NATIXIS BEYOND BANKING

Flash Economics

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Does the current Keynesian stimulus signal a strong preference for the present?

Several countries (United States, France, Italy, euro zone as a whole, China, Japan) are now implementing large Keynesian stimulus packages even though unemployment rates are low.

This choice may lead to economic difficulties in the future:

- The need to reduce fiscal deficits to stabilise the public debt ratio;
- Deterioration in cost competitiveness if the stimulus entails an increase in wages;
- Inability to use a countercyclical monetary policy in the future if interest rates are kept at a very low level.

The choice of a Keynesian policy today, despite the fact that unemployment rates are low, therefore reveals a strong preference for the present.

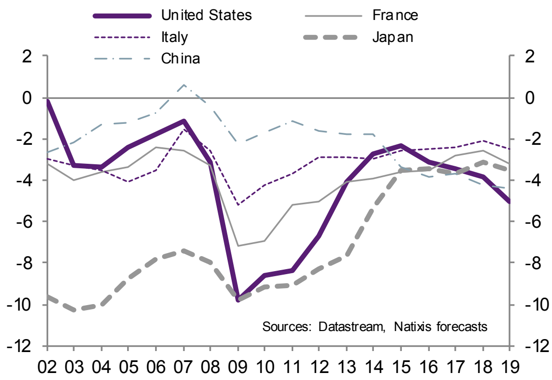
Patrick Artus
Tel. (33 1) 58 55 15 00
patrick.artus@natixis.com
@PatrickArtus

Keynesian stimulus in many countries

Keynesian (demand) **stimulus packages are being implemented in many countries.**

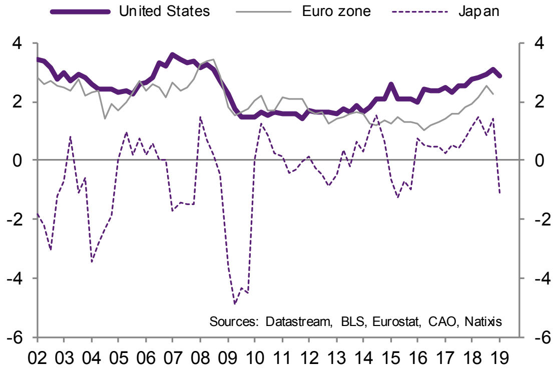
- **Fiscal policy has become expansionary** in the United States, France, Italy, Japan and China **(Chart 1)**;

Chart 1
Fiscal deficit (as % of nominal GDP)



- **Wages are picking up** in the United States, the euro zone and Japan **(Chart 2)**;

Chart 2
Nominal per capita wage (Y/Y as %)



- **Monetary policy has become even more expansionary** in the United States, the euro zone, Japan and China **(Charts 3A, B, C** and **D)**.

Chart 3A
United States: Fed Funds rate and interest rate on 10-year Treasuries (as %)

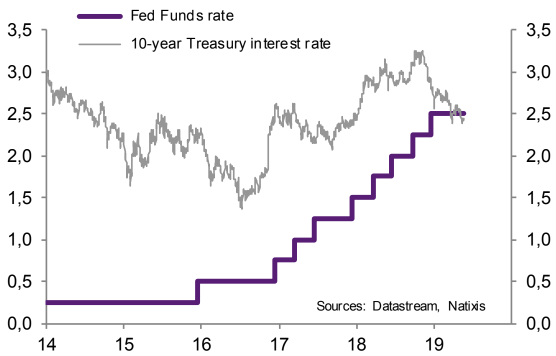


Chart 3B
Euro zone: Euro repo rate and interest rate on 10-year government bonds (as %)

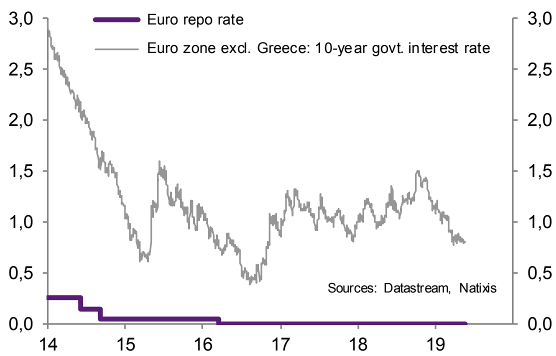


Chart 3C
Japan: BoJ base rate and interest rate on 10-year government bonds (as %)

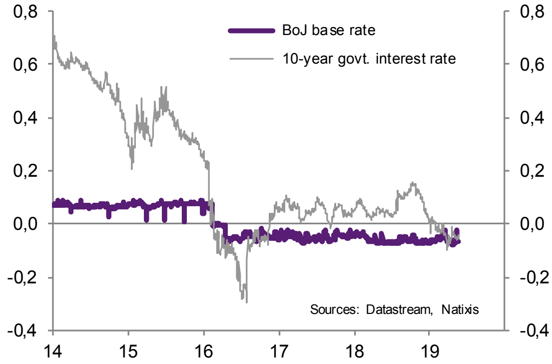
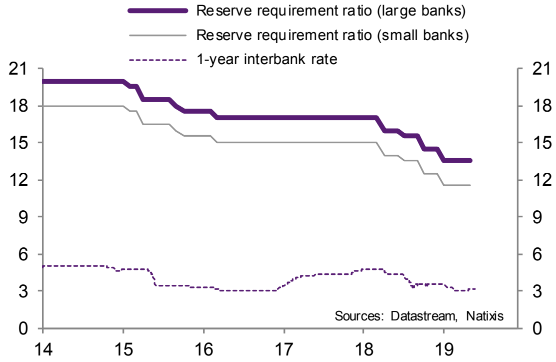


Chart 3D
China: Banks' reserve requirement ratios and 1-year interbank rate

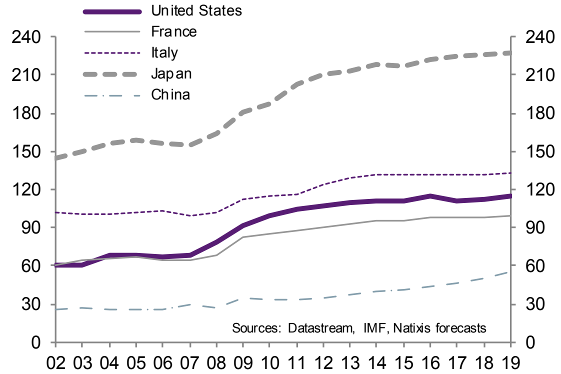


So in all these countries there is a clear policy to stimulate demand in 2019.

This choice may lead to problems in the future

- **The expansionary fiscal policies being implemented in 2019 (Chart 1) will in the future lead to restrictive fiscal policies,** which will be necessary to stabilise public debt ratios **(Chart 4)**;

Chart 4
Public debt (as % of nominal GDP)



- **Rising wages are eroding cost competitiveness** (**Charts 5A** and **B** show that this is the case in the euro zone, Japan and China);

Chart 5A
Unit labour costs (Y/Y as %)

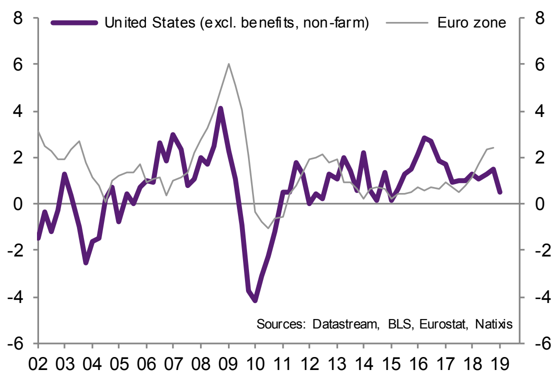
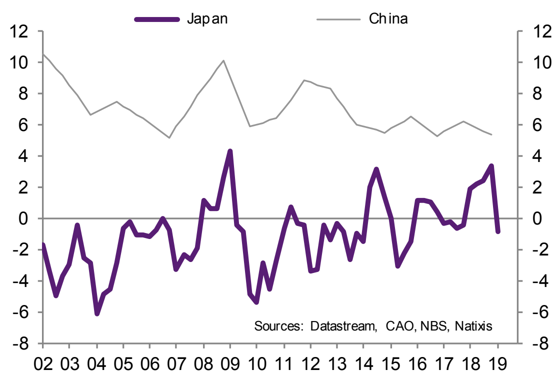


Chart 5B
Unit labour costs (Y/Y as %)



The United States, the euro zone and Japan have already **lost market shares** in the most recent period **(Charts 6A, B, C** and **D)**;

Chart 6A
Global trade and exports
(in volume terms, Y/Y as %)

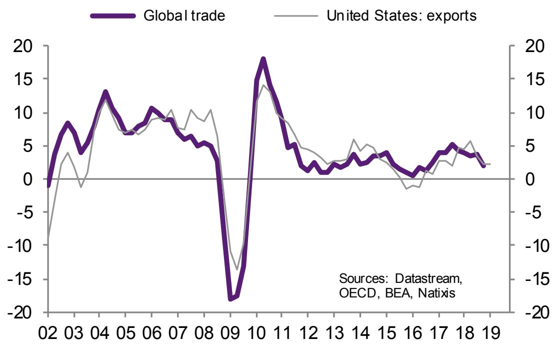


Chart 6B
Global trade and exports
(in volume terms, Y/Y as %)

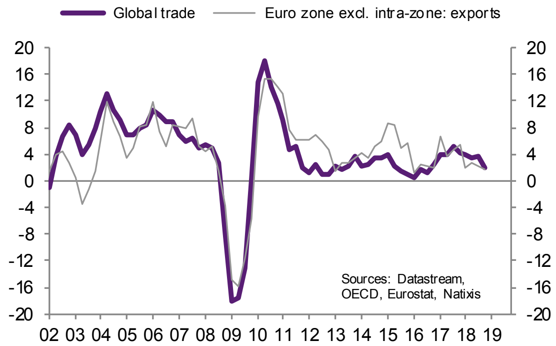


Chart 6C
Global trade and exports
(in volume terms, Y/Y as %)

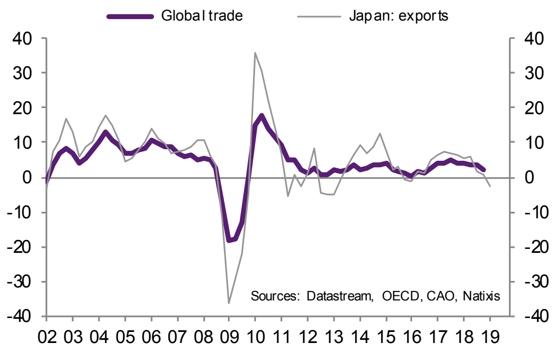
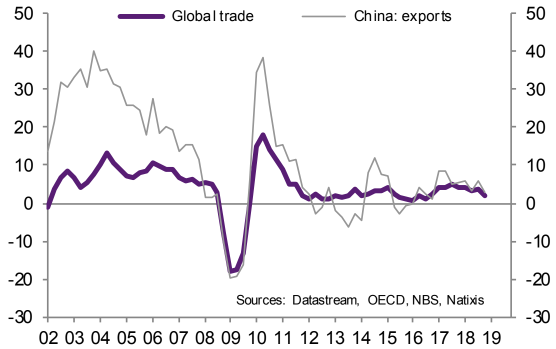
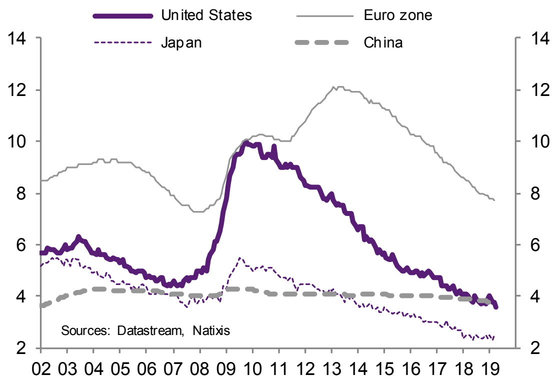


Chart 6D
Global trade and exports
(in volume terms, Y/Y as %)



- **Today's very low interest rates (Charts 3A, B, C** and **D), despite the fact that unemployment is very low** (close to structural unemployment, **Chart 7**), **will prevent monetary policy from being used for countercyclical purposes in the future.**

Chart 7
Unemployment rate (as %)



Conclusion: These governments have a strong preference for the present

The fact that many governments (United States, euro zone, Japan, China) have currently chosen to implement a Keynesian policy (demand stimulus) even though unemployment rates are low and these policies will have significant costs in the future (need for a restrictive fiscal policy, loss of competitiveness, inability to conduct a countercyclical monetary policy) **reveals these governments' strong preference for the present.** To gain a little growth in the short term, at full employment, they are using ineffective Keynesian policies and overlooking their future costs.

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