

Central Bankers Admit that Central Banks Have Failed to Fix the Economy

By [Washington's Blog](#)

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Between 2008 and 2015, central banks pretended that they had [fixed the economy](#).

In 2016, they're starting to admit that they haven't fixed much of anything.

The current head of the Bank of England (Mark Carney) [said](#) last week:

The global economy risks becoming trapped in a low growth, low inflation, low interest rate equilibrium. For the past seven years, growth has serially disappointed—sometimes spectacularly, as in the depths of the global financial and euro crises; more often than not grindingly as past debts weigh on activity

This underperformance is principally the product of weaker potential supply growth in virtually all G20 economies. It is a reminder that demand stimulus on its own can do little to counteract longer-term forces of demographic change [[background](#)] and productivity growth.

In most advanced economies, difficult structural reforms have been deferred [[true](#), [indeed](#)]. In parallel, in a number of emerging market economies, the post-crisis period was marked by credit booms reinforced by foreign capital inflows[including from [central banks](#) themselves], which are now brutally reversing....

Since 2007, global nominal GDP growth (in dollars) has been cut in half from over 8% to 4% last year, thereby compounding the challenges of private and public deleveraging

Renewed appreciation of the weak global outlook appears to have been the underlying cause of recent market turbulence. The latest freefall in commodity prices – though largely the product of actual and potential supply increases – has reinforced concerns about the sluggishness of global demand.

Necessary changes in the stance of monetary policy removed the complacent assumption that “all bad news is good news” (because it brought renewed stimulus) that many felt underpinned markets [Zero Hedge [nailed this](#)].

As a consequence of these developments, investors are now re-considering whether the past seven years have been well spent. Has exceptional monetary policy merely bridged two low-growth equilibria? Or, even worse, has it been a pier, leaving the global economy facing a global liquidity trap? Can more time be purchased? If so, at what cost and, most importantly, how would that time be best spent?

Despite a recent recovery, equity markets are still down materially since the

start of the year. Volatility has spilled over into corporate bond markets with US high-yield spreads at levels last seen during the euro-area crisis. The default rate implied by the US high-yield CDX index is more than double its long-run average [background [here](#) and [here](#)]. And sterling and US dollar investment grade corporate bond spreads are more than 75bp higher over the past year.

Similarly, the former head of the Bank of England (Mervyn King) is [predicting](#) catastrophe:

Unless we go back to the underlying causes [of the 2008 crash] we will never understand what happened and will be unable to prevent a repetition and help our economies truly recover.

The world economy today seems incapable of restoring the prosperity we took for granted before the crisis.

Further turbulence in the world economy, and quite possibly another crisis, are to be expected.

Since the end of the immediate banking crisis in 2009, recovery has been anaemic at best. By late 2015, the world recovery had been slower than predicted by policymakers, and central banks had postponed the inevitable rise in interest rates for longer than had seemed either possible or likely.

There was a continuing shortfall of demand and output from their pre-crisis trend path of close to 15pc. Stagnation – in the sense of output remaining persistently below its previously anticipated path – had once again become synonymous with the word capitalism. Lost output and employment of such magnitude has revealed the true cost of the crisis and shaken confidence in our understanding of how economies behave [[Right](#)].

Almost every financial crisis starts with the belief that the provision of more liquidity is the answer, only for time to reveal that beneath the surface are genuine problems of solvency [[We told you](#)].

A reluctance to admit that the issue is solvency rather than liquidity – even if the provision of liquidity is part of a bridge to the right solution – lay at the heart of Japan's slow response to its problems after the asset price bubble burst in the late 1980s, different countries' responses to the banking collapse in 2008, and the continuing woes of the euro area.

Over the past two decades, successive American administrations dealt with the many financial crises around the world by acting on the assumption that the best way to restore market confidence was to provide liquidity – and lots of it.

Political pressures will always favour the provision of liquidity; lasting solutions require a willingness to tackle the solvency issues.

Former Federal Reserve chairman Alan Greenspan [said](#) today that the Dodd-Frank financial bill didn't fix anything [[d'oh!](#)], that we're in real trouble, and that he's been pessimistic for a long time:

We're in trouble basically because productivity is dead in the water...Real capital investment is way below average. Why? Because business people are very uncertain about the future.

The [Dodd-Frank] regulations are supposed to be making changes of addressing the problems that existed in 2008 or leading up to 2008. It's not doing that. "Too Big to Fail" is a critical issue back then, and now. And, there is nothing in Dodd-Frank which actually addresses this issue.

I haven't been [optimistic on the economy] for quite a while.

And the world's most prestigious financial agency – called the “Central Banks’ Central Bank” (the Bank for International Settlements, or BIS) – has [consistently slammed](#) the Fed and other central banks for doing the *wrong* things and [failing to stabilize](#) the economy.

If the central bankers’ words aren’t clear enough for you, their [actions reveal their desperation](#).

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