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The problem with MMT

Market Comment, June 2021

Once again in 2021, the popularity of a pragmatic, expansionary monetary policy that provides ongoing stimulus to the economy in all global regions appears to be enduring. This approach to monetary policy can be described as one way of applying so-called "Modern Monetary Theory (MMT)". Particularly in the US, but also in Europe, the financial markets have so far responded positively to the ballooning of central bank balance sheets. 2022 and 2023 are likely to be the real test for advocates of MMT. Trust in paper currencies could be put to the test.

Just like the financial crisis of 2008/2009, the coronavirus crisis has shown that the expansion of central bank balance sheets via bond purchases on a huge scale and an increase in government debt can be essential tools of monetary policy at a time of crisis. MMT, which originated on the left side of the economic policy spectrum, has been gaining admirers in the Democratic Party in the US and beyond for some time now. The astonishing surge in popularity of MMT essentially dates back to 2019, when Olivier Blanchard, the former Chief Economist of the International Monetary Fund, stated that the costs of public-sector debt "might not be so bad" as traditionally assumed.

MMT postulates that money arises as a "quasi-product" of governments through government spending and taxation, rather than being attributable – as per the classic definition – to credit creation and the banking sector. According to MMT, it therefore follows that governments capable of printing their own currency and lending money can hardly be forced into a default situation, as they can print their own new money to pay off their debt.

In addition, champions of MMT argue that as inflation has been low for many years, government budget deficits have been too small, i.e. too little money has been created in this way. At times of economic weakness, governments should therefore seek to increase spending and deficits even more, as the limits of government indebtedness are actually at a much higher level than what was formerly deemed critical. Finally, MMT advocates point to the fact that the flood of liquidity released after the financial crisis of 2008 did not lead to high inflation, as was feared by traditional monetarists.

> "MMT and excessive government debt could lead to a loss of trust in paper currencies."
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> Gérard Piasko, Chief Investment Officer

These MMT arguments have been difficult to refute so far. But the conclusion arrived at by advocates of MMT, namely that the link between central banks and governments is only artificial, is highly problematic. Specifically, it threatens the necessary independence of central banks – an aspect that is insufficiently stressed nowadays. Quite how much pressure can be placed on a central bank and how much a central bank balance sheet can be extended is clear from the example of Japan: Quantitative easing was invented here some 20 years ago, and has been applied to the point where some 10% of the entire market capitalisation of Japanese equities has been bought up by the Bank of Japan. Thus, the authorities there have intervened in a market economy on an enormous scale.

In Europe and the US, the current situation is still some way removed from the full-on espousal of MMT. While it is true that the US central bank (Fed) has purchased government debt securities on a massive scale, it has only done so in the secondary market. If the US government were to issue fixed-income securities via the US Treasury and these were purchased directly by the Fed, the independence of the US central bank would probably be a thing of the past. The increasingly popular view that high government debt and budget deficits are acceptable in the long term looks dangerous enough in itself. It is to be hoped that this acceptance of high government

debt (i.e. the popularity of MMT) wanes in the future. Otherwise, excessive fiscal stimulus could have negative long-term effects.

As explained in our Market Comment "The consequences of financial repression" back in August 2020, there are many disadvantages to financial repression and artificially low interest rates. Social inequality increases, while savers and pension funds are at a disadvantage to anyone who takes on more debt – which in turn results in speculative bubbles forming in many markets. This could lead to instability in the financial system, higher inflation or a loss of trust in paper currencies such as the US dollar and the euro. The beneficiaries of such a scenario could be real investments and gold, among others.

Gérard Piasko

Gérard Piasko is Chief Investment Officer and head of the investment committee of private bank Maerki Baumann. Before he was for many years Chief Investment Officer of Julius Baer, Sal. Oppenheim and Deutsche

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Maerki Baumann & Co. AG
Dreikönigstrasse 6, CH-8002 Zurich
T +41 44 286 25 25, info@maerki-baumann.ch
www.maerki-baumann.ch