

## More of the Same

by Richard Stutley, CFA

The tale of Goldilocks and the Three Bears was a popular analogy in markets in the years post the Great Financial Crisis, used to describe the global economy as not too hot, not too cold, but just right. Extending the idea to today's central bank policy: too hot would be embarking on helicopter money or large scale debt forgiveness; too cold would be abandoning tools like quantitative easing, possibly in response to criticism of QE's role in fuelling asset price bubbles; just right, then, is a continuation of current policy and hence central bankers need to hold their nerve in the face of rising inflation and provide more of the same.

Central bank policy used to revolve around managing short term interest rates. While the Bank of Japan embarked on quantitative easing to fight domestic deflation in the early 2000s, it wasn't until the Great Financial Crisis that the policy was adopted more widely. Having expanded their toolkit to include focusing on the term structure of interest rates, last year many central banks, including the US Federal Reserve, also began targeting the credit structure of interest rates by buying corporate debt.

Quantitative easing has been criticised for driving up asset prices while appearing to have only a limited impact on inflation. Higher asset prices favour current owners of those assets, hence the policy is also blamed for exacerbating wealth inequality. Lower interest rates are designed to encourage greater demand for money and greater spending: individuals will decide where that spending is ultimately directed. Where money finds its ways into assets, including land and premises, the marginal cost of production rises and companies will raise prices accordingly, thus delivering the desired inflation. Hence rising asset prices are part of the transmission mechanism of monetary policy and their appearance shouldn't stop central banks from doing quantitative easing, now or in the future.

There are those who advocate more aggressive policies, like helicopter money: sending households cheques in the mail. While appealingly egalitarian, handing out money blindly in this fashion has its drawbacks, as the Reddit trading experience perhaps shows (read my colleague Lorenzo La Posta's excellent blog from last week if you would like to know more about what happened).

Quantitative easing does not alter the risk-based way in which capital is allocated throughout the economy, merely the price at which it flows. Another option being contemplated is large scale debt forgiveness. Here again, there are problems with administering such a policy: should we forgive government debt or corporate debt? Which corporates deserve it? The success of the financial system rests on the faith of participants – why else would you accept a voucher as a means of payment? – and while participants have so far accepted quantitative easing and negative interest rates, writing off debt may well be the final straw. Hence our view is that central banks should continue using the existing tool kit rather than adding more levers at this stage.

The primary goal of monetary policy is ensuring price stability (somewhat confusingly, defined as some inflation rather than zero inflation/constant prices). Inflation expectations derived from government bond markets have been rising sharply, suggesting at first glance that current policy may be too loose. Short term rises are to do with base effects (prices had been crushed this time last year) and some supply issues, most importantly affecting the price of shipping containers, both of which appear short term in nature to us. So far central banks are saying the right things in terms of looking through these rises and longer-term expectations remain reassuringly anchored. We are following inflation expectations and measures of slack in the labour market closely and agree with policymakers' assessment that there are no signs of capacity exhaustion currently.

It is a case of so far so good regarding central bank policy and we advocate more of the same rather than a premature tightening of financial conditions. However, the law of unintended consequences still holds and hence we will be watching central banks closely for signs of a policy mistake.



# Global Matters Weekly

15 February 2021

For more information, please contact your adviser or alternatively contact:

Belvest Investment Services Limited  
研富投資服務有限公司  
9th Floor, Centre Mark II  
305-313 Queen's Road Central  
Sheung Wan, Hong Kong

Tel +852 2827 1199  
Fax +852 2827 0270  
belvest@bis.hk  
[www.bis.hk](http://www.bis.hk)

## Important notes

This communication is issued by Belvest Investment Services Limited and/or Belvest related companies (collectively, and individually Belvest) solely to its clients, qualified prospective clients or institutional and professional investors. Unless stated otherwise, any opinions or views expressed in this communication do not represent those of Belvest. Opinions or views of any Belvest company expressed in this communication may differ from those of other departments or companies within Belvest, including any opinions or views expressed in any research issued by Belvest. Belvest may deal as Distributor or Agent, or have interests, in any financial product referred to in this email. Belvest has policies designed to negate conflicts of interest. Unless otherwise stated, this e-mail is solely for information purposes.

This message may contain confidential information. Any use, dissemination, distribution or reproduction of this information outside the original recipients of this message is strictly prohibited. If you receive this message by mistake, please notify the sender by reply email immediately.

Unless specifically stated, neither the information nor any opinion contained herein constitutes as an advertisement, an invitation, a solicitation, a recommendation or advise to buy or sell any products, services, securities, futures, options, other financial instruments or provide any investment advice or service by Belvest.

No representation or warranty is given as to the accuracy, likelihood of achievement or reasonableness of any figures, forecasts, prospects or return (if any) contained in the message. Such figures, forecasts, prospects or returns are by their nature subject to significant uncertainties and contingencies. The assumptions and parameters used by Belvest are not the only ones that might reasonably have been selected and therefore Belvest does not guarantee the sequence, accuracy, completeness or timeliness of the information provided herein. None of Belvest, its group members or any of their employees or directors shall be held liable, in any way, for any claims, mistakes, errors or otherwise arising out of or in connection with the content of this e-mail.

This e-mail and any accompanying attachments are not encrypted and cannot be guaranteed to be secure, complete or error-free as electronic communications may be intercepted, corrupted, lost, destroyed, delayed or incomplete, and/or may contain viruses. Belvest therefore does not accept any liability for any interception, corruption, loss, destruction, incompleteness, viruses, errors, omissions or delays in relation to this electronic communication. If verification is required please request a hard-copy version. Electronic communication carried within the Belvest system may be monitored.