

Making sense of the global economic mayhem

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Contents:

1. Global backdrop: focus switches from inflation to growth. Debt could be next.
2. The UK: recession avoided, jobs market robust but growth is sluggish
3. Rates and yields: policy normalisation and the end of cheap money

Summary and take-aways

1. The global backdrop

Inflation persists

Early in 2021 I asked, which ‘p’ was inflation?

Would it, Pass through, Persist, or be Permanent?

First-round: supply-side shocks & lax monetary policies.

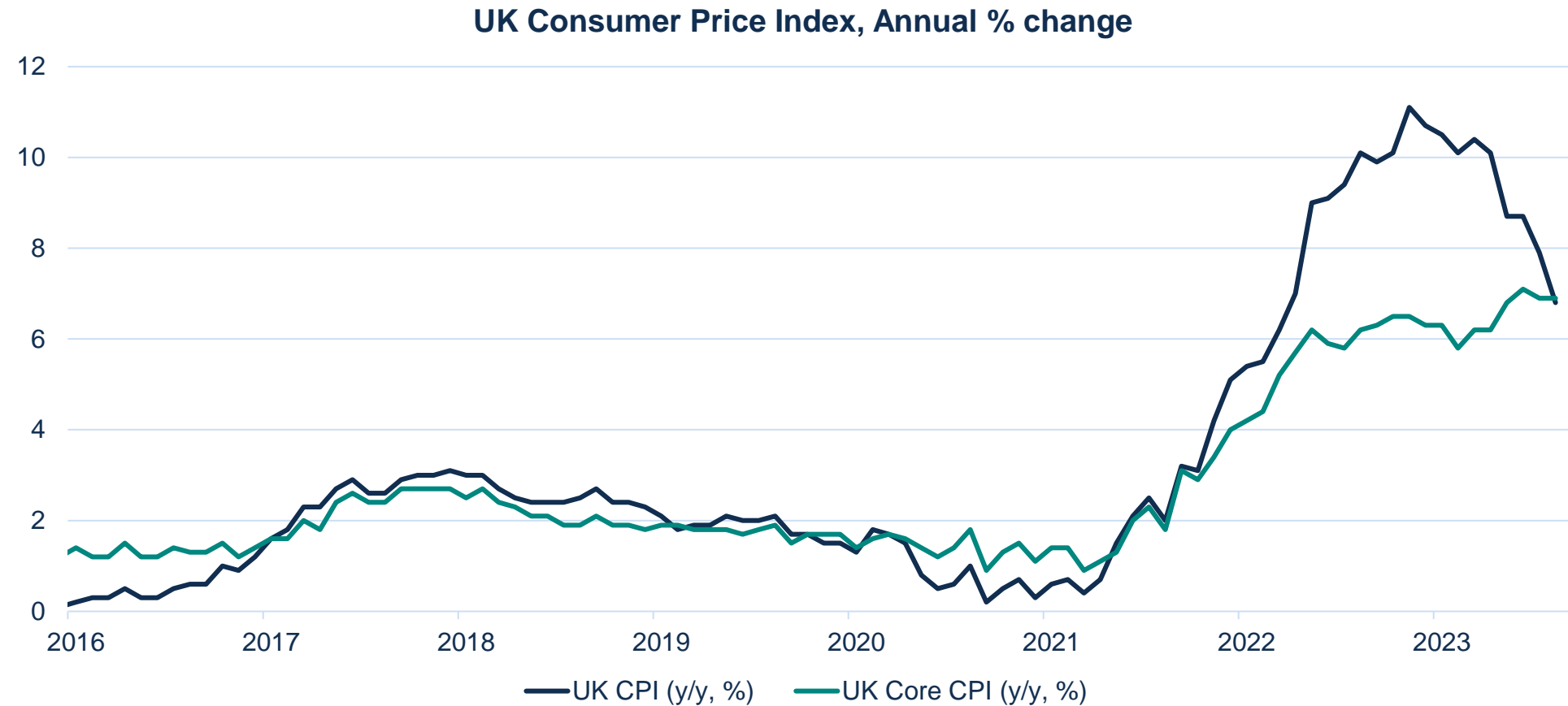
Second-round: wages and corporate margins.

Global factors keeping prices down:

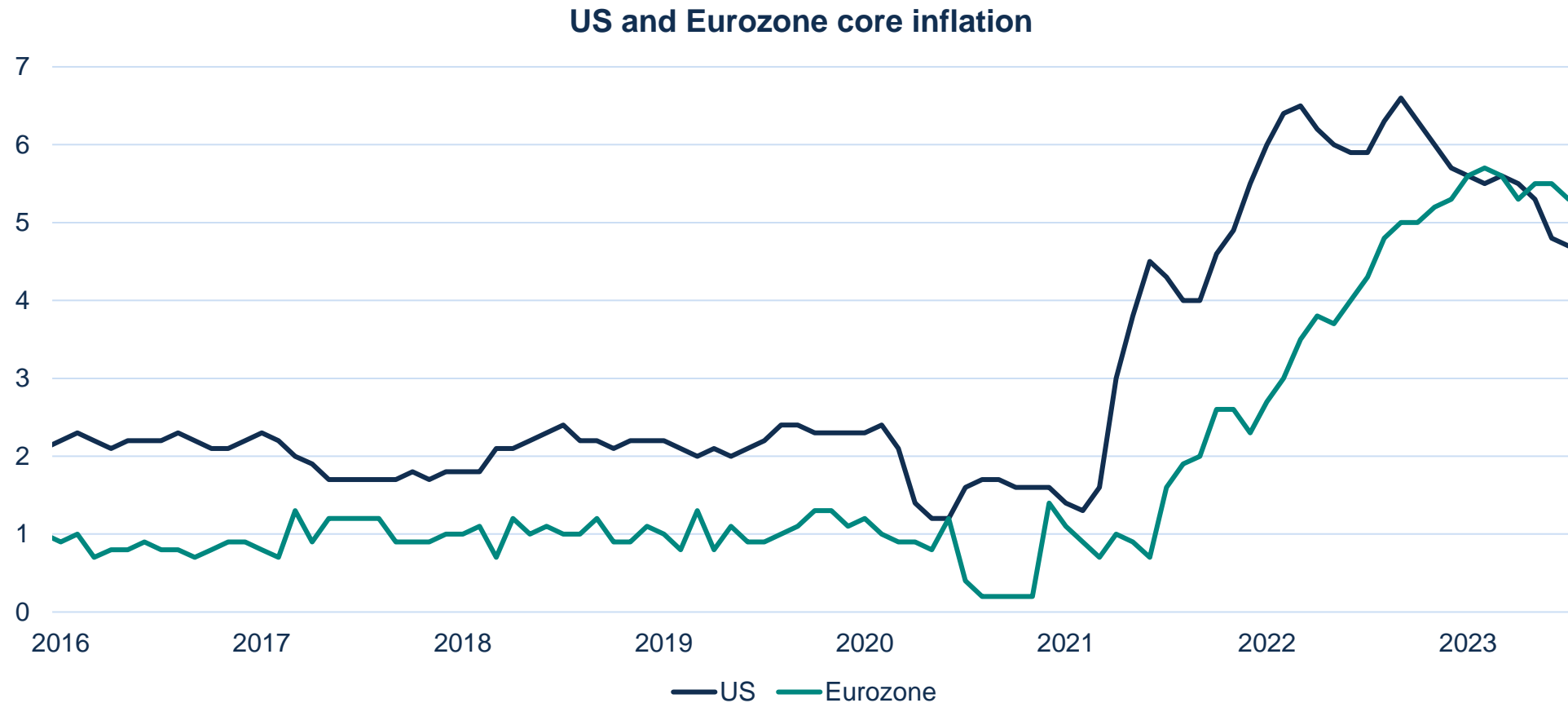
globalisation, low wage share, technology and financialisation.

2 of these 4 have changed. Inflation may settle at a higher level than before.

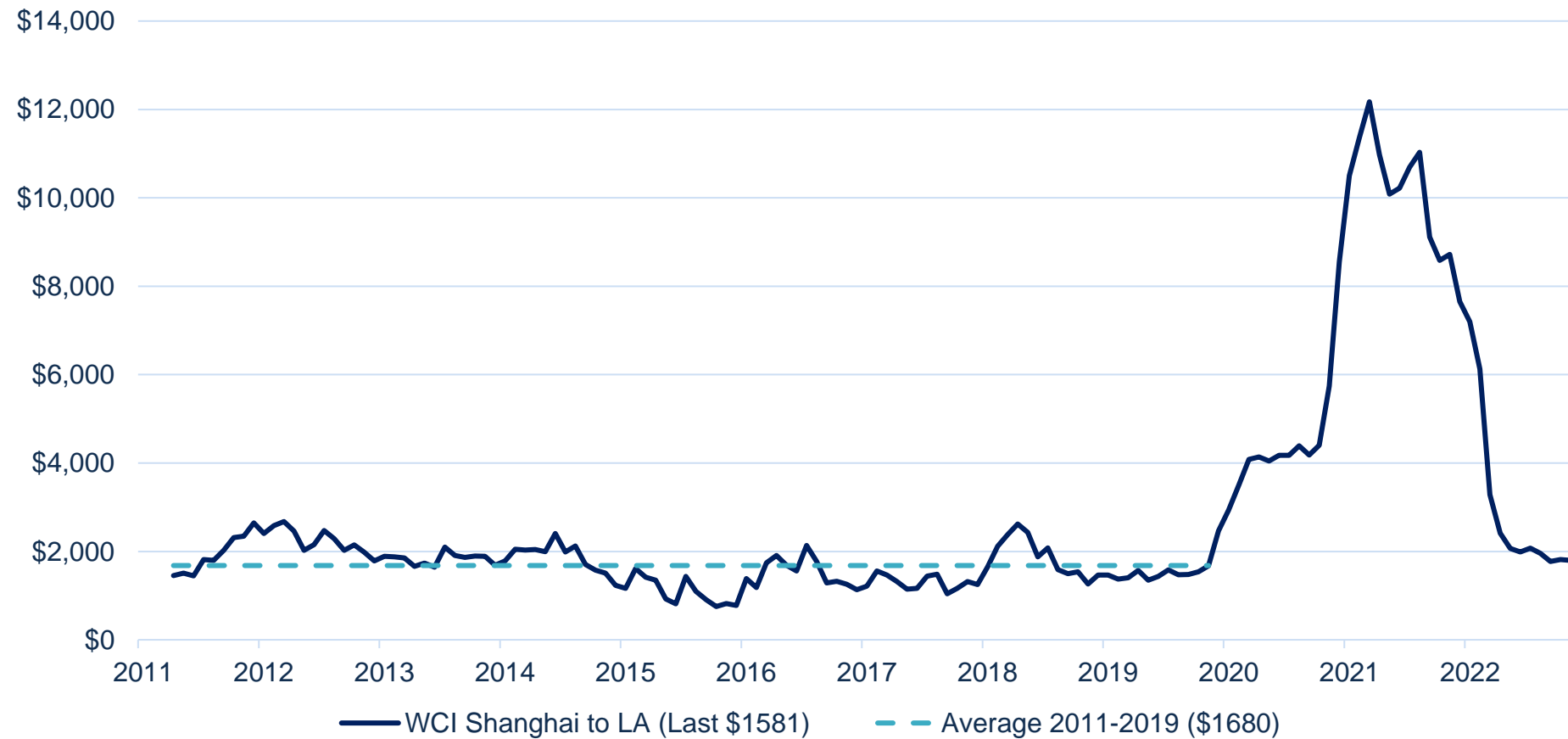
As UK headline inflation decelerates, the policy focus is on core inflation



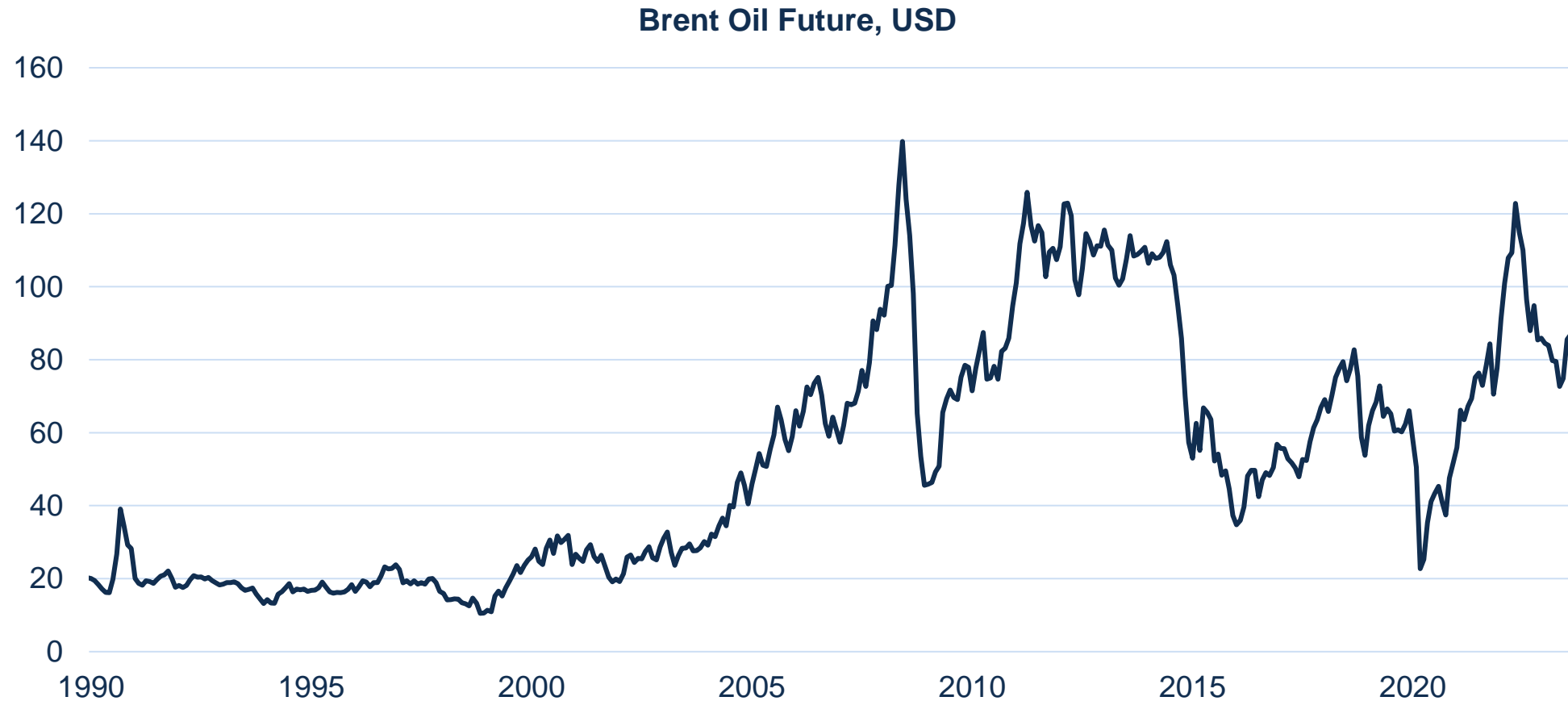
Core inflation has been stubborn in the US and euro area, too



First-round inflation effects are reversing



... but, oil prices have firmed recently

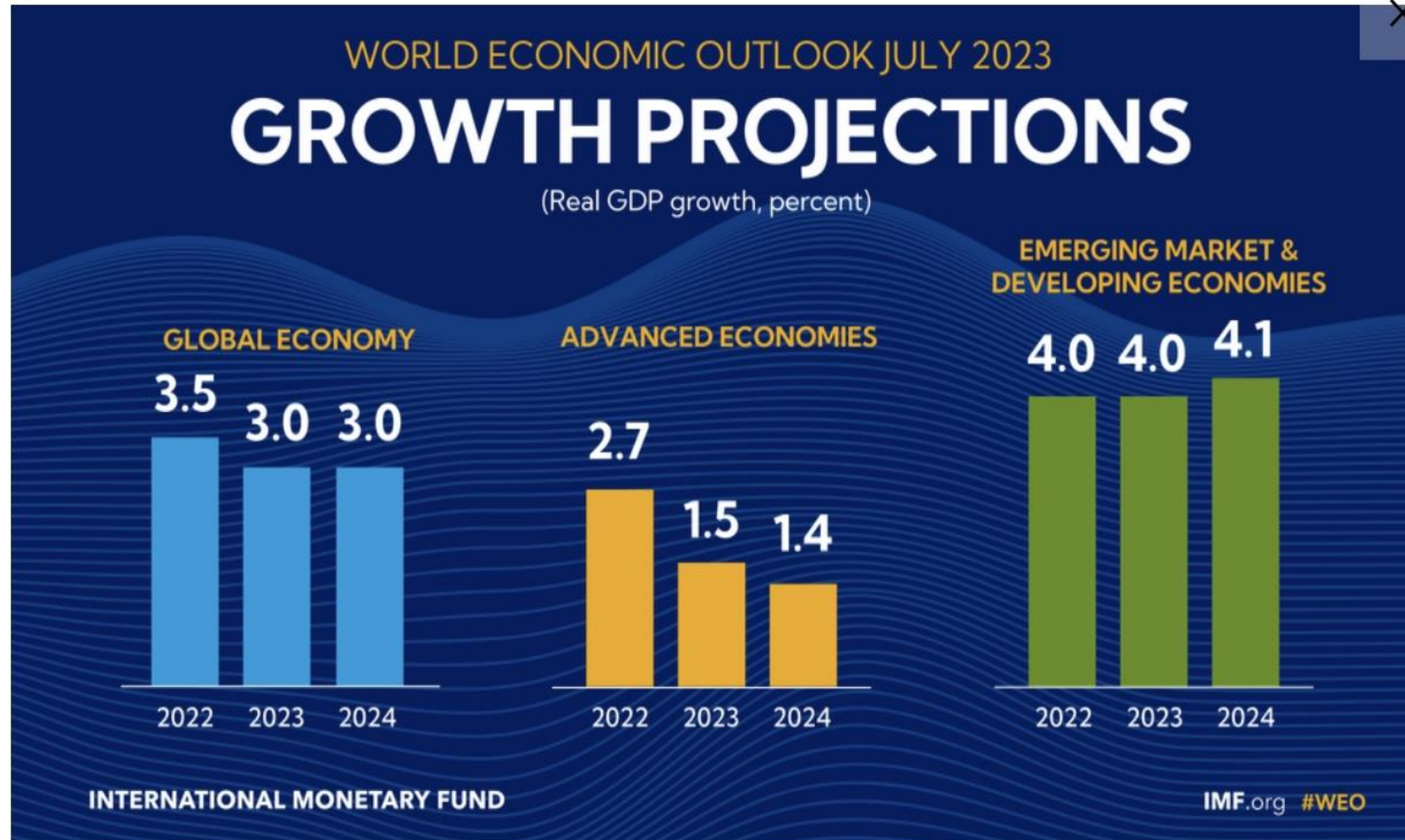


Growth concerns come to the fore:

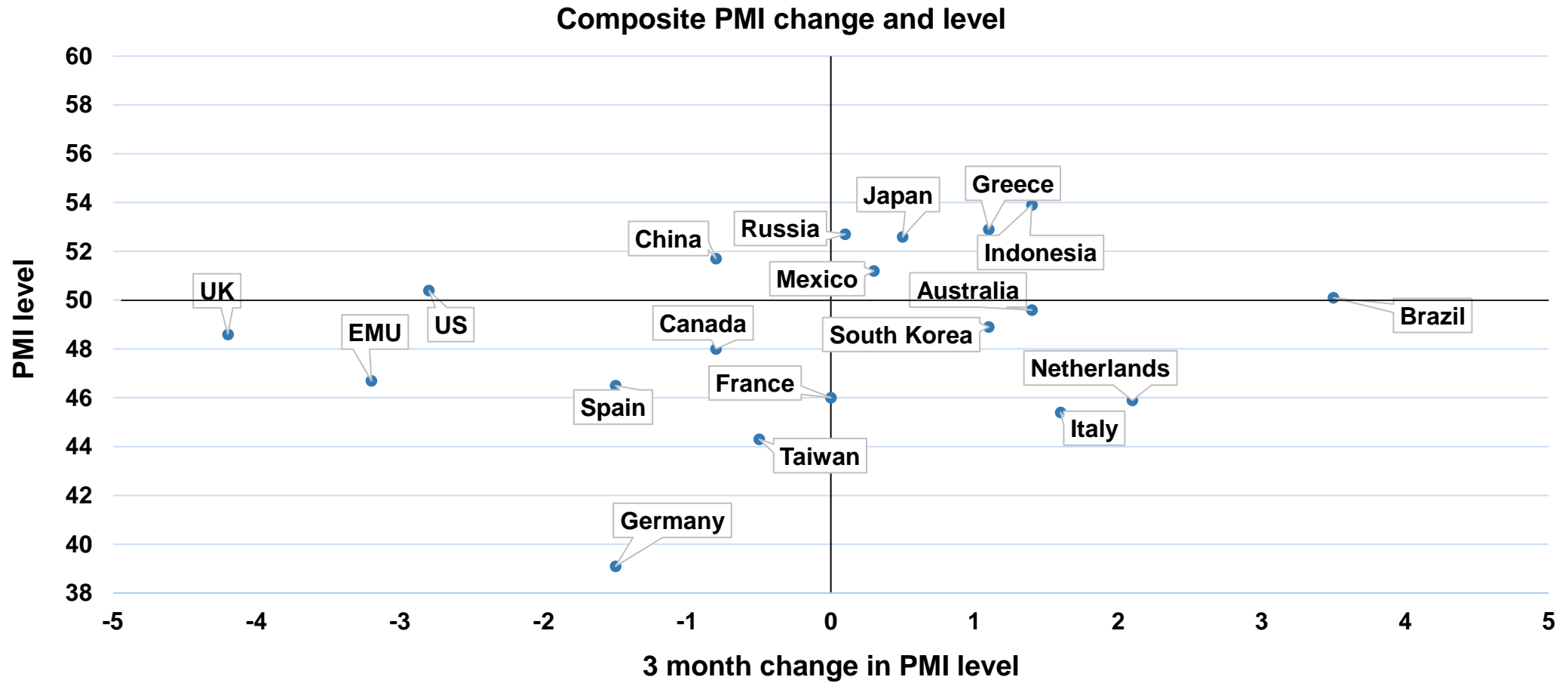
Global recession worries:

- IMF forecast is sluggish growth & lagged impact of monetary tightening**
- China slowdown, as economy has lost momentum through year**
- Future trend rate of growth low, and more volatile**
- Shift in balance of power to IndoPacific**
- Climate change and green agenda add to structural challenges & opportunities**
- Pandemic led to the three G's: Grassroots, Green and Geopolitics**

The IMF forecasts tend to capture the consensus view



Global manufacturing weakness



2. The UK context

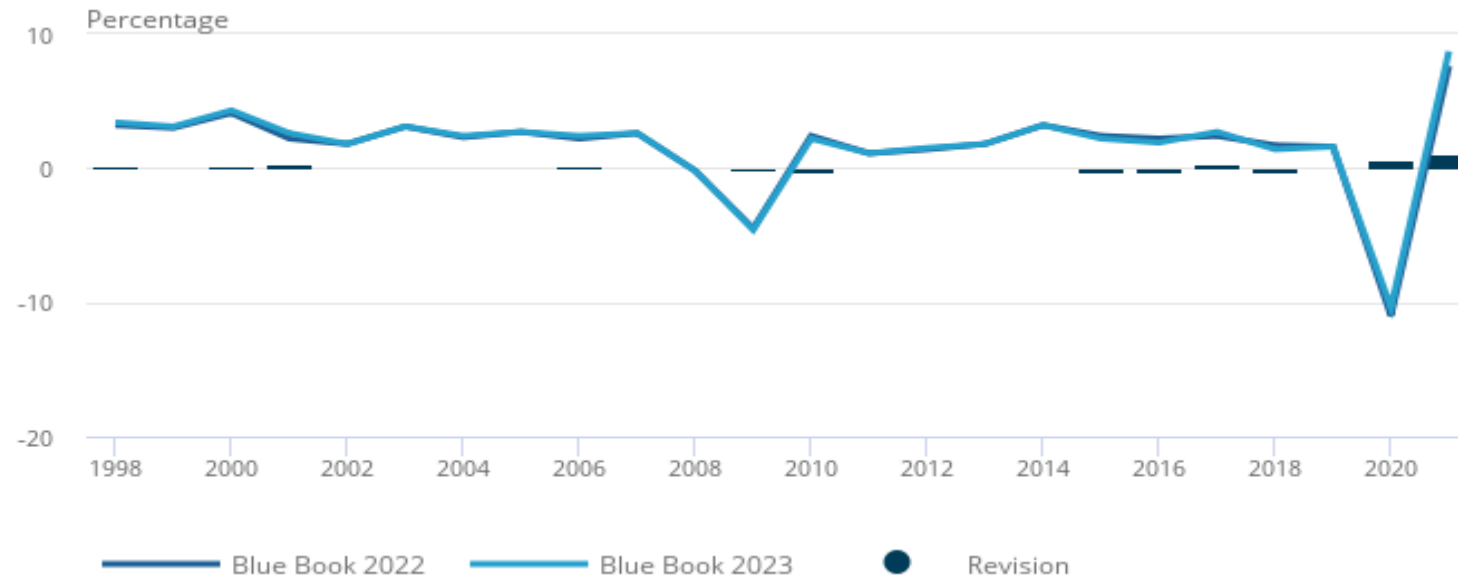
UK, like western Europe, hit by succession of shocks

- **2008** Global financial crisis. Haven't really recovered since
 - **2016** Brexit. Political event, but economic and financial process
 - **2020** Pandemic, lockdowns and global recession
 - **2022** Ukraine War and energy crisis
 - **2023** End of cheap money, febrile financial markets
- High public debt levels high**
- Resilience in some areas, with solid jobs growth
 - But UK is a low trend growth, low productivity, low wage economy. #
 - Now a high spend and high tax economy too.

UK GDP was revised higher last week, ONS data revisions shown here

Figure 3: Annual volume GDP is now estimated to have increased by 8.7% in 2021

UK, volume GDP growth, 1998 to 2021



Source: UK National Accounts from the Office for National Statistics

Employment is high, with recent focus on inactivity rate

UK employment, unemployment, and economic inactivity rates, seasonally adjusted, between April to June 2008 and April to June 2023

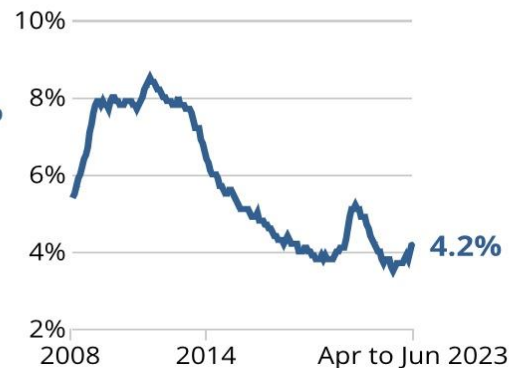
Employment (all aged 16 to 64)

Three month change: -0.1pp ▼
Dec 2019 to Feb 2020: -0.8pp ▼



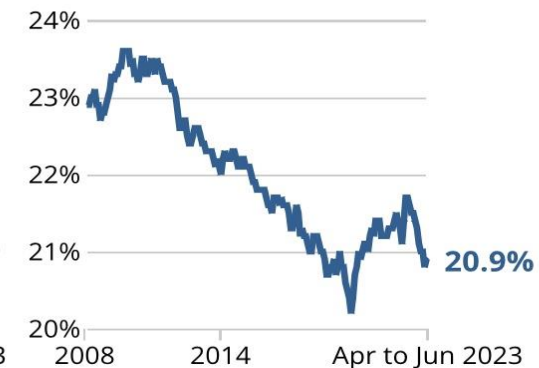
Unemployment (all aged 16+)

Three month change: 0.3pp ▲
Dec 2019 to Feb 2020: 0.2pp ▲



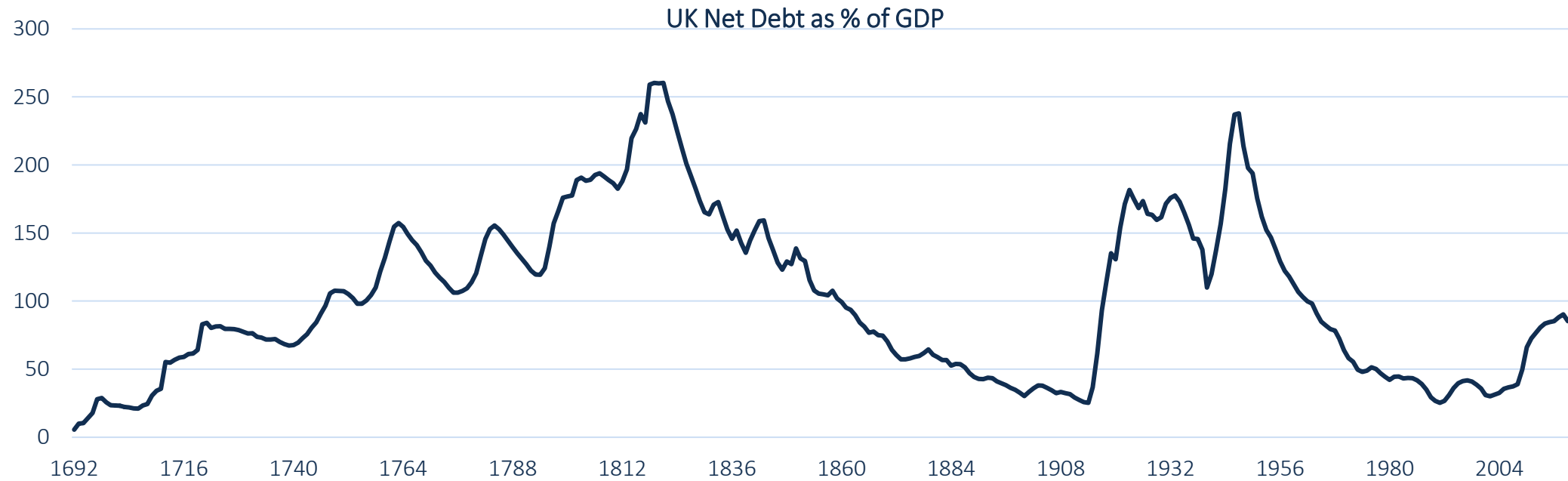
Economic inactivity (all aged 16 to 64)

Three month change: -0.1pp ▼
Dec 2019 to Feb 2020: 0.7pp ▲



Source: Labour Force Survey from the Office for National Statistics

Debt will be the next focus... UK debt to GDP



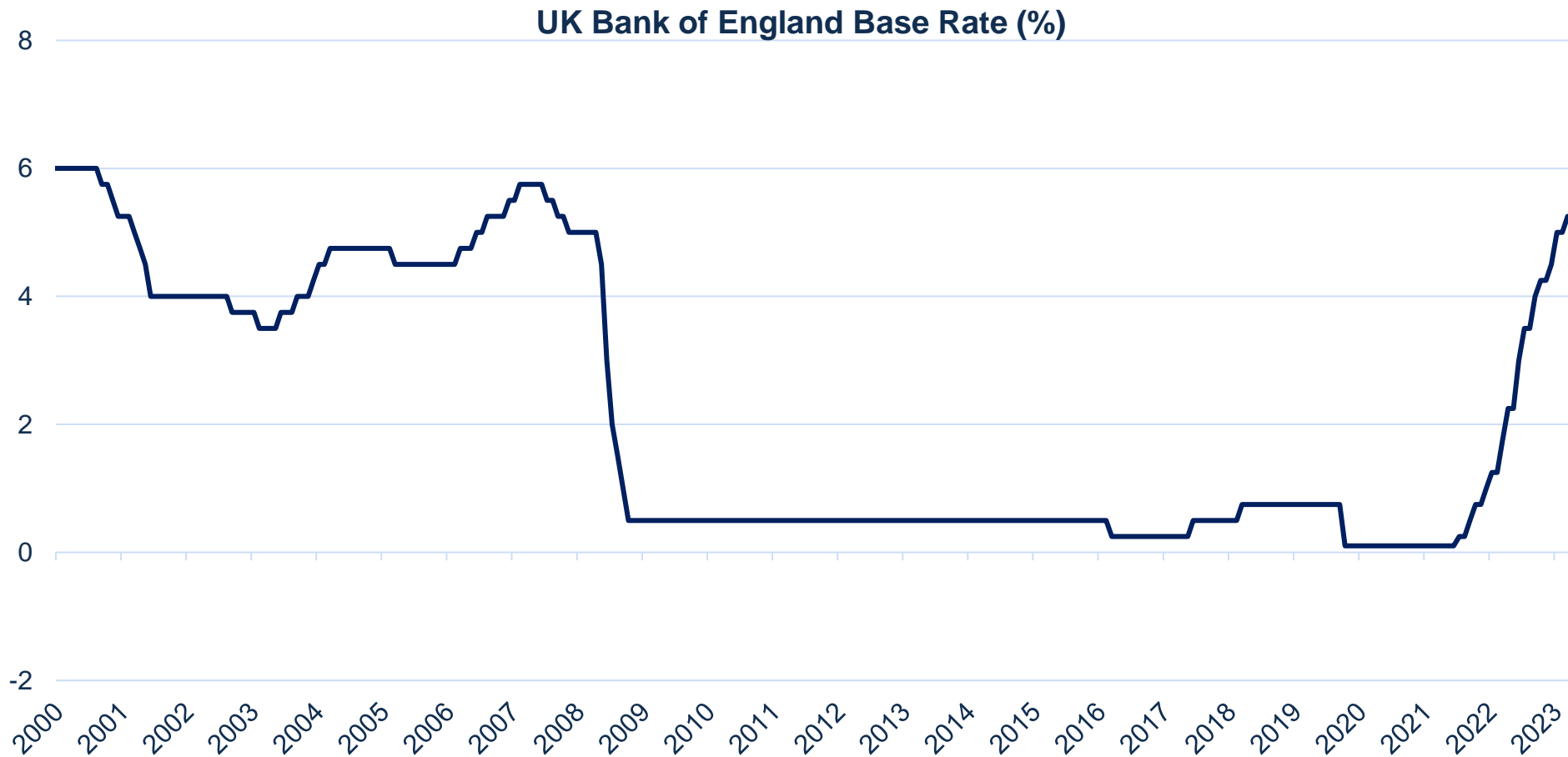
3. The end of cheap money

Cheap money has led to many problems:

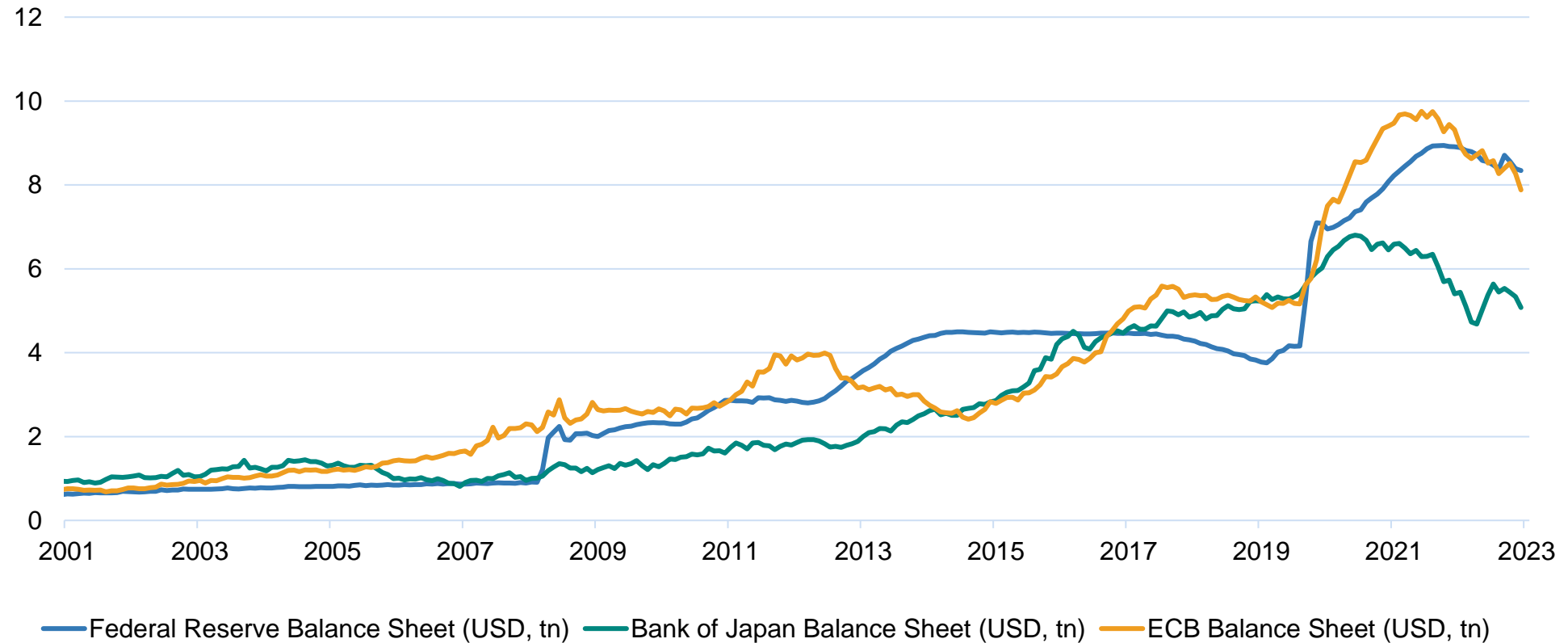
- Asset price inflation – across financial markets and housing**
- Financial markets not pricing properly for risk**
- A misallocation of capital**
- An inflationary environment, as evidenced in recent years**

- Testifying to the Treasury Select Committee I described the UK's three phases of QE since 2008 as: the good, the unnecessary and the bad**
- Tightening has exposed problems: LDI, US regional banks, property market**
- . It is also raising the question of what constitutes a risk-free asset?**

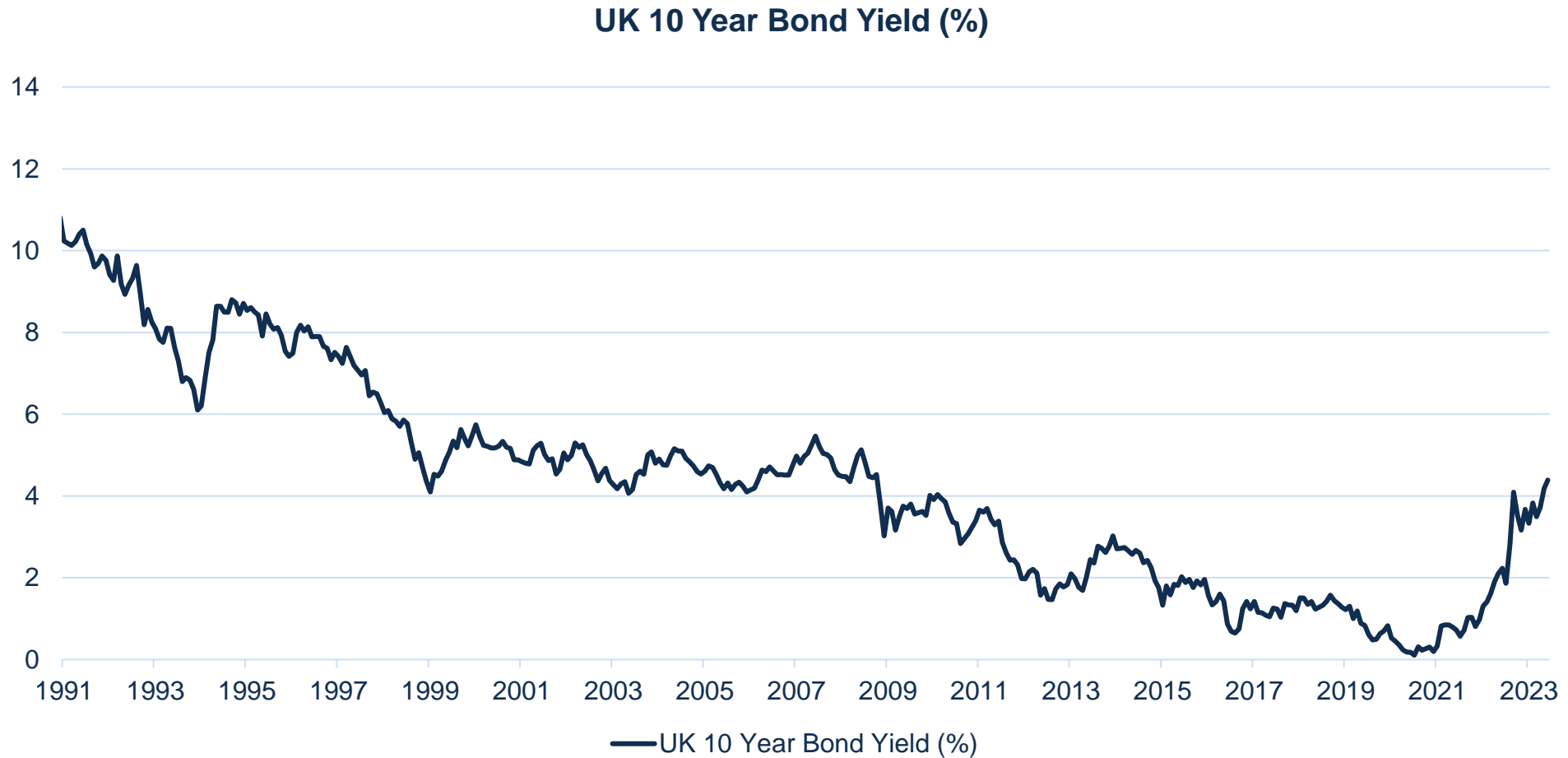
UK policy rates start to normalise, unclear where they will settle



Central bank balance sheets globally ballooned. They are now shrinking

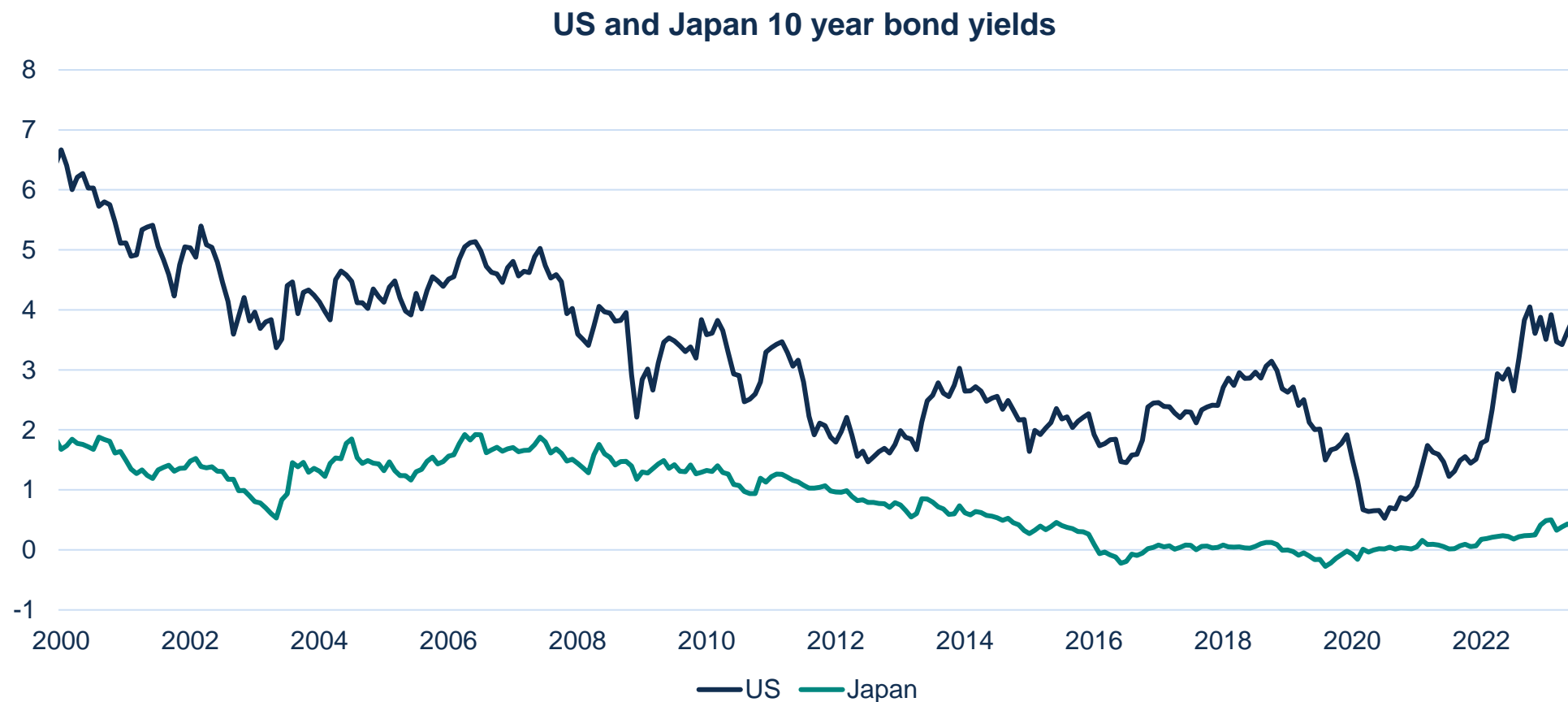


Higher ten-year UK gilt yields

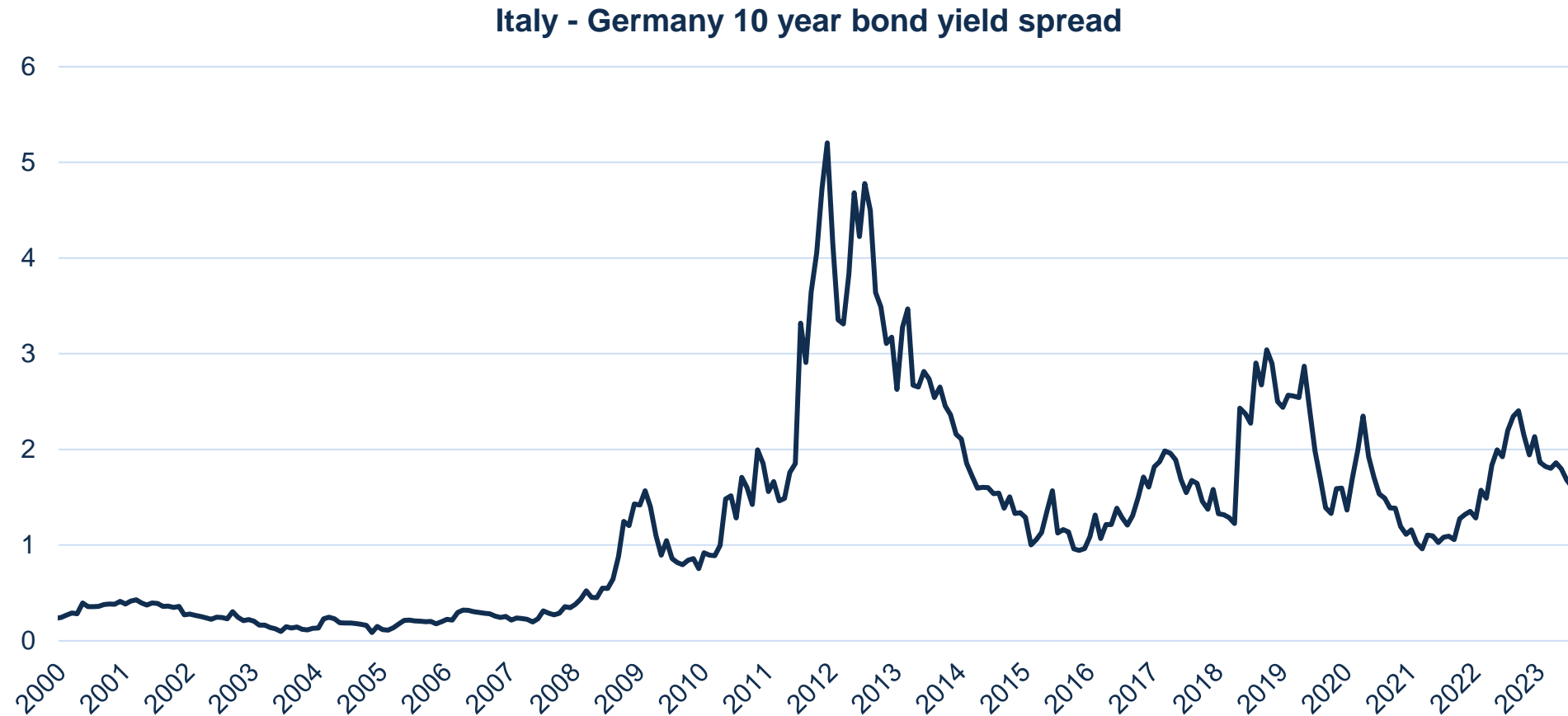




What constitutes a risk-free asset, as ten-year yields rise in Japan & US, too netwealth



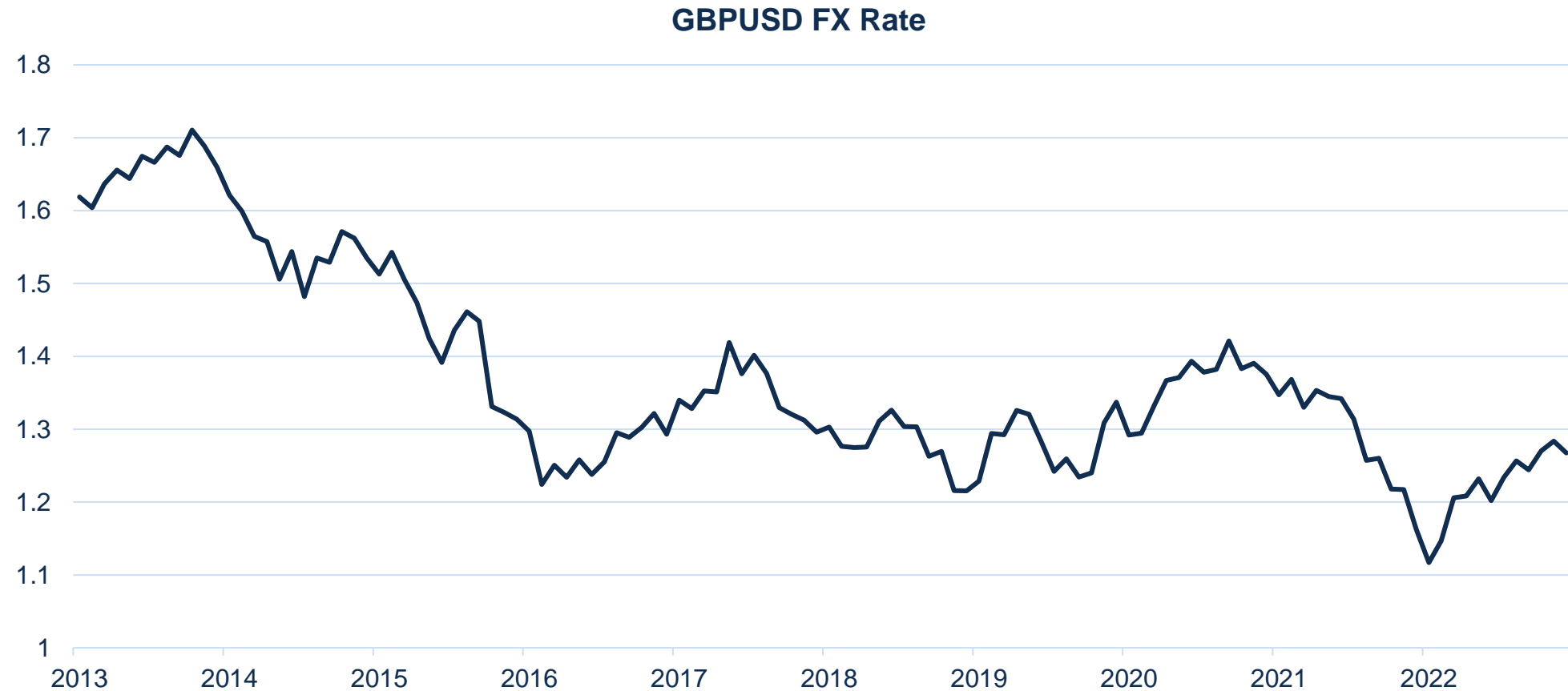
Not all areas of market concern have materialised



Monetary policy normalisation:

- Some are easing (Brazil, Chile, China). Will monetary policy be the shock absorber again in the west?
- Where will policy rates settle?
 - Pre-panemic “r-star” was believed to be close to zero.
 - At Jackson Hole this year, talk of cloudy skies
- In future we need policy rates that are positive in real terms
 - If inflation was 2%, r-star of zero implies policy rate of 2%
 - If inflation is 3% & growth 1.5%, policy rates may need to be 4.5%

Also the UK has to be mindful of how the rest of the world sees us



Summary and take-aways