



## Finding ways of spurring growth No time to compromise on stability

**Andrew Large, Advisory Board**

**If we want to restore growth and avoid social collapse we need skilful actions. People will have to accept that some austerity is necessary. Deleveraging is the vital building block back to restoring consumption and investment.**

There will be pressure to bring in elements of debt monetisation. So retaining long-term integrity of the monetary authorities is of fundamental importance. The seeds of crisis are not just sown in times of exuberance. Attempts to rekindle growth may add to vulnerability. So don't let us take our eyes off the stability goal.

We all recognise that leverage was too high. A shock caused confidence to collapse. Until leverage comes down I see no way that confidence will be rekindled. Yet that rekindling is what is needed to re-establish the confidence that will restore consumers to spend and businesses to invest. When I was Deputy Governor at the Bank of England and on the monetary policy committee, I always worried about rising leverage. My economist friends told me not to worry because that debt was just a residual. Now, it is a major determinant.

The longer we leave the issue of leverage unaddressed the greater will be the pain of austerity. There are several factors that reduce the need for adjustment only through cuts. It helps if you have a reserve currency. This may explain the lack of US urgency about the debt time bomb. If the euro area was a credible political union, it would gain such benefits. It helps, too, if you can devalue, and monetise the problem to some extent. But you have to develop credible plans to deleverage to prevent continuing bond vigilante activism. As long as that persists as Spain and Italy show there is little hope of confidence returning. Such credibility requires a combination of fiscal consolidation and bank deleveraging as well as tackling supply side constraints. The one form of debt that vigilantes may accept is well-crafted infrastructure spending, where a tangible return is anticipated.

The spectre of social collapse and political extremism is on the horizon. Apart from human misery this would produce still worse economic outcomes. Little wonder that forms of monetisation are on the agenda. The prospect of moderate inflation may appeal. If you have 5% inflation for five years you bring 100% debt to GDP down to 75%. And maybe our confidence in the ability of monetary policy to anchor expectations and prevent a runaway inflation turns minds to this. In the euro area, the idea of Germany inflating so the periphery can get out of its problems is no longer completely unacceptable. Despite potential impact of higher interest rates, this sounds like a better option than socially damaging austerity, and certainly better than default.

But there is a longer term issue too. We have begun to see the emergence of macroprudential policy frameworks and macroprudential authorities which seek to prevent crises from occurring. The gap in policy which we spotted from the failures leading up to 2008 is fortunately being addressed. That's why policy frameworks like the Financial Policy Committee in the UK and other institutional set-ups in many jurisdictions are being developed. However, policy in this area is very tough. Definitions are hard, and objectives hard to pin down. Which instruments to use is difficult enough; their calibration is uncertain. And such policy frameworks are unpopular. They stunt growth, to the despair of politicians. They thwart bonus capture by bankers. And slowing down credit is disliked by the creditors.

I worry that the process may get hijacked. The idea of giving the macroprudential authority a dual objective emerges: to stop crises on the one hand, and to foster growth on the other. This would be a disastrous outcome. If macroprudential policy needs to take account of growth, this must be subsidiary to stopping crises. A single authority with dual objectives is a recipe for confusion. It would undermine legitimacy, and make accountability all but impossible. How much of each should be achieved? The danger is that both policies would be compromised. ☒

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