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"Clarify economic and financial news to better anticipate and control risks"

Your Money or your Life?

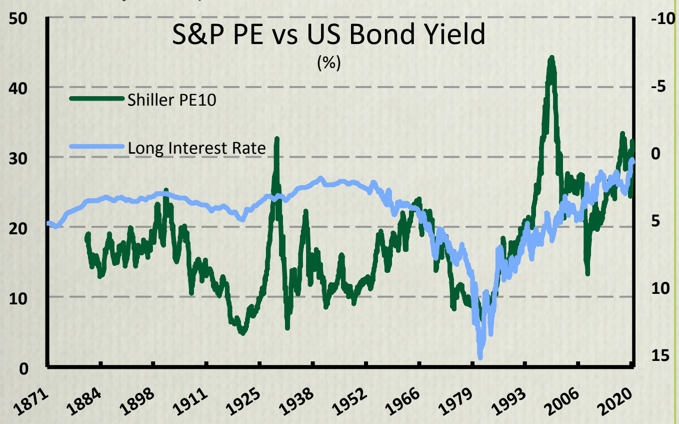
By Olivier Dyer

The worldwide pandemic will serve to show that in terms of economics, our knowledge is still very limited and our analysis shaped by prejudices. What we know works mainly during normal times. **We have much less understanding of long-term history, which is in fact a succession of pandemics, wars and major financial or economic crises.**

Today is no exception to the rule. One of the – fortunate – consequences is that systematically, we have overestimated the effects of the crisis, or underestimated the effects of the unprecedented measures taken to cope with the crisis. The result is that economic activity is currently "better" than expected, even though this optimism is moderated by the second lockdown.

The stock markets seem to have understood this insofar as they are continuing to break records on all continents. To the point that they have become for some the seeds of the next financial catastrophe, that will destabilise our world even more quickly due to governments and central banks having used up a lot of their ammunition since 2008.

As the chart below shows, shares have never been as expensive over the last 150 years, apart from on two occasions: 1929 and 2000!



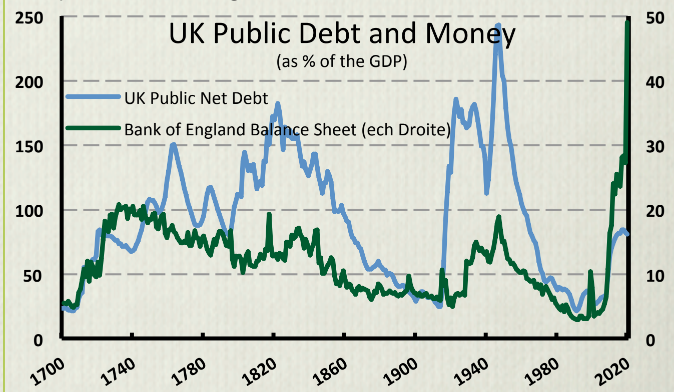
Source: FRED - Agata Capital

This configuration is only the reflection in the world of equities of what is happening in the world of bonds, which promise negative yields on at least $18,000 billion of assets worldwide.

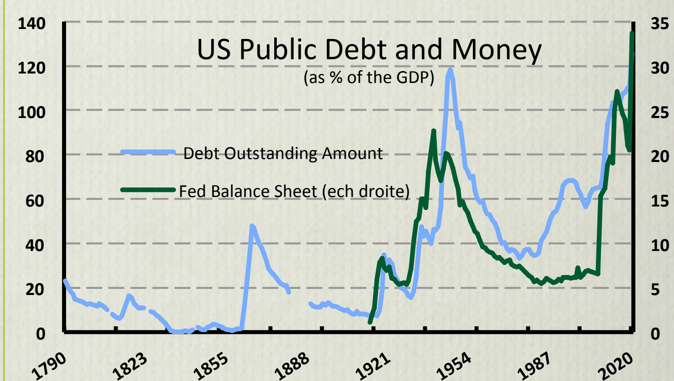
Stock market investors therefore only reflect the fact that at this level of pricing, equity future yields have every chance of being negative. That being said, they also respond to the incentives of central banks, which – by inundating the market with liquidity – encourage households to spend rather than save, and savings to be directed towards businesses. So what should we think about current public policies, where governments have for a time "nationalised" 25% of their economies; and where in the same way central banks are buying up debt securities that have been used for this nationalisation as well as in many cases private debt and even equities, in proportions never seen before in history, as shown by the two charts opposite illustrating the respective situations in the United States and the United Kingdom.

In the United Kingdom, the central bank balance sheet represents 49% of GDP, smashing the previous record levels of 1947 (19%), a legacy of the Second World War, and particularly of 1732 (21%) following the collapse of the South Sea Company and a significant reduction in taxes. At 80% of GDP, public debt is still well below its highest post-World War Two level of 243%.

In the United States, since the start of the year, public debt (125%) and the Federal Reserve balance sheet (34%) have well exceeded their previous record highest levels reached in 1946 and 1939.



Source : Central Banks - Agata Capital



Source: Central Banks - Agata Capital

Which makes a lot of people wonder: **should we choose between Money or Life?**

Paradoxically, it's not debt that is a problem at present: particularly not with negative interest rates, and particularly not if this money is used to make productive investments. As observed by William White, former economist at the Bank for International Settlements, we need to stop using debt purely for financial purposes such as to buy up assets; we need more competition in our economies and less concentration: the "Tech" world is the perfect example where monopolistic structures are becoming more widespread and have led to a concentration of wealth that significantly hinders growth. As all the very long-term charts above show, the pandemic has only amplified the excesses that have long existed. It has highlighted them, like a reminder to prepare ourselves for events that have become inevitable like increases in tax rates, **long overdue homogenization of taxation levels amongst countries**, the need to bring tax evasion to an end and to tackle the issue of climate change, which leads to natural disasters, the proportions of which are likely to become much more significant than that of the current pandemic.

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