Debt Supercycle versus Secular Stagnation

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Secular Stagnation dominated post-GFC policy debate

- There are many interesting idea, but this paper argues that the entire discussion was greatly overblown. Proponents of secular stagnation far too easily dismissed the Global Financial Crisis (and related crises before and after) as a central reason for the post GFC growth malaise and low interest rates.
- Could a major part of the "secular stagnation" evidence in fact have been better attributed to a debt supercycle that originated in the US (maybe Japan and East Asia before that), then moved to Europe (Reinhart and Rogoff, 2009) and now, perhaps inevitably, now to China? (per Rogoff, 2016, Rogoff and Yang, 2020)

Secular Stagnation Thesis...

- Implied to many that real interest rates would be lower forever
  - Summers (2013) posited that post Global Financial Crisis real interest rate decline mainly a continuation of post 1970s trends.
  - Views problem as pointing to a major trend shortfall in global demand that government can fill in.
- Postulated that US productivity growth has permanently slowed.
  - Gordon (2016) argues that after 250 years of rapid progress, economically impactful innovation had dramatically slowed.
- Top journals replete with papers explaining why interest rates were ultra-low and likely to continue falling due to factors such as demographics, lower productivity, and inequality.

Higher Debt (almost) a free lunch

- Widely (and correctly) agreed that ultra-low long-term real interest rates make high return infrastructure investments particularly attractive, even if financed by higher government debt
- A stronger and far more speculative proposition, was that because the interest rate on “safe” government debt appeared to be reliably lower than the interest rate, governments in advanced economies could, at the margin, increase debt further without ever raising taxes or cutting spending.
  - Blanchard (2019), but others earlier, e.g., DeLong (2016)

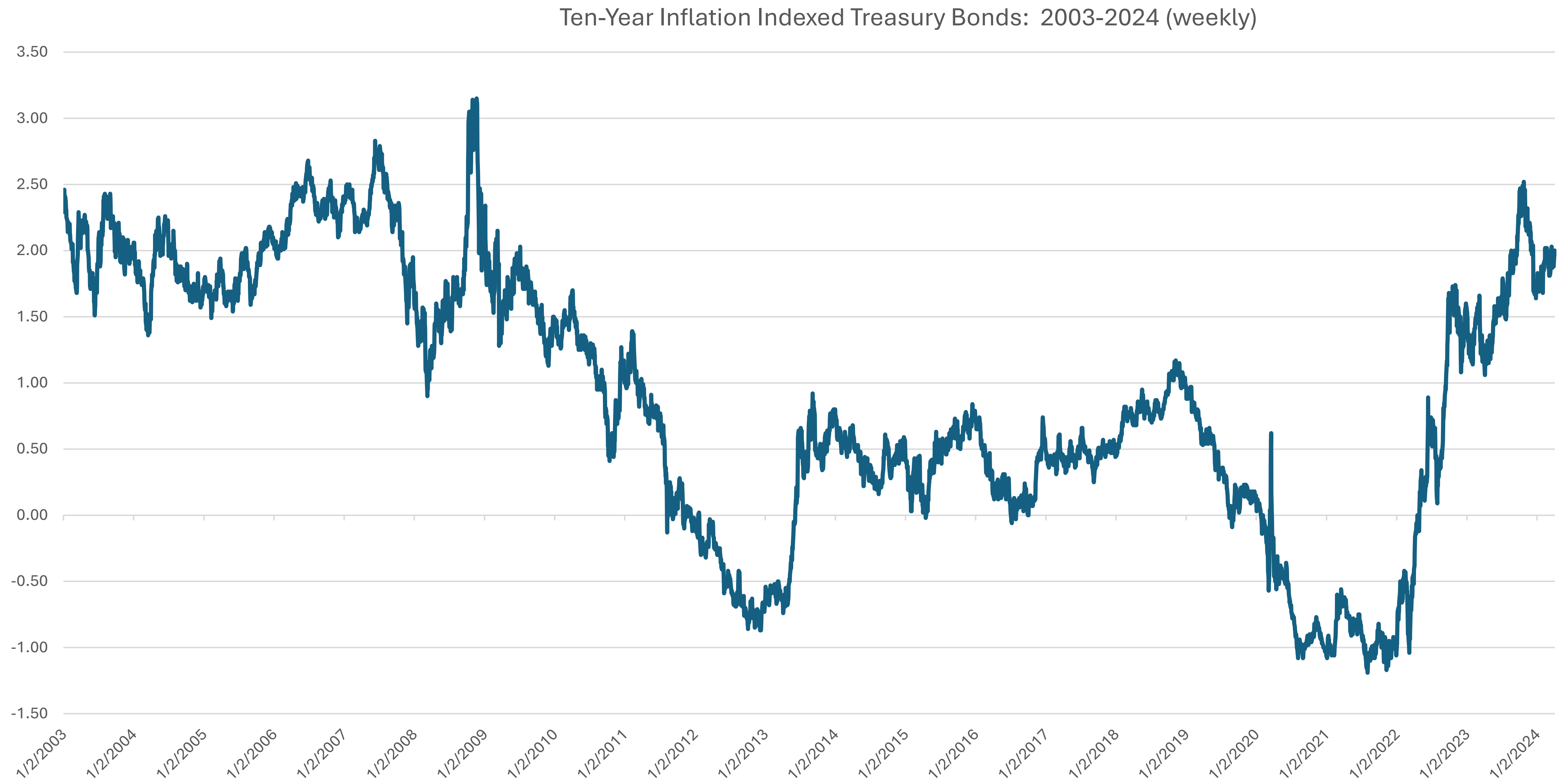
Big shift in academics towards relying much more on fiscal policy

- Many papers in top journal about creative ways to use fiscal policy at zero bound
- Progressives argued that debt could be used to solve many social problems
- Conservatives argued that tax cuts could be paid for by higher growth – even if growth wasn't higher….
- Relatedly, strong shift among economists toward using fiscal policy as a first line of defense against recessions

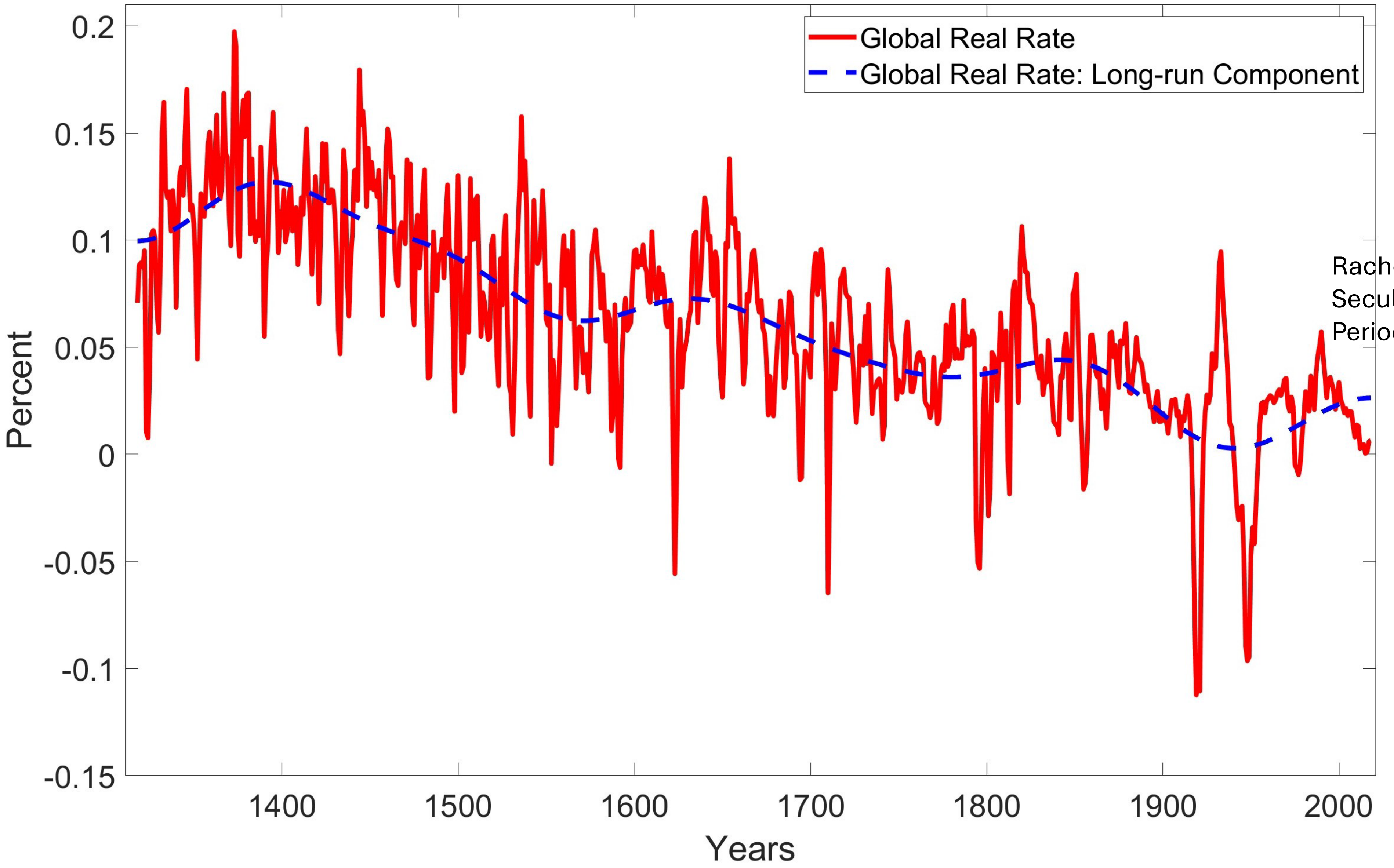
Modern version of Secular Stagnation very close to Alvin Hansen (1938, 1939)

- Hansen's views of the end of innovation are remarkably parallel to Gordon (2016)
  - If perhaps more cautious….
- "when giant new industries have spent their force, it may take a long time before something else of equal magnitude emerges. In fact, nothing has emerged in the decade in which we are now living."
- Rather than diagnose the Great Depression of the 1930s as a Banking Crisis (as Bernanke 1983 conjectured give decades later), Hansen argued that the core problem was a shortfall in investment
- "there is equally no basis for the assumption that we can take for granted the rapid emergence of new industries as rich in investment opportunities as the railroad, or more recently the automobile, together with all the related developments, including the construction of public roads, to which it gave rise."

But should the post-GFC collapse in real interest rates ever have been considered as permanent?



Global Real Rates and Long Run Trend: 1311-2022



Rachel-Summers Secular Stagnation Period

Source: Rogoff, Rossi and Schmelzing *American Economic Review* 2024 (forthcoming).

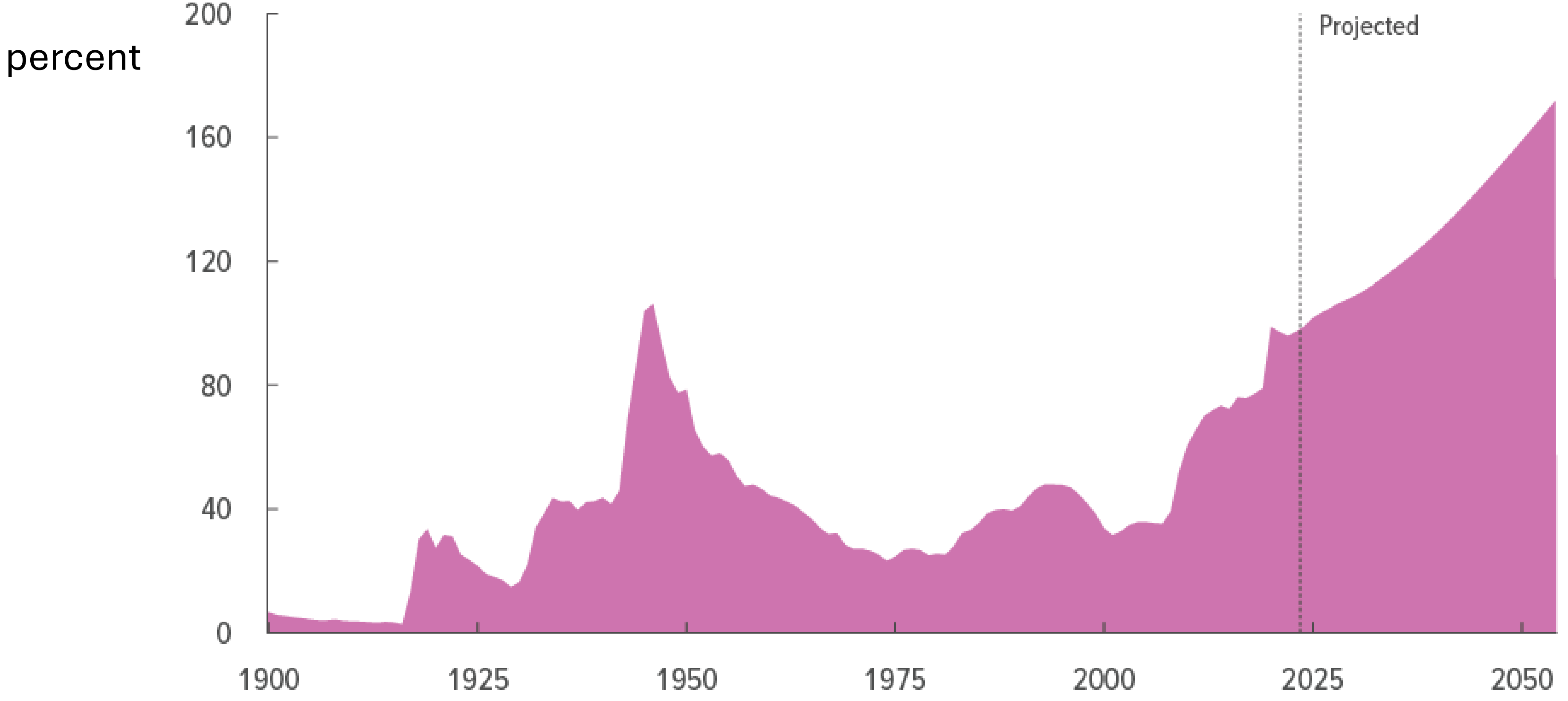
- Schmelzing (Yale University Press, 2025) historical data base on nominal interest rates a major advance over Homer and Sylla (1962, 2005), as well as Jorda, Schularik and Taylor (2017), filling in multi-decade missing gaps by using primary sources, expanding to eight countries.
- Rogoff, Rossi, and Schmelzing (AER 2024) question whether demographics and productivity hold up as long-run explanations of trend decline in real interest rates; over many centuries, the correlation even goes in the wrong direction up until World War II (which with demographics should be so surprising, e.g., Goodhart and Pradan (2020))
    - Rising liquidity and lower default risk almost surely the first-order explanations

The role of financial repression is keeping government real interest rates has been understated

What factors might explain new normal (near return to old normal) normal in long-term real interest rates?

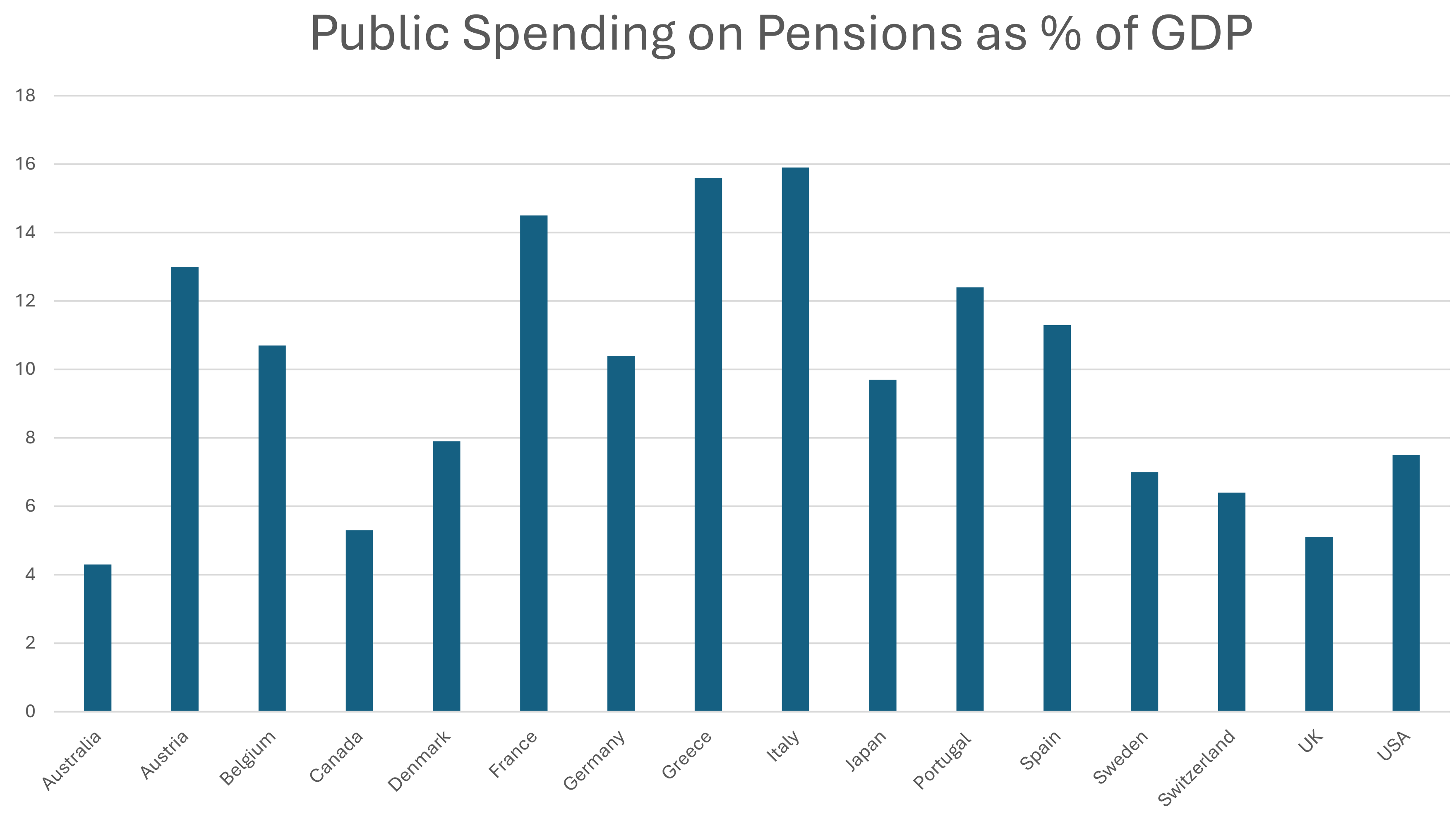
- Higher debt and more generous old-age benefits, both of which will raise real interest rates in almost any plausible model
- Geopolitical instability leading to markedly higher defense expenditure
- Green transition costs
- Rise of populism especially in advanced economies
- Higher term premium (end of QE, post pandemic reminder that inflation is always a risk)
    - But r* has likely risen as well

US Central Government Debt Held by Public/GDP



Source: Congressional Budget Office, February 1, 2024

Are Public Pension Obligations De Facto Junior Debt? (Rogoff, 2020)



Source: Rogoff, Kenneth. 2020. "[Falling Real Interest Rates, Rising Debt: A Free Lunch?]" JPM

If not mostly secular stagnation, then what?

- A far simpler explanation is that a substantial component of the sluggish growth and low interest rates in 2010s, as well as in the 1930s, was the (typical) aftermath of financial crisis
    - Reinhart and Rogoff (2009) show that one should not only at growth also many other markers, including equity prices, housing prices, unemployment and current accounts, among other factors.
    - Importantly one must not excessively focus on the United States, but look at the whole world to properly diagnose the maladay.

Past Experience with Severe Financial Crisis, Peak to Trough Changes

Spain (1977), Japan (1992), Norway (1987) Philippines (1997), Sweden (1991), Hong Kong (1997), Colombia (1998), Korea (1997), Malaysia (1997), Finland (1991), Thailand (1997) Indonesia (1997), Argentina (2001),	Cumulative % change	Duration
Housing prices	**-36%**	**5** years
Equity prices	**-56%**	**3.4** years
Unemployment	**7%**	**4.8** years
Real GDP per capita	**-9.3%**	**1.7** years

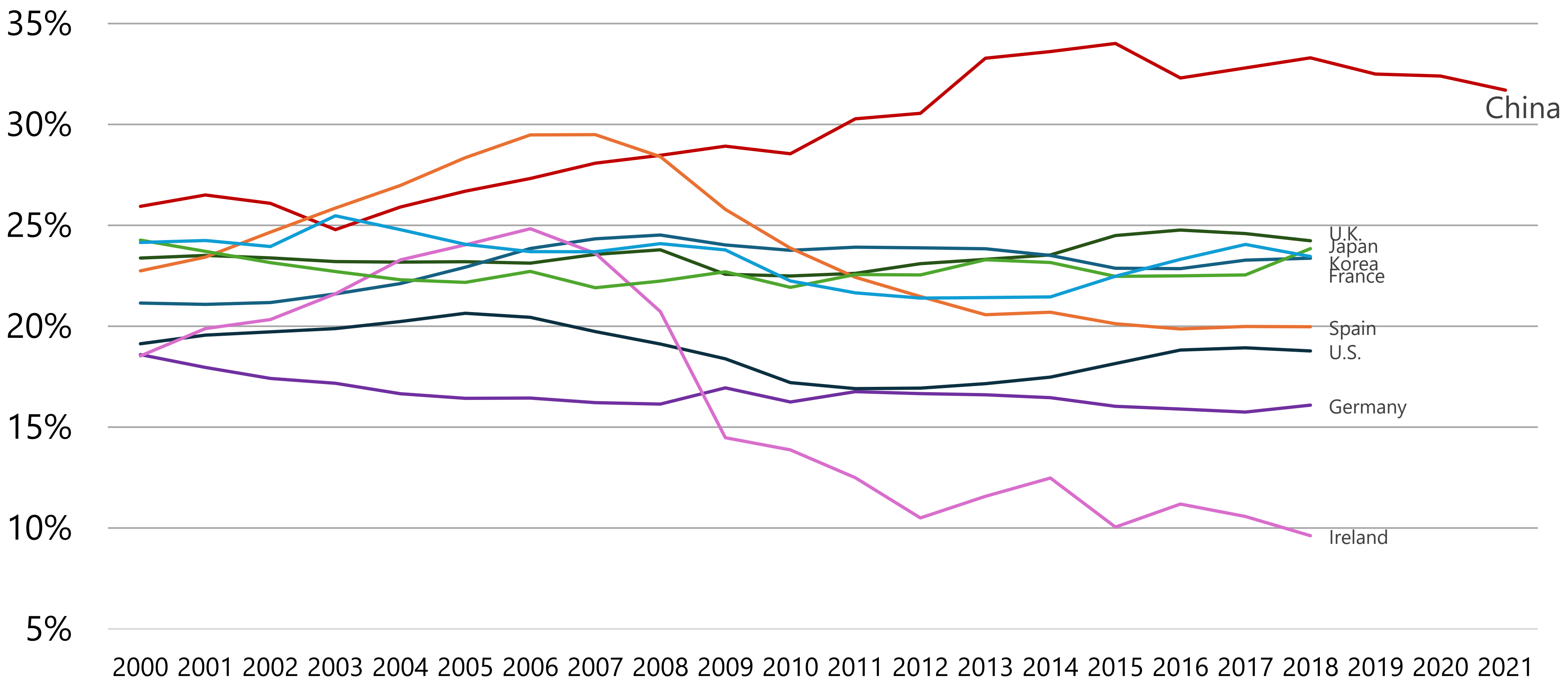
Reinhart and Rogoff, 2009
"The Aftermath of Financial Crises"

A Debt Supercycle?

- Indeed, there has been a remarkable debt supercycle that has now come to China. Many issues, but decades of over-dependence on real estate and infrastructure construction have lead to situation where difficult adjustment are needed (Rogoff and Yang, 2020, “Peak China Housing”

China's real estate and infrastructure construction is outsized by international standards

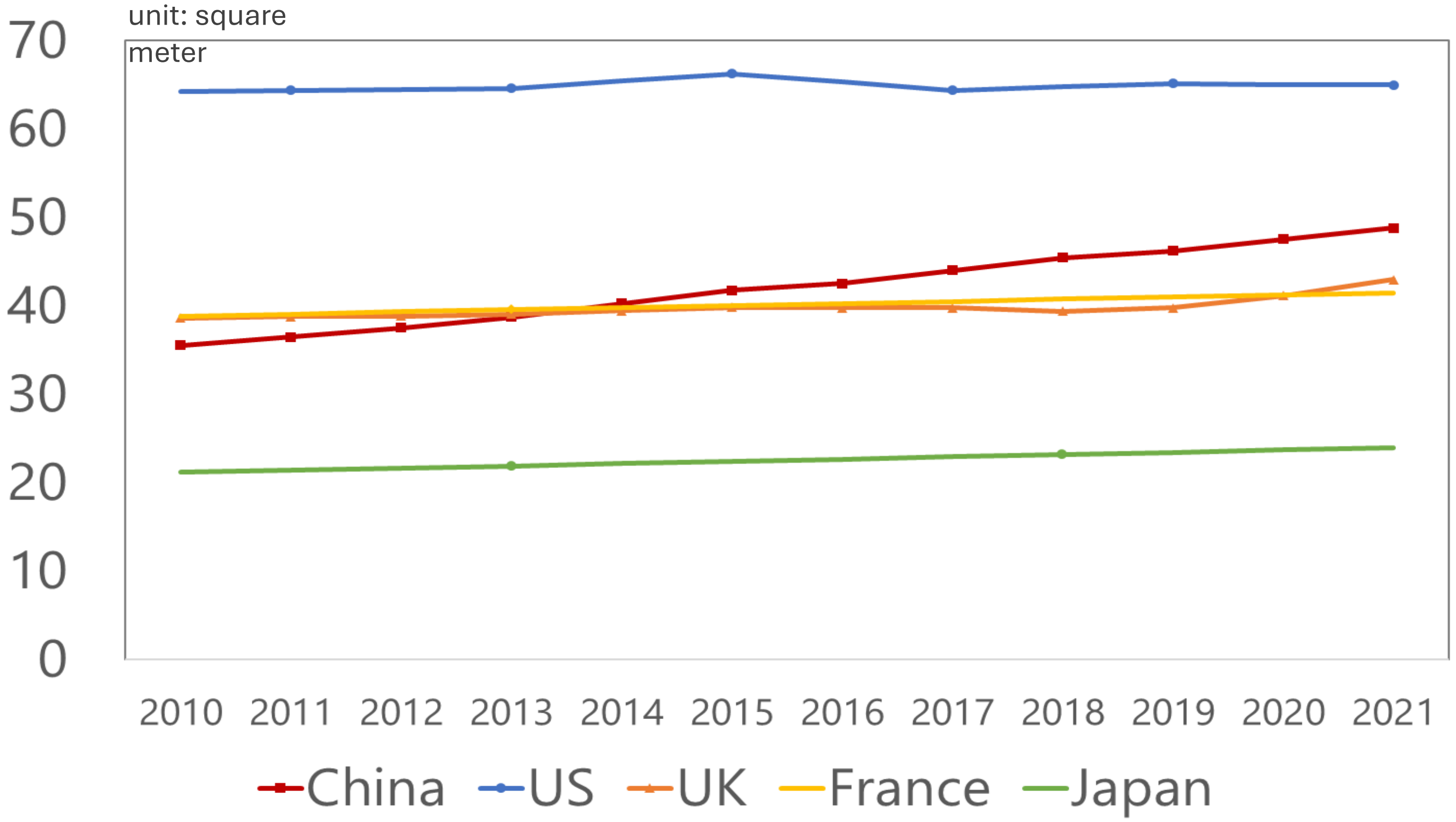
- **Real Estate and Infrastructure Share of GDP by Country**



Sources: Rogoff and Yang, Economic Policy, 2023. Author calculations based on data from NBS, OECD harmonized input-output tables, United States Bureau of Economic Analysis, United Kingdom Office for National Statistics, European Construction Industry Federation, Eurostat, Spanish Statistical Office, Statistics Bureau of Japan, and Statistics Korea

China’s per capita living space on par with many advanced economies

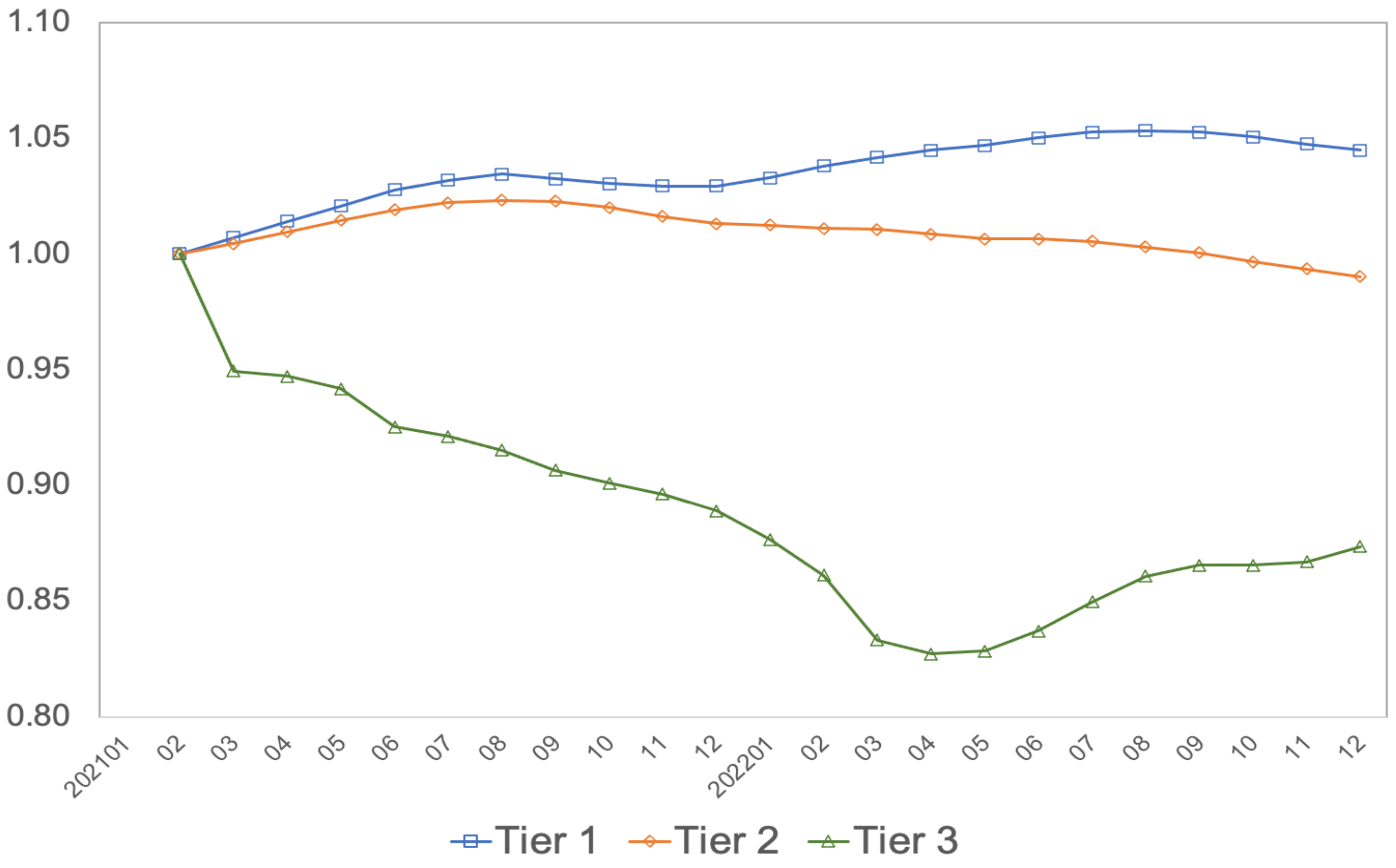
- **Per Capita Floor Space of Selected Countries (square meters)**



Source: Rogoff and Yang, Economic Policy, 2023. Author calculation based on data from NBS, US Census Bureau American Housing Survey, UK English Housing Survey 2010-2021, Les Conditions de Logement en France, édition 2017, Japan Land and Housing Survey 2018

House prices have fallen sharply in Tier 3 cities since the onset of the pandemic (even by official numbers)

- **Housing Prices by City Tier (2021M2=1.00)**



Source: Rogoff and Yang, Economic Policy, 2023, compiled based on NBS house price and transaction data

How might supercycle been connected across Japan (Asia), US, Europe and China?

Conclusions

- The belief in interest rates and inflation would be lower forever, that the speed of impactful innovation has slowed dramatically (and permanently), and that the big problem is deficient demand, were important ideas.
- However, proponents grossly overstated secular effects and understated the long-lasting (but ultimately temporary) effects of the global financial crisis and more broadly, the debt supercycle.
- Was there ever a “secular stagnation era”? Or did the global economy simply experience the normal aftermath of a severe global financial crisis, and supercycle of crises that followed?