

INVESTMENT TEAM

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My Ever Changing Moods

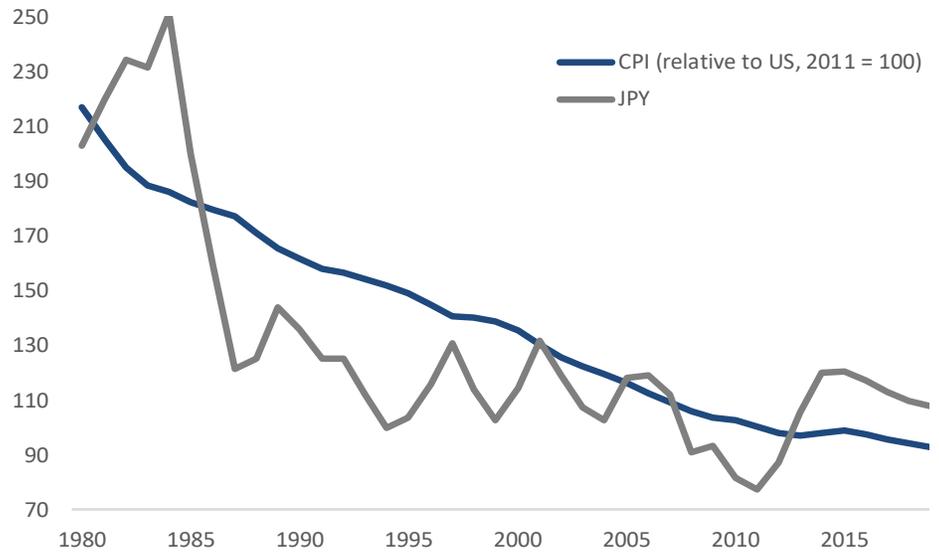
Following on from our note on MMT last week, we consider the most likely regions where it may be used, and then some market consequences. Inflation would seem to be the most likely economic consequence, and a weaker currency the most likely market reaction to such a radical economic policy. Barring a change of government in the US, it is least likely to be implemented there, and because there is more monetary headroom in the US than elsewhere. In the UK a Labour government may well find this thinking attractive, particularly after a hard BREXIT. Japan and Europe are therefore most exposed.

Policy interest rates remain negative in Europe (deposit rates) and Japan and are unlikely to rise above zero until 2021 at the earliest. Inflation in both regions remains stubbornly below target and presents clear deflation risk should we see another economic shock. That would make them ideal candidates for MMT, given the lack of scope for reducing rates further. Europe, however, does not issue federal debt, and no individual country within Europe controls its own currency (a precondition for MMT). That makes Japan the most likely country in the developed world to implement MMT, just as it was an early adopter of Quantitative Easing. It is difficult, however, to see inflation rising out of control in Japan, but a weaker Yen may be likely consequence.

So, what might become of Europe should the world become subject to another deflationary shock? Given the lack of monetary headroom and the absence of suitable fiscal infrastructure to stimulate beyond monetary measures, Europe would appear to be the most likely developed country to slide into a Japanese style deflation spiral. A stronger Euro may be the most likely result of that (Figure 1), with most economic pain felt on the periphery (again).

While the future path of policy is far from clear in many countries, should we become exposed to another global deflationary shock, we are not sure that MMT takes us much further forward towards solutions, but it may just prove irresistible to populist politicians. In the days before hyphenated words became popular, the Style Council sang out, "I wish we'd come to our senses and see there is no truth, oh in those who promote the confusion for this ever changing mood."

Figure 1: Japanese Yen versus CPI Inflation (relative to the US)



Source: DataStream, Canaccord Genuity Wealth Management

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