The most dangerous words in finance and economics

It is often said that the most dangerous words in finance and economics are that "this time is different". I strongly agree with the sentiment, but it is best viewed over the long term rather than a short to medium term prediction.

Stanley Druckenmiller is regarded as one of the greatest investors of all time, with many arguing his investment record is better than Buffett's. After 30 years of exceptional performance, he pulled back from managing other people's money in 2010 and now just looks after his own money. Over the last decade he's become a voice of logic and reason that the media turns to when crazy things are happening in finance.

In a recent interview he made the comment that "I can't find any period in history where (American) monetary and fiscal policy were this out of step with the economic circumstances". The Fed and Congress are going full bore at stimulus when the US economy is recovering strongly. This can be seen across a range of measures, such as retail sales, new home sales and employment. On employment, American employees are receiving substantial pay increases and small employers are reporting record levels of vacancies. A normal reaction to this sort of economic recovery would be to raise interest rates and look to get back to a balanced budget. America's politicians and central bankers are doing the opposite.

Druckenmiller's comments can equally be applied to Australia and to a lesser extent Europe. Japan has been doing this for 30 years so arguably there's little change in trajectory for them. Politicians and central bankers in major economies have together drunk the Kool-aid of MMT and think the age-old rules of economics and finance no longer apply. I'm struggling to think of a period in history when so many countries have undertaken so much stimulus at the same time, with the world wars perhaps the closest comparable. Like Druckenmiller, the extraordinary stimulus this time around does look different to me.

Given this, the range of potential outcomes in the medium term is far larger than would normally be expected. With so much stimulus pouring out, it is entirely possible that many economies see strong employment and GDP outcomes perhaps for along as a decade. However, history has taught us many, many times over that without productivity growth an economic boom will only be transitory. As few governments have any meaningful actions underway on this front (arguably most are embarking on productivity inhibiting spending and taxation policies) this strong recovery cannot last. In this way, I don't expect that this time will be different in the long run. There will be an ugly comedown from this almighty sugar hit, likely through lower growth and negative real interest rates for decades.

A long term counterpoint to this madness is the tiny European nation of Estonia. After the Soviet collapse in 1991, Estonia has gone from being a low income to high income country in less than 30 years by prioritising market based reforms as well as efficient and low taxes. The turnaround has earned it the nickname of the "Baltic Tiger", much like high growth Asian and Irish economies before it. It's always easier to grow strongly when starting from a low base, but Australia and New Zealand both saw long runs of above average growth when they implemented productivity focussed economic reforms. Japan, Europe and the US now look too far gone; but hopefully Australia won't have drunk too much of the Kool-aid before we back to these time proven methods of growing our prosperity.

Written by Jonathan Rochford for Narrow Road Capital on 22 May 2021. Comments and criticisms are welcomed and can be sent to info@narrowroadcapital.com

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