<u>"POPULISM" AND CENTRAL BANKS</u>
 July 12, 2016

"Big boss man, can't you hear me when I call?" "Big Boss Man" (Al Smith and Luther Dixon), performed by Elvis Presley, the Grateful Dead, and others

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<u>OVERVIEW AND CONCLUSION</u>

The United Kingdom's recent shocking referendum vote to leave the European Union not only sparked ferocious marketplace fluctuations. It did not merely underscore ongoing and widespread unease regarding mediocre economic growth and insufficient inflation in many nations inside and outside of Europe.

Brexit also highlighted previously existing and growing fears among many global economic and political elites ("the establishment") and their disciples about increasing "populism" and its potential consequences. These worries extend beyond the troubles of the European Union and the Eurozone and nervousness regarding their fracturing or break-up. The British departure outcome probably inflamed populist ambitions in other countries. In any case, substantial divisiveness and partisan fervor are not confined to Europe or the United States. See "America: a House Divided" (12/7/15).

The "establishment", like "populism", is diverse rather than monolithic. Even among the advanced OECD nations such as the United States and those seeking to emulate them, it is not the same everywhere. Mainstream political parties and their economic agendas are not precisely identical, even though such different groups (such as Democrats and Republicans) can belong to the same establishment. What is an establishment (or populist or other anti-establishment) view can change over time.

Different cultures of course will have leaders, but their particular "establishment" ideologies may be significantly and perhaps dramatically different. The current Chinese establishment's guiding faith in part overlaps with (resembles) but nevertheless is not identical to the creed prevailing in the United States establishment. Or, compare a primitive rural culture and that of a modern Western industrial nation.

However, as a rough and admittedly simplified guideline, one can summarize the ruling Western economic ideology of the post-World War Two period. It is a "capitalism" that in principle generally adores free (open) markets for goods and services, free trade, and free movement of capital, as well as (subject to immigration concerns) fairly free movement of people. Such economic goals (and political and social gospels related to them) are labeled and valued as good and desirable by the so-called establishment. Often they are honored as being rational, reasonable, intelligent, sensible, and prudent. In the post-World War Two span, these good outcomes have intertwined with globalization, which the elites (power structure), likewise generally (on balance) bless. Therefore these authorities view populism, at least to the extent it endangers such good capitalism and the related "structure (arrangement) of things", as generally bad (or less good; inferior).

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The establishment responded to the British outcome with passionate rhetoric. The dangers of supposedly overly left-wing or right-wing movements, or excessively nationalistic or protectionist ones, or fringe or radical groups must be handled somehow, right? Or so such currently empowered elites advise audiences.

Leading central banks and regulators such as the European Central Bank, Federal Reserve Board, Bank of England, and International Monetary Fund of course stress their devotion to their assorted mandates. Indeed their noble quest to secure praiseworthy aims such as stable prices (sufficient inflation), maximum employment, and economic growth are on behalf of "all of us". Yet such loosely-defined legislative directives in practice provide these economic high priests wide scope for their interpretation.

In practice, central bankers, even if widely-revered, generally reflect the key economic and political doctrines and ambitions of traditional (current establishment) leaders. And "populism", though one cannot define it scientifically, though its historical and current international appearance is not everywhere the same, still can "shake the existing economic and political situation and its institutional structures up a lot". And such resulting uncertainty and disruption (and especially big changes) on balance would be bad (or at least not very good), right? So the Brexit vote was a bad (undesirable and unfortunate) outcome. Populist pressure, especially if it involved challenging the independence of central banks, might even make it more difficult for central bankers to achieve their beloved mandates. Leading central banks nowadays consequently want to preserve the basic structure and trends of the post-World War Two world "order", to preclude revolutionary or even mildly substantial changes in it.

Therefore, the British "Leave" vote and its aftermath probably will encourage various leading central banks such as the Fed, ECB, Bank of England, and their allies to battle even more fiercely than before against populist menaces. Continued sluggish growth (or a recession), rising unemployment, or a renewed sovereign or private sector debt crisis (whether in Europe or around the globe), would inflame populist ardor, particularly given anger over widespread economic inequality. The central banks therefore likely will sustain existing highly accommodative policies such as yield repression and money printing for longer than previously anticipated, perhaps expanding them "if necessary".

<u>THE ESTABLISHED ORDER SPEAKS OUT</u>

"I'm in with the in crowd
I go where the in crowd goes…
And I know what the in crowd knows…
Our share is always the biggest amount". "The In Crowd", by the Mama's and the Papa's

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A liberal survey of quotations (including editorials) from economic, political, and media representatives of "the establishment" regarding "populism" displays the agitation of elites regarding actual and potential populist advances. The fear accelerated after the Brexit outcome. These quotations portend the probability of continued highly accommodative central bank action, and perhaps expansion of such policies.

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In its "Financial Stability Review", the European Central Bank warned of populist threats to economic and financial stability in the Eurozone. This could challenge fiscal and structural reform implementation and make it harder for governments to service their debts (Financial Times, 5/25/16, p4).

Prior to the British referendum, a Pew Research Center poll revealed that skepticism (discontent) about the European Union is on the rise across Europe (NYTimes, 6/8/16, pA6). A couple of governments had shifted to a populist stance before the UK's vote. Poland and Hungary are EU but not Eurozone members. "Poland's populist party vows to end liberal market model" (FT, 6/10/16, p4). Hungary's government has embraced "populist economic measures" (6/10/16, p5).

Shortly before the referendum, the Financial Times ("FT"; 6/17/16, p3) cited the International Monetary Fund's view on the economic damage to the UK and other European states that would result from Britain's decision to leave the EU. "The bleak verdict [from the IMF] is a last throw of the dice for the international economic establishment, which has been united in its warnings about the risks of Brexit."

A FT epistle before Britain's decision (5/28/16, p6) proclaimed: "Voters need a credible alternative to populism", "The rise of the far right and left [the opinion piece mentions Germany, France, and Spain] reflects the establishment's failures".

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"British Stun World with Vote to Leave E.U."; this front page New York Times ("NYT") headline is entirely in capital letters (6/24/16, pA1). "British Politics in Chaos As Vote Result Sinks In, Sidelining Key U.S. Ally…Washington's Direct Line to Continent Suddenly Frays" (NYT, 6/27/16, pA1). Britain's Prime Minister resigned. Assorted articles detail leadership battles within Britain's Conservative and Labour parties, conjectures regarding a potential general election, and assess probabilities for a reversal of the Brexit vote. Scotland voted for the UK to stay in the European Union. According to Scotland's first minister, it is "highly likely" to hold a second independence referendum regarding staying in the UK (NYT, 6/25/16, pA7). The FT speaks of currency crises, displaying a graph of Sterling against the dollar (7/9-10/16, p7).

The International Monetary Fund declared that Euro area real GDP growth will fall from 1.6 percent this year to 1.4pc in 2017, "mainly due to the negative impact of the U.K. referendum outcome". Inflation and inflation expectations are very low (Article IV Consultation, "Press Release", 7/8/16).

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The Financial Times ((6/25-26, p11), discussing Brexit in a full page article, mournfully headlines: "For more than 40 years, British politicians were instrumental in shaping a liberal world order. But Britain's exit from the EU now threatens to undermine the globalised economy it fought to create."

The first page of the NYT (6/26/16) screams: "A Caustic Postwar Unraveling…A Test of Western Alliances and Institutions". The article says the British vote "is also generating uncertainty about an even bigger issue: Is the post-1945 order imposed on the world by the United States and its allies unraveling, too?" The "Unraveling Pulls at Bonds That Secured Postwar Order" (p8). Moreover, in speaking of the 2016 United States presidential race, the NYTimes that day notes "A Populist Revolt Casts a Shadow Over Clinton's Path of Caution" (p10; article references Trump and Sanders).

"Rattled [European Union] leaders fight to salvage union dream…British departure poses do-or-die challenge for bloc to overcome skepticism in most member states and restore momentum". (FT, 6/25-16, p2). "The UK vote to leave has raised doubts about the survival of the EU amid voter discontent, the rise of populism and calls for more referendums." (FT, 6/27/16, p11). The

German Chancellor "seeks to calm EU crisis fears ahead of summit as concerns rise over populism" (FT, 6/27/16, p4). European Union leaders, meeting without Britain's, "all agreed that the European Union need to change the way it works if it is to curb a rising tide of populism driven in large part by hostility toward Brussels." (NYT, 6/30/16, pA8).

"This verdict is a grievous blow to the world order" shouts a column written by the Financial Times's Tony Barber (6/25-26/16, p14). "Make no mistake about it. Britain's vote to leave the EU is the most damaging blow ever inflicted on the liberal democratic international order created under US auspices after 1945. Pandora's box is well and truly open….The repercussions will be immense in Britain and the rest of the world. In the EU, practically the only politicians toasting the result are anti-establishment populists, mostly on the extreme right."

Citing unnamed senior US officials, the FT reports America wants Europe "to contain populism by taking foot off the austerity pedal" (6/30/16, p1). A senior administration official worries about "populism eating away at centrism and political moderation".

Lawrence Summers, a Harvard professor and a former US Treasury Secretary, remarks that the Brexit vote and Trump's successful campaign show that voters are "revolting against the relatively open economic policies that have been the norm in the US and Britain since the second world war." (FT, 7/11/16, p9). His murky recommendation: "Reflex internationalism needs to give way to responsible nationalism or else we will only see more distressing referendums and populist demagogues contending for high office."

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Populism likely will capture substantial political and economic attention around the globe for the next several months. In addition to the UK's Brexit issue and its entanglement with the overall global situation, don't forget the importance of France's National Front, generally branded as a right-wing populist party. Italy's "populist Five Star Movement has emerged as Italy's leading political party" (FT, 7/7/16, p2). That party has called for a referendum on ceasing to use the Euro currency. Austria's "far-right euroskeptic party" is in a close race to win the presidential election scheduled for 10/2/16 (NYT, 7/2/16, pA1). A far-right party has established some traction in the Netherlands. And even though the Spanish general election saw "voters put faith in political establishment" (FT, 6/28/16, p8), left-wing populist forces remain influential (Podemos party), and the Catalonia regional issue has not disappeared.

And of course keep in mind the United States 2016 election year political festivities in view (Election Day is 11/8/16). Distrust of the establishment and many of its leaders is widespread. Donald Trump, the Republican Presidential candidate, espouses many populist opinions. "Trump Assails Foreign Trade Accords in Break with G.O.P. Orthodoxy" and condemns "globalism" (NYT, 6/29/16, ppA1, 17). Trump praised Brexit (NYT website, 6/24/16). Many associate his "nationalistic" viewpoints ("Make American Great Again!" he yells) and his opinions on immigration as "populist". In the Democratic primary, the left-wing populist, Bernie Sanders, was a strong runner-up to Hillary Clinton, the Democratic victor. The Democratic campaign propaganda likely will support some populist notions.

CENTRAL BANKS: DOING WHATEVER IT TAKES (WHAT WE MUST)

"You say you got a real solution
Well, you know
We'd all love to see the plan". "Revolution", The Beatles

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To help the world escape and recover from the international economic disaster of 2007-09, major central banks such as the Federal Reserve engaged in and sustained highly accommodative and often innovative policies. Interest rates were slashed and yields were repressed. Various rounds of money printing (quantitative easing) occurred. Massive deficit spending by the political sector also aimed to resurrect the national and global economic situation. The dovish Fed's policies remain highly accommodative even though about seven years have passed since the darkest days of 2008-09.

The Eurozone sovereign debt and banking crisis (in Greece and other countries) several years ago encouraged vigorous European central bank action. Since the ECB did not want the Eurozone to break into pieces (Grexit and so on), why should it and other central banks nowadays permit the crumbling of the current world order? It is almost the five year anniversary of the ECB President's famed "whatever it takes" sermon (7/26/12) and the unveiling of the outright monetary transactions (OMT) policy (8/2/12). More recently, the ECB generated a negative rates scheme and embarked on a substantial money printing program.

In the Eurozone, fiscal policies in practice sometimes intertwine with ECB policies. Thus to some extent in recent years, the ECB's lax monetary policies have found their counterpart in relaxing (bending) the requirements of the European Union's Stability and Growth Pact. Though its terms are complex and allow room for interpretation, the Pact requires Euro Area government budget deficits to be no more than three percent of GDP and public debt to be no greater than 60pc of GDP. Look at the treatment of Greece, Portugal, Spain, Italy, and France. This fiscal flexibility issue remains current (for example, see the FT, 7/6/16, p3).

Greece's Eurozone debt relief and reform saga displays the continued willingness of European leaders (perhaps further inspired by recent European national soccer competition) to "kick the can down the road". Not long before the Brexit vote, rescue loans postponed the danger of a Greek default crisis until at least October 2016 (NYTimes, 5/25/16, pB2; FT 5/26/16, p2).

Japan's concern with deflation and low growth persisted after the recovery commenced. So after the December 2012 elections, "Abenomics" brought about more monetary easing and fiscal stimulus. It encouraged Japanese Yen depreciation. The Bank of Japan's Quantitative and Qualitative Monetary Easing (4/4/13) has been a centerpiece of the Japanese establishment's strategy.

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So given the vigorous central bank reactions to these prior major crises, given the long-running substantial commitment by central banks to monetary easing, and given the nearly apocalyptic cries by establishment guides relating to Brexit, populism, and dangers to the global economic (and political) system, what will the Fed, ECB, and other central bank guardians do? These benevolent central banks will retain and perhaps (if necessary in their opinion) expand their highly accommodative policies. After all, the central banks essentially are establishment institutions.

The central banks will do what they can to prevent or minimize further damaging consequences from Brexit. The ECB in particular, with memories of World War Two and before as part of its perspective, will do what it must in order to preserve the unity of the Eurozone (and the European Union).

Central banks, like most of the rest of the establishment, do not want Donald Trump and other populist leaders to attain power and will try to stop them from doing so. Central banks do not want current populist ideas contrary to the ruling Western economic dogma of the post-World War Two era to strengthen. The establishment does not want fierce, sustained, and severely damaging fights ("class wars") between "capital" and "labor" to erupt. Highly accommodative monetary policies will help to achieve these central bank (establishment) goals.

Highly accommodative policies aiming to reduce unemployment and generate sufficient economic growth can help to reduce populist agitation, including efforts for a fairer distribution of income and wealth (and political and social power). Inflation creation, all else equal, tends to benefit debtors rather than creditors; calming the debtors can reduce the appeal of populist notions. Moreover, the rhetorical and practical efforts by central banks and the rest of the establishment to respond to (deflect and assuage) significant and widespread populist agitation, can reduce the probability of significant economic, cultural, and social change. And this (at least for a time) can benefit the "haves" (which includes much of the establishment) a great deal.

Wall Street and its media friends generally belong to the establishment. Given Wall Street's allegiance to modern capitalism and its hostility to substantial sustained economic weakness and bear marketplace trends in stocks and real estate, it favors easy money policies (at least until inflation allegedly becomes "too great").

In sum, the Brexit outcome and related risks, uncertainties, and challenges are a pretext for ongoing central bank easing.

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"They say that breaking up is hard to do,
Now I know that it's true.
Don't say that this is the end.
Instead of breaking up
I wish that we were making up again."
I beg of you don't say goodbye.
Can't we give our love another try?" Neil Sedaka, "Breaking Up Is Hard to Do"

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In the recent past and nowadays, many industrialized (advanced) nations appear at least partly frozen on the political front. To some extent, this reflects divisions within the establishment. For example, look at the deadlock on the US national scene between Democrats and Republicans on many issues. Apparently needed economic and political reforms thus are delayed. Such inertia (and divisions) within the political establishment tends to encourage populist rhetoric and broaden support for populist action, particularly in an environment where incomes for and wealth of a majority of citizens appear inadequate.

But central banks indeed are problem-solvers! Those saviors played a major role in rescuing the world (and notably the establishment) from the terrifying global economic disaster. Thus several years after the eruption of the worldwide economic crisis, and partly because dedicated central bank policies have to some extent succeeded in their aims, the Western political (economic) establishment substantially and arguably increasingly relies on leading central banks to make many key policy decisions for them. Arguably the central banks merely have boosted confidence and bought time; they have postponed permanent solutions for problems such as massive indebtedness by pushing them off into the future.

Some may wonder if much of the world (particularly the so-called establishment) has become addicted to highly accommodative central bank policies. After the passage of an extended time period, is it possible the monetary schemes, even if bolstered, will begin to lose their effectiveness? If populism advances further, this in part may signal the waning power of (and reduced faith in) the longstanding interconnected international central bank easing programs.

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The Brexit divorce likely will take time. Exit negotiations with the EU probably will not end quickly. Also, the referendum result is not legally binding; Parliament must pass laws to move Britain out of the EU.

In any case, in March 2016, the Bank of England's Financial Policy Committee identified several routes by which the referendum could boost risks to financial stability. These included "subdued growth in the global economy, including the euro area, which could be exacerbated by a prolonged period of heightened uncertainty" and "fragilities in financial market functioning". After the referendum, the FPC concluded: "There is evidence that some risks have begun to crystallise. The current outlook for UK financial stability is challenging." ("Financial Stability Report", 7/5/16).

Thus the Bank of England's Governor warns of impending monetary stimulus. The Bank of England, according to this shepherd, will take "whatever action is needed to support growth". Another round of monetary easing could include interest rate cuts and more quantitative easing (Financial Times, 7/1/16, p1; 7/2-3/16, p2; Speech by Governor, "Uncertainty, the economy and policy", 6/30/16). The Bank of England meets 7/14/16.

The European Central Bank convenes 7/21/16. The European Central Bank is printing mountains of money. Might the ECB expand or extend its QE program or cut already negative policy rates further?

The international economic establishment generally criticizes currency wars. However, sometimes currency moves can appear desirable to achieve establishment aims. To what extent relative to current levels might Britain, the Eurozone, Japan, the United States, and others (including China) encourage their home currency to depreciate?

America's Federal Reserve Board gathers 7/26-27/16. The Federal Reserve is not currently engaged in a quantitative easing round. However, its highly accommodative policy (which includes yield repression) remains intact. Fed concerns about international turmoil (such as Brexit fallout) arguably make it less likely the Fed will boost raise the Fed Funds rate soon. Given the Fed's previous hints at raising rates in calendar 2016, such Fed caution appears to many as akin a "relative easing".

Despite the Brexit vote, the S+P 500 thereafter achieved a new record high at 2155 on 7/12/16, edging above 5/20/15's 2135 peak. Does this stock marketplace rally hint the Fed will continue to persist in its lax policies?

Buried in the IMF's "Concluding Statement" of its Article IV Consultation with the US is an interesting viewpoint (paragraph 10, 6/22/16). The IMF not only says "there is a clear case to proceed along a very gradual upward path for the fed funds rate". It also proclaims "the path for policy rates should accept some modest temporary overshooting of the Fed's inflation goal to allow inflation to approach the Fed's 2 percent medium-term target from above."

The Bank of Japan assembles 7/28-29/16. Some conjecture the Bank of Japan, which continues to print money, will consider even more asset purchases or deeper negative interest rates (Financial Times, 7/2-3/16, p4).

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"I'll tip my hat to the new constitution
Take a bow for the new revolution
Smile and grin at the change all around
Pick up my guitar and play, just like yesterday
Then I'll get on my knees and pray
We don't get fooled again…
Meet the new boss
Same as the old boss". The Who, "Won't Get Fooled Again"

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