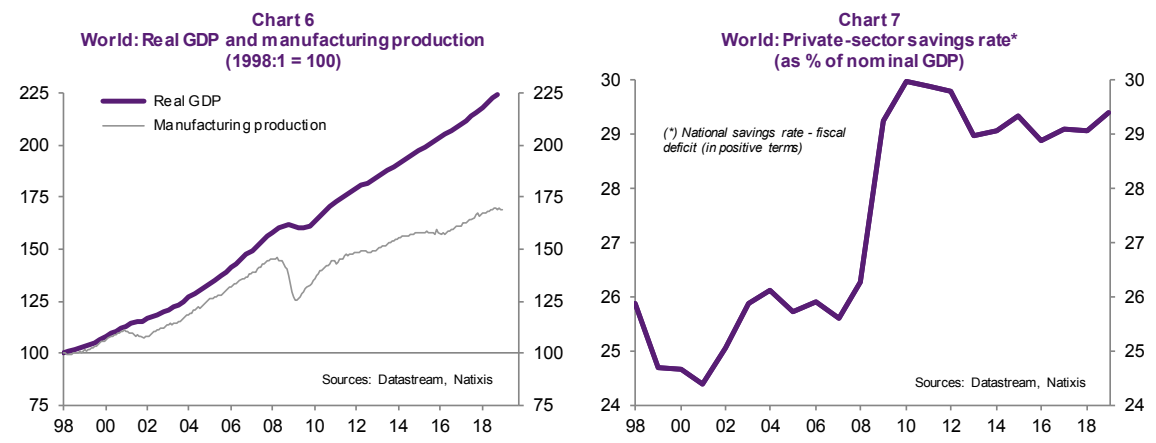
The fact that at equilibrium, the world has low inflation (Chart 4) and low real interest rates (Chart 5) shows that the world is in deflation.



As long as the world is in deflation, global inflation will remain low, the equilibrium (neutral) interest rate will remain low, monetary policy will remain expansionary, and an expansionary fiscal policy is not a problem.

Will the world remain in deflation?

- (1) The world is becoming a service economy (Chart 6), which means that the global investment requirement is declining since services are less capital-intensive than industry. This means we are moving towards a permanent situation of *ex ante* excess savings over investment.
- (2) The global private savings rate (Chart 7) is high, and rose markedly from 2007 to 2010.



Conclusion: A key question to determine whether the economic policies being conducted now are responsible

For the fiscal and monetary policies being conducted currently - which are all expansionary - not to be dangerous, the world must keep the inflation rate and equilibrium real interest rates low, and the world must therefore permanently remain in a deflationary situation (significant *ex ante* excess savings over investment).

We are seeing:

- A transformation of the world into a service economy, which is reducing the global investment requirement;
- A high level of global private savings, **all of which are consistent with a persistent situation of deflation.**

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