

The Stamp Memorial Lecture 2017 hosted by the Department of Economics and the  
Centre for Macroeconomics

# The State of Advanced Economies: forces, interactions and uncertainties

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# State of the Advanced Economies: Forces, Interactions, Uncertainties

Stamp Lecture, LSE

Olivier Blanchard

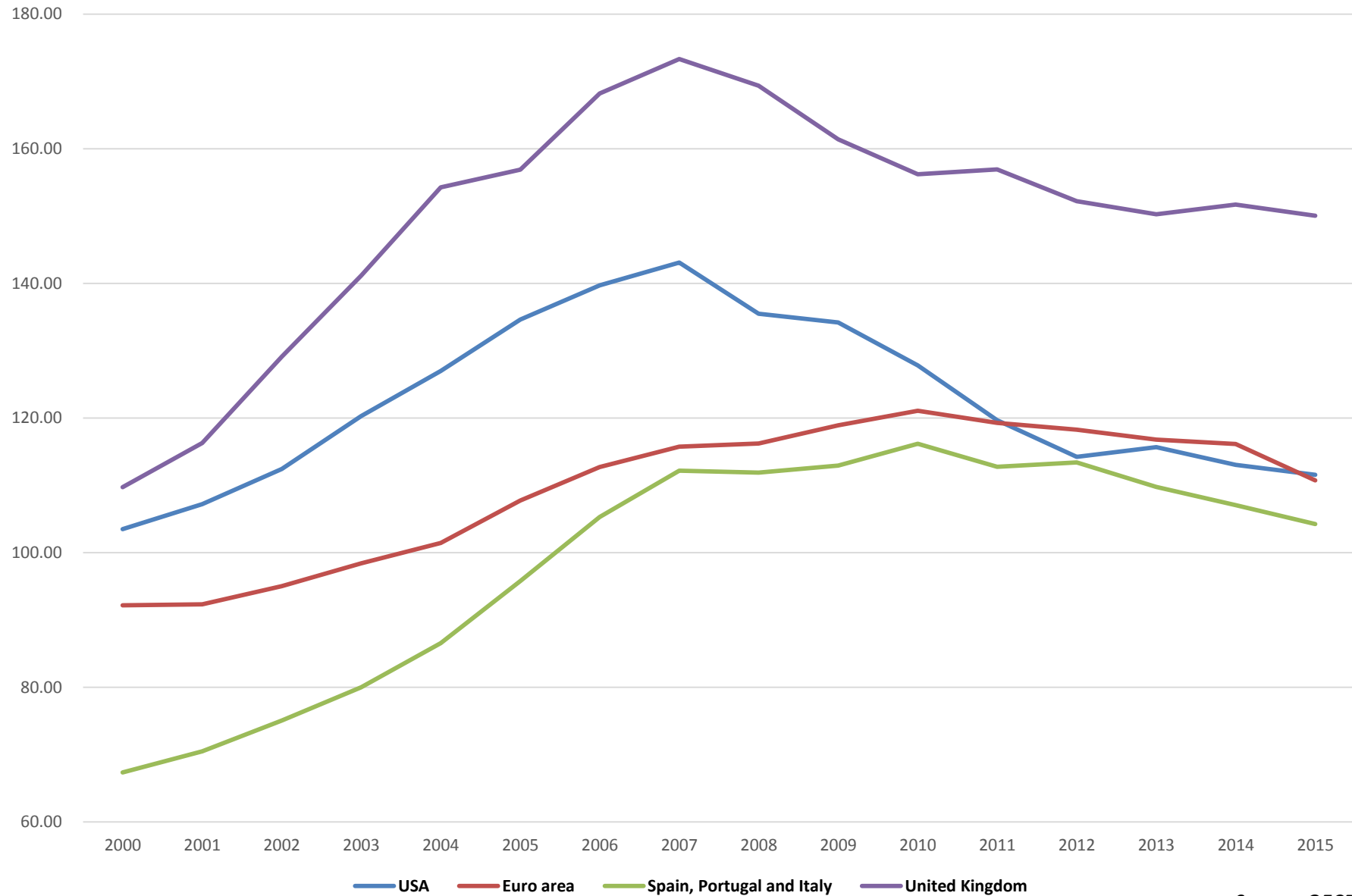
# Three main forces at work

1. Legacies from the financial/euro crises.  
Fading, but unevenly across countries
  2. Lower current and prospective productivity growth.  
Important even in the short run.  
Demand effects fading.
  3. Political uncertainty, and shades of populism.  
Translating into macro uncertainty?
- Interactions: A better but still mediocre baseline
  - Uncertainties. A highly uncertain baseline.

# 1. Legacies from the (acute phases of the) financial and euro crises

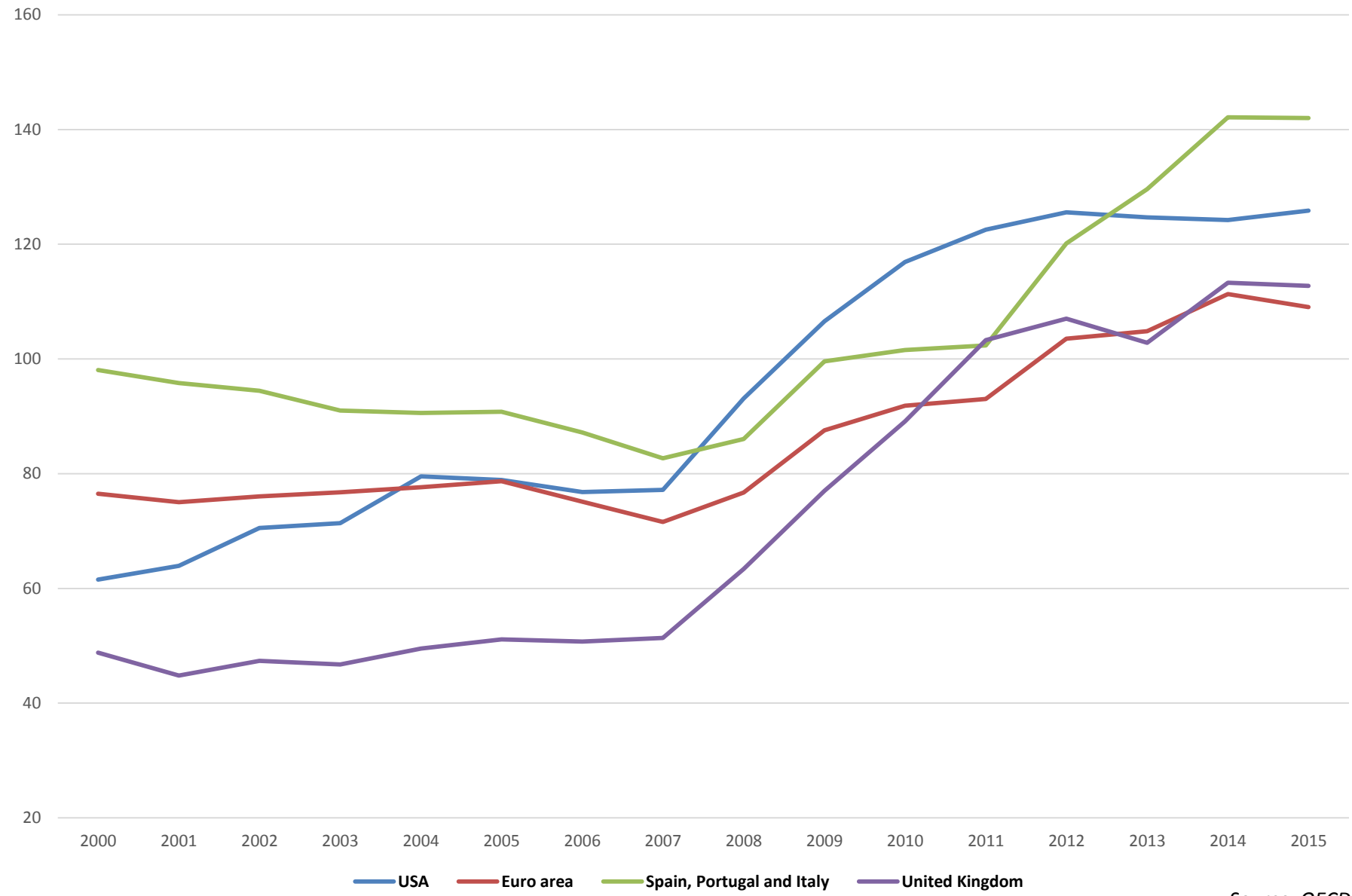
- High private debt (largely from before the crisis)
- High public debt (largely from during the crisis )
- Why high debt matters. Asymmetry debtors/creditors
- Initial adjustment: Fiscal consolidation, deleverage, private saving
  - Dominated 2010-2014. Largely over.
- After the initial adjustment
  - Interest and growth sensitivity. Still very relevant
- Countries most exposed
  - Japan: At potential, but with extremely high debt
  - Euro periphery. Far from potential, with high debt

# Household debt level (% disposable income )



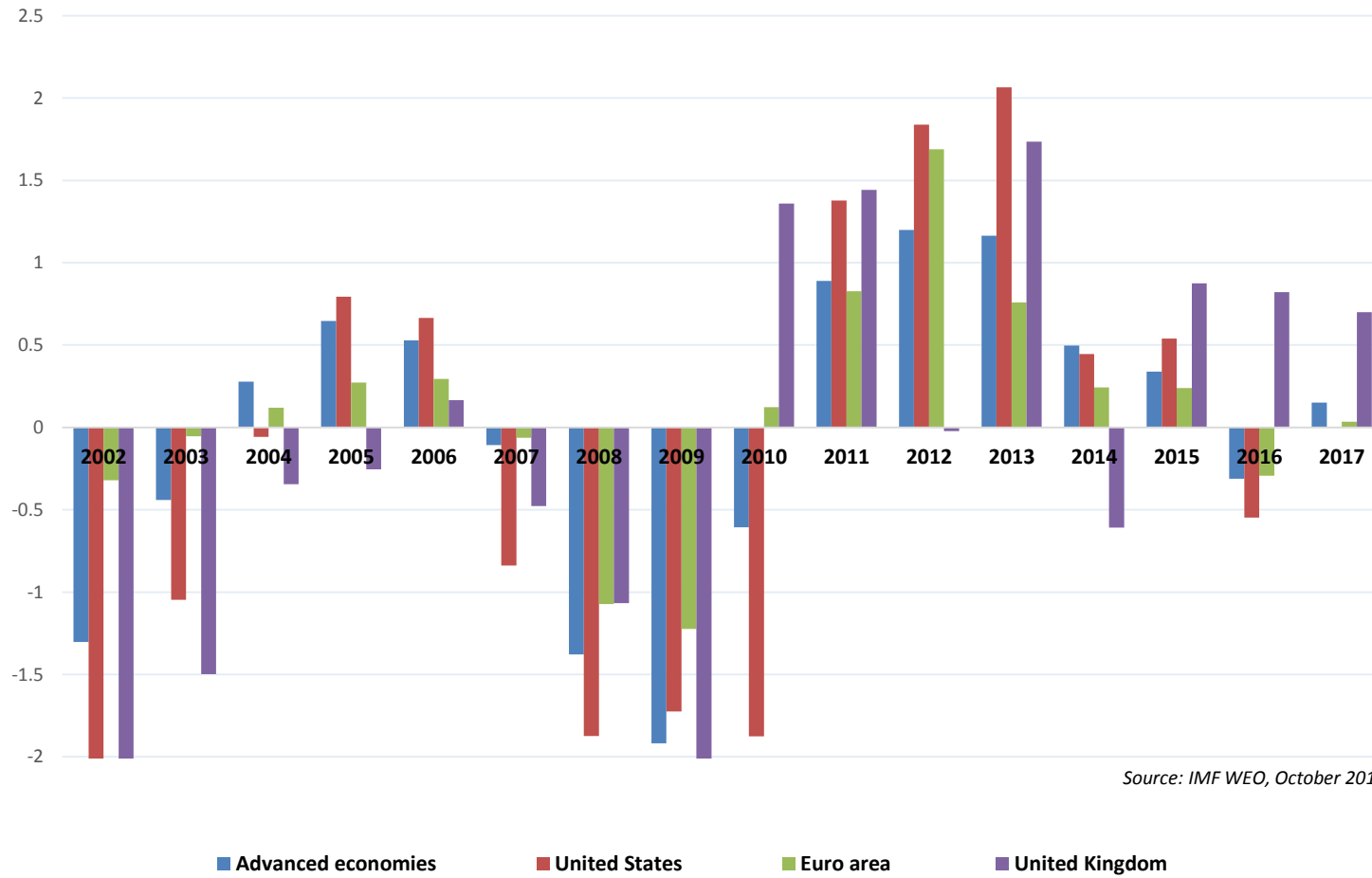
Source: OECD

# Government debt level (% GDP)



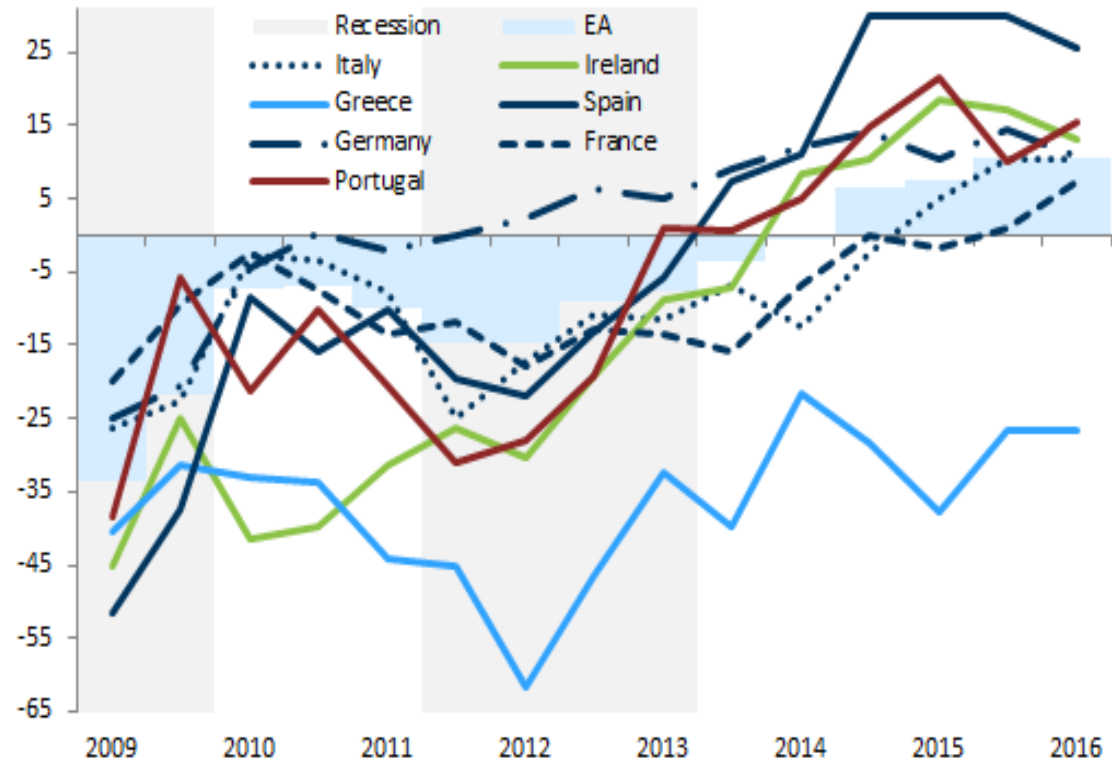
Source: OECD

# Change of general government structural balance (Percent of potential GDP)



Source: IMF WEO, October 2016

# Changes in credit availability





## 2. Lower productivity growth

Very low during the crisis. Not very surprising.

But also very low since then, despite recovery: Unusual.

True for nearly all advanced economies \*

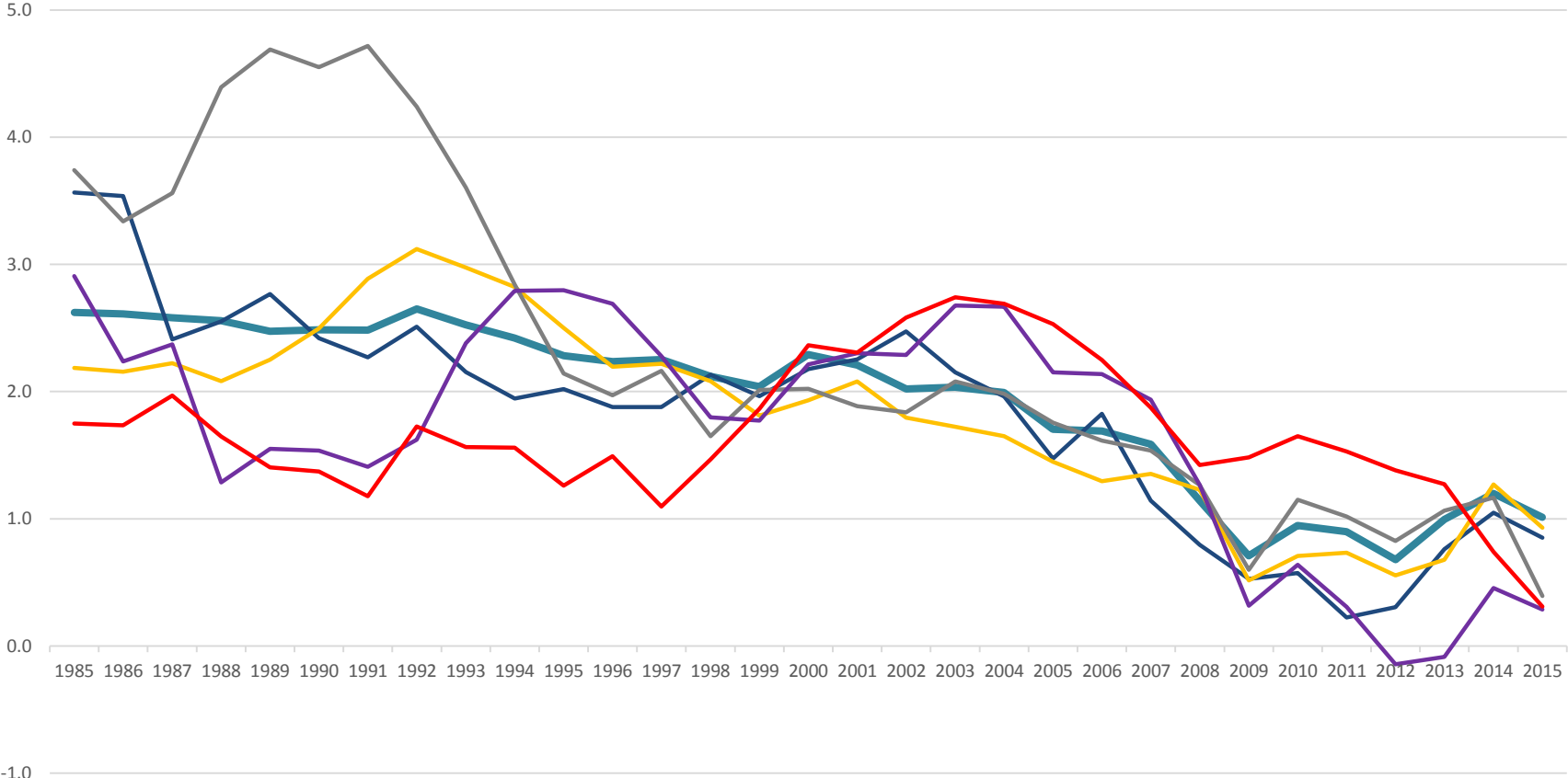
Magnitude of revisions in potential growth: Substantial

CBO US estimates. \* More than 1% decline since 2002

About 0.5% decline since 2012.

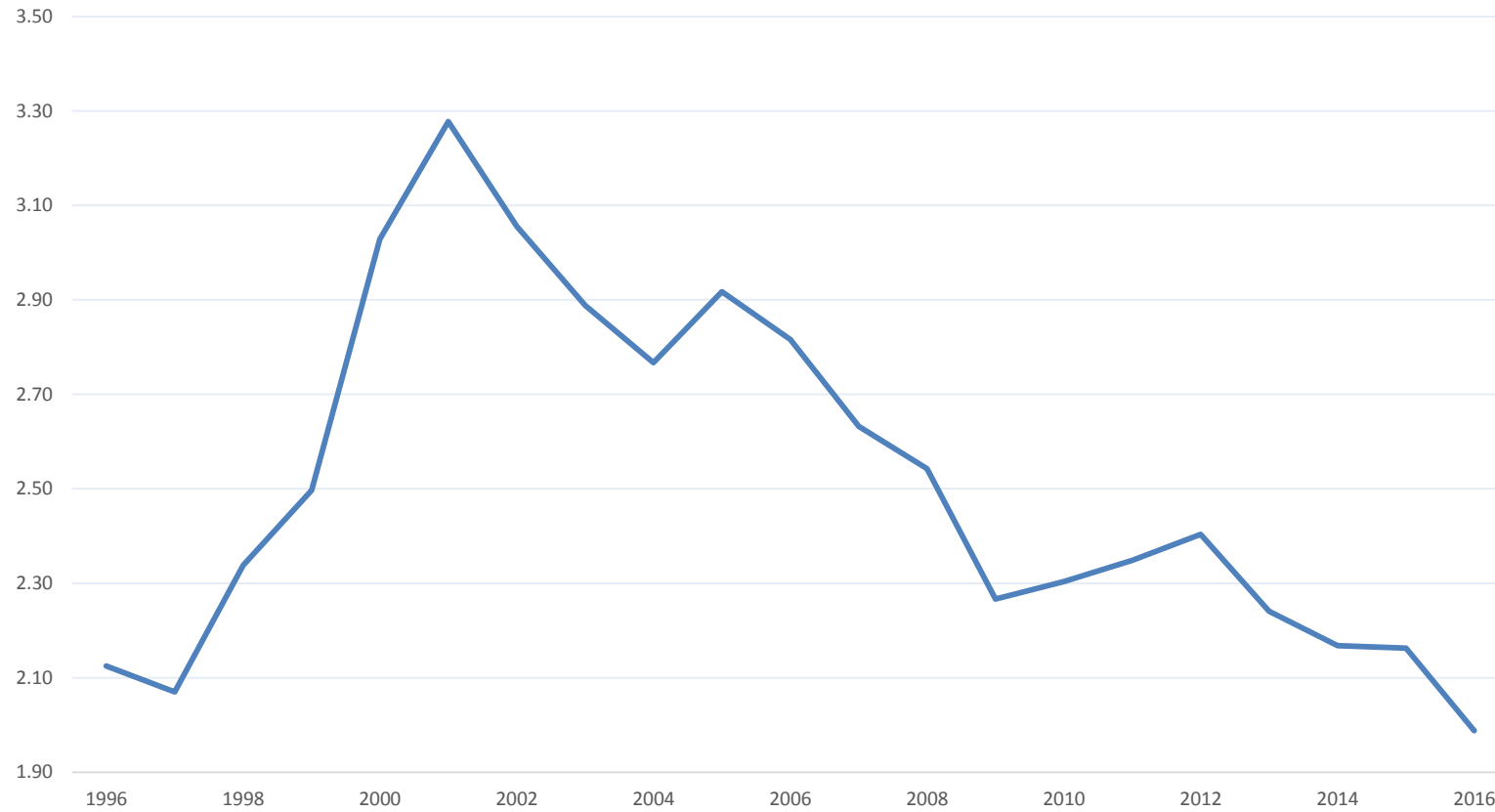
# Growth of GDP per hour worked, constant prices

## 5-year moving averages



Legend: Broad advanced country average (unweighted) (teal), France (dark blue), Germany (yellow), Japan (grey), UK (purple), US (red)

# Long run potential growth (CBO forecast)



Source: Congressional Budget Office

## Could it be measurement error?

- IT sector badly measured, especially software. But  
Still small sector.  
Also, more IT produced abroad. No effect on US productivity
- A lot of measurement problems in intermediate goods.  
Does not matter for overall productivity.
- A lot of improvement in quality of leisure.  
Not part of market economy. Not measured in GDP
- But what about health care, transportation?
- Probably understates the level, but unlikely to explain the decrease since the crisis.
- What if growth were in fact higher? Perceptions matter. Would populism be as successful?

# What about future productivity growth?

- Innovation continues apace. (although becoming more expensive)
- At the frontier, productivity growth comes in bursts. 1995-2005.
  - Low correlation from decade to decade

The meta discussion:

- The end of major discoveries: Gordon, \*
- The era of technological breakthroughs
- Robots, and the end of work. Perceptions and reality.

Why does all this matter today? Anticipation effects:

- [Weak demand in anticipation of a mediocre future](#)
- Explains why we have had weak demand growth despite zero rates
- If no further bad news, demand should/will recover partly.

### 3. Inequality, populism, and political risks.

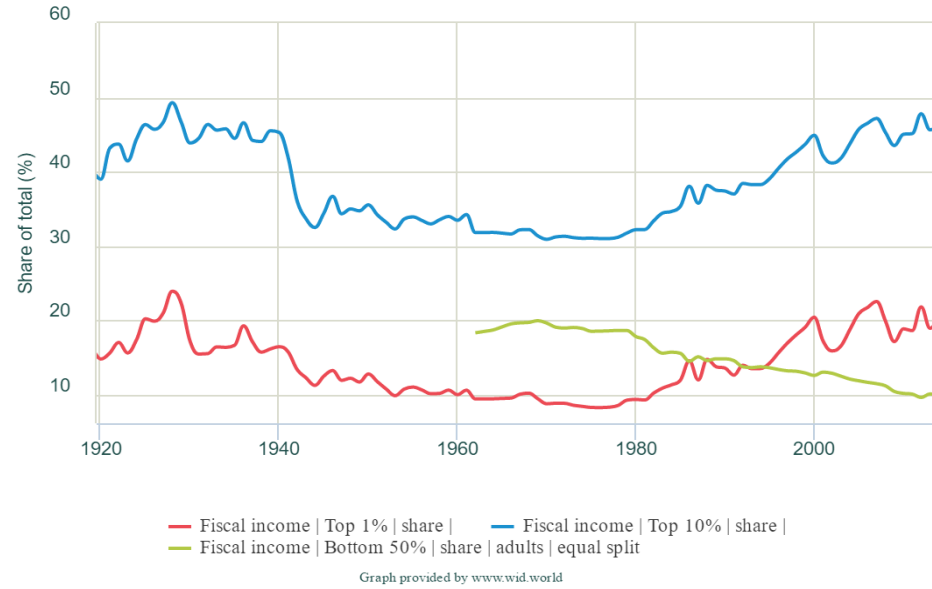
Political surprises. Brexit, US elections, shifts towards populism,

Sources: Inequality? In part, but a complicated story  
United States versus France. \* \*

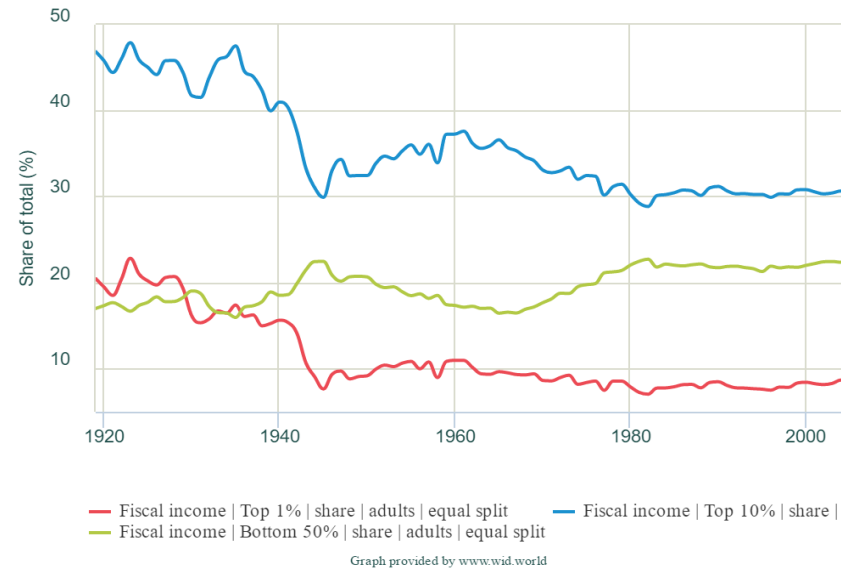
Implications?

- The Trump incarnation. Non standard. Pro-business, checks and balances
- The risk of more traditional populism elsewhere?

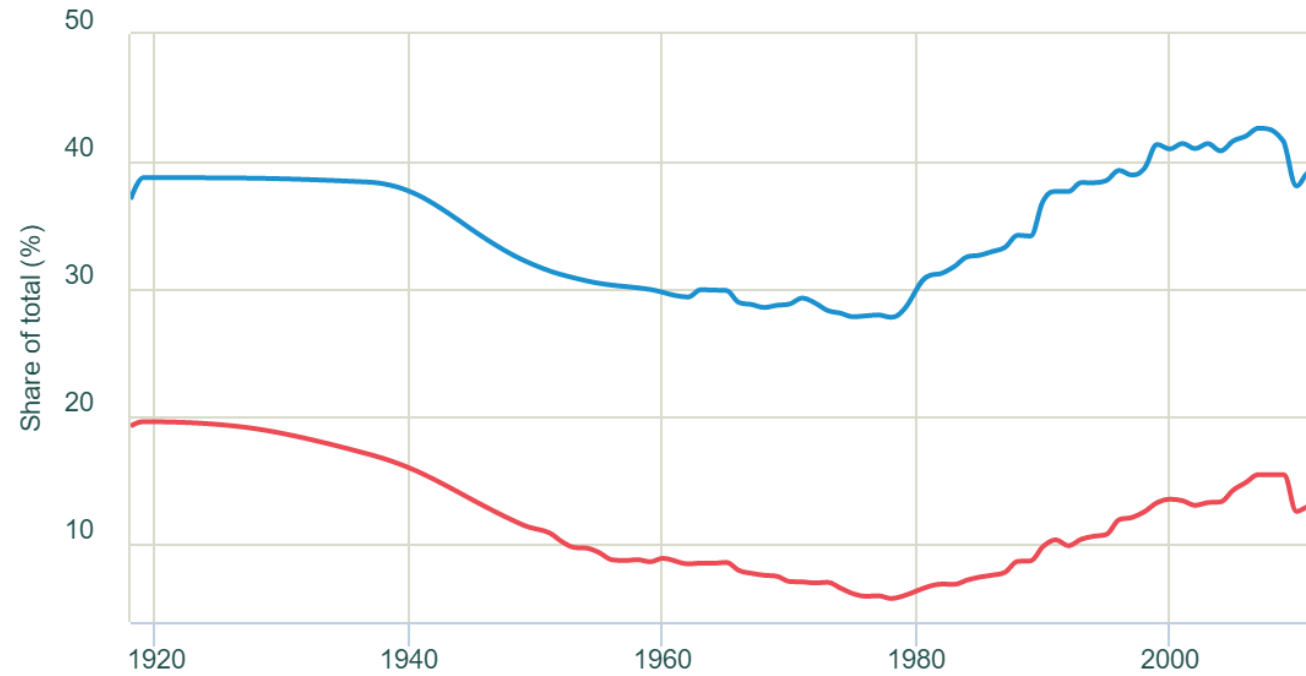
### Income inequality in the USA, 1920-2015



### Income inequality in France, 1920-2013



## Income inequality in the United Kingdom, 1918-2012



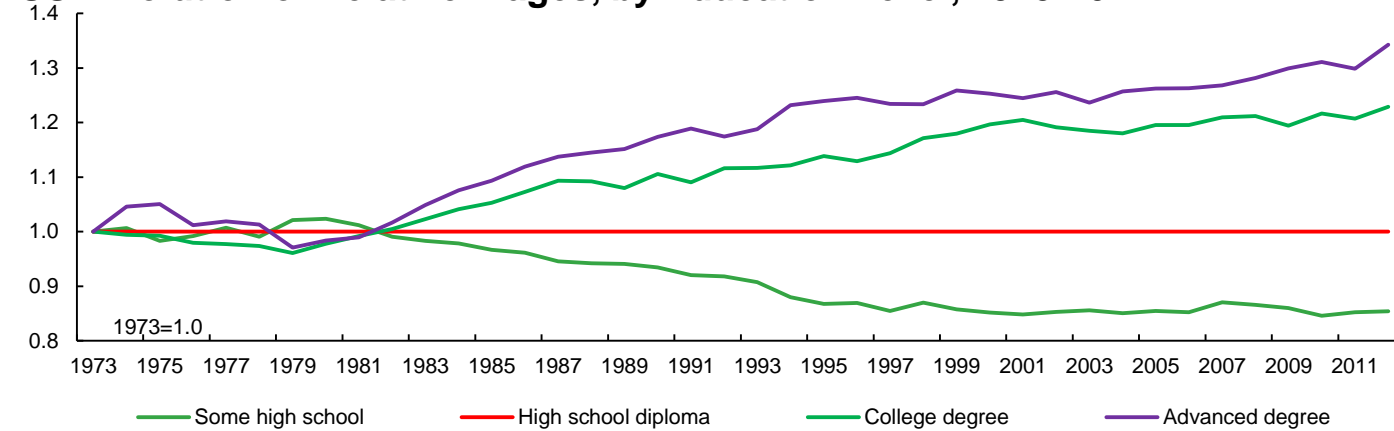
— Fiscal income | Top 1% | share | — Fiscal income | Top 10% | share |

Graph provided by [www.wid.world](http://www.wid.world)

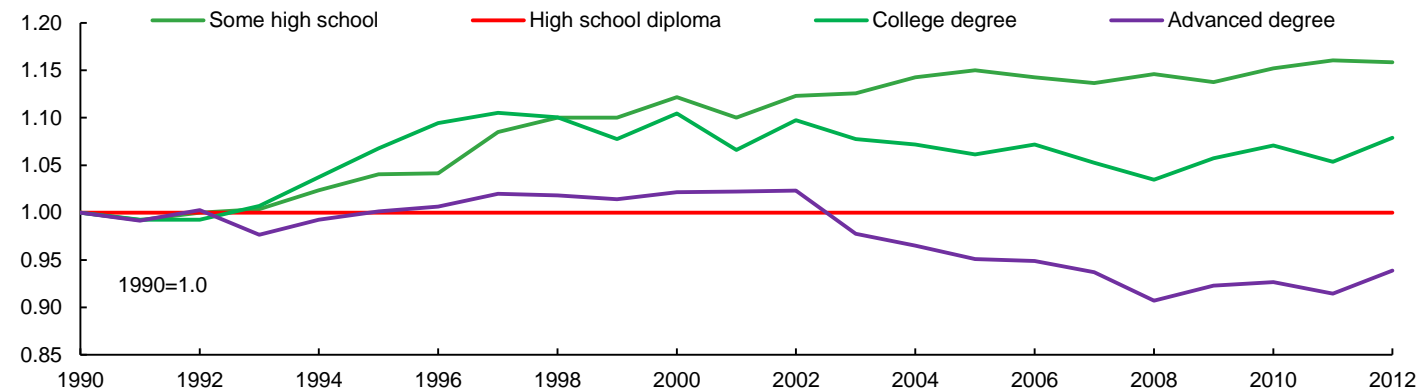


# The evolution of relative wages: United States versus France

**US: Evolution of Relative Wages, by Education Level, 1973-2012**

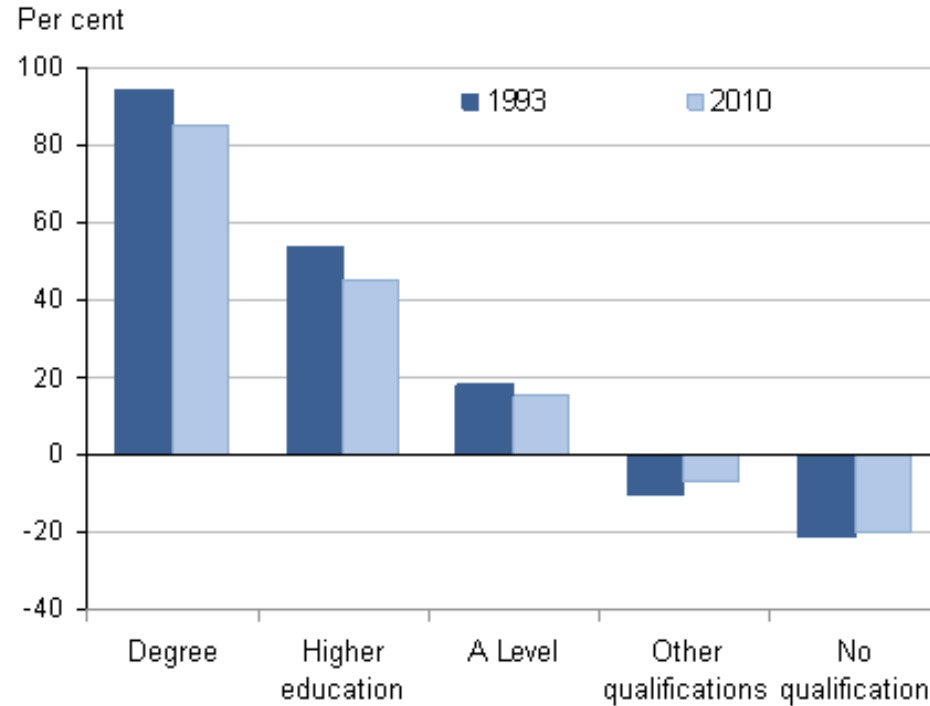


**France: Evolution of Relative Wages, by Education Level, 1990-2012**



# Evolution of relative wages in the UK

Percentage hourly pay gap to employees with GCSE or equivalent level of education, age 22 to 64



Source: Office for National Statistics, Earnings by Qualification

# Macro implications of Trump policies. Uncertainty

Fiscal policy. Administration versus Congress

Infrastructure, tax cuts versus deficit hawks

Corporate tax cuts and some deregulation

Best guess: Some increase in deficits

Monetary policy. Two levels of uncertainty.

Reaction function of the Fed to deficits?

Governance at the Fed? Hawks versus doves

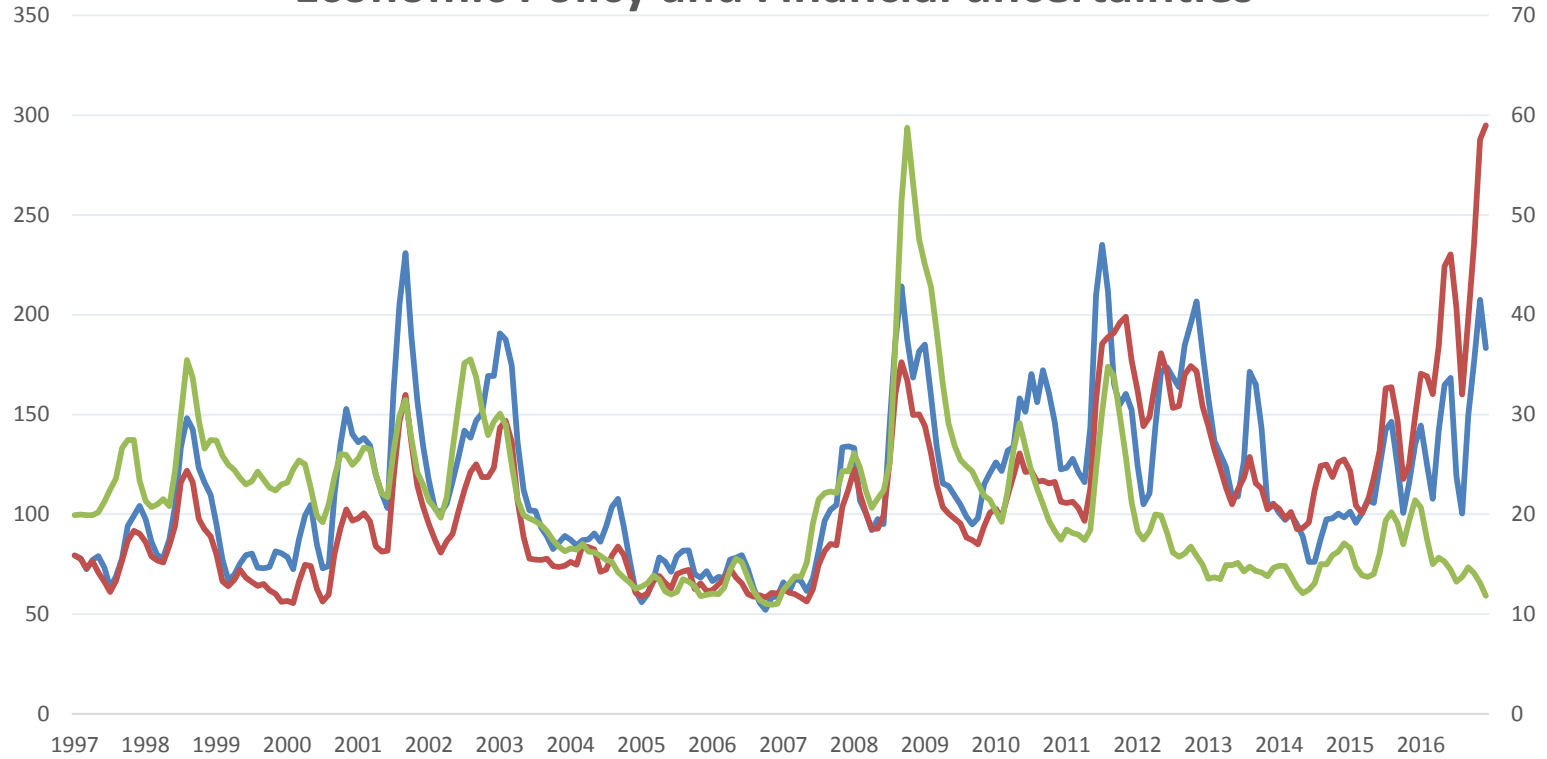
Trade policy. Trade wars or symbolic wars?

Trade war tools. Old: Tariffs

New: Dislocation of global supply chains

Big issue: [Effect of uncertainty per se?](#) \*

# Economic Policy and Financial uncertainties



Sources: Policyuncertainty.com,  
Haver analytics

News-Based Policy Uncert Index

Global EPU Index with PPP-adjusted GDP Weights

VIX

# Putting it together. Baseline

- Slow fading of financial crisis legacies
  - Debt ratios will decrease very slowly
  - But they are not constraining demand
- If no further downward revisions of medium term growth
  - End of short term demand adjustment
- Trump fiscal expansion, cum higher uncertainty.
- Medium term: Remaining low potential growth.

All imply:

Stronger demand growth in advanced economies in 2017-2018

Increase in interest rates. More so in US

## Growth rates (current and IMF forecast)



## Putting it together. (Two) Risks.

In a high debt ( $D$ ) environment, what is crucial is the joint movements in growth ( $g$ ), and the real interest rate ( $r$ ).

The risk of stronger demand, and higher interest rates.

Interaction with high public debt

Danger in Euro periphery

Danger in Japan

The risk of stronger productivity growth

Likely to come with interest rates also.

If  $g$ ,  $r$  move together, roughly neutral for debt ratios

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