Article

Activity & growth

The economists' bench

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Oriol Aspachs
Research Director

There is a coach within all of us. Think, for instance, about how you felt the last time you saw your team lose. *They should have sold him years ago! We need a shake-up on the bench!* These are expressions we have all heard, if not shouted out ourselves at some point.

For years, the same was the case with the economy, albeit usually with a little less passion. *It's all because of the budget cuts! Of course the ECB should lower interest rates!* Who hasn't stepped into the role of Minister for Economy to give their friends a recipe for fixing their country, or the entire world, in a couple of days?

However, while we continue to play the coach with enthusiasm, there are ever fewer people brave enough – or foolhardy enough – to want to play the Minister for Economy in the current context.

The data published over the past few weeks have confirmed that the slowdown in global growth, while not a recession, continues as expected. In the US, GDP grew by 2.0% year-on-year in Q3; in China, by 6.0%, while in the euro area, the pace of growth stood at a modest 1.1%. All these figures are in line with expectations, but they paint a clearly deteriorating picture that gives rise to concern. The trepidation only increases when we ask ourselves: what should be the economic policy response in this context? Therein lies the fateful question, since the options offered by traditional economic policy do not seem appropriate at the current juncture.

The most commonly used tool in recent years has been monetary policy, but this is a resource that has already been squeezed to its limit and the support it can offer now is somewhat limited.

For instance, at its October meeting, the ECB limited itself to reinforcing the expectation that interest rates will remain very low for a long time. After all, the economic stimulus generated by any new rate cuts would be minimal. Note, however, that if interest rates are kept so low for a long time, bubbles could end up appearing in financial asset or real estate prices, provoking financial stability issues. Indeed, the Bank for International Settlements has already given this warning on numerous occasions.

The Fed, which was more asserted in raising interest rates during the economic recovery, now has more margin to support the US economy. In October, it cut the reference interest rate for the third time this year, and it is highly likely to do so again in the coming months. In any case, with the interest rate at 1.75%, there is less scope for reduction than in previous cycles.

Classical fiscal policy, which seeks to stimulate demand through tax cuts or an increase in current account spending, also appears to have limited scope to offer support. Public debt remains at levels not seen in decades in most developed countries (Germany is the major exception). It is true that the financial effort

required from the public sector to pay off this debt remains contained, thanks to such low interest rates. But we must proceed with the utmost caution, since any changes in the environment that cause a country's risk to be reassessed, as occurred in the case of Italy, could put a strain on the public finances. Furthermore, as we have seen in the US with the fiscal stimulus implemented by the Trump administration in 2018, measures of this kind can dramatically increase the rate of growth, but the effect is temporary. When it is diluted, the economy slows back down and ends up with higher levels of public debt.

Not even so-called supply-side policies, such as giving the markets greater flexibility, seem easy to implement in the current context. In general, measures of this k ind can increase an economy's growth potential in the medium term, but usually result in economic and social costs in the short term. The fact is that the boost to economic efficiency they provide can translate, at least temporarily, into an increase in unemployment and difficulties for less competitive companies. There are, of course, areas that need to be explored further, such as reducing impediments to business growth or measures that promote recruitment on permanent contracts. However, at a time of significant social polarisation and a surge in so-called populist parties, the widespread implementation of supply-side policies is highly risky.

So what can we do to stimulate the economy in the short term? *An investment stimulus!* There are three areas in which there is broad consensus that implementing a major investment stimulus is both necessary and possible: infrastructure (especially in the US and Germany), digitisation and the circular economy (please, read the Dossier of this *Monthly Report* if you are not yet convinced). The role of the public sector is crucial in helping to ensure that the resources available to us are allocated to these areas. Furthermore, doing so does not necessarily require a significant increase in public spending. We need to be creative, to think of a combination of taxes and tax incentives that better fits the new priorities and to design a regulatory framework that facilitates the mobilisation of resources towards these objectives. These may seem like grand words with little substance, but if you read the articles we have been writing on these topics in the pages of the *Monthly Report*, you will find concrete measures.

There is still a game-changer on the economists’ bench.

Oriol Aspachs

Head of Research

Oriol Aspachs

Research Director

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