No. 24 | FEBRUARY 2021

ECONOMICSFORALL

SG Economic and Sector Research

Secular stagnation

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In the wake of the Great Recession of 2008-9, the notion of "secular stagnation" made a comeback on the academic scene. The years that followed the crisis saw a number of developed economies record abnormally sluggish growth, obstinately low inflation levels, and a persistent decline in real interest rates. The Great Depression of 2020 could aggravate these trends.

The concept of "secular stagnation"

Developed at the end of the 1930s by the economist Alvin Hansen, the concept of secular stagnation was revived by Lawrence Summers in a presentation he gave at the IMF Forum in November 2013. After several years of disappointing growth in many developed economies in the wake of the Great Recession of 2008-9, Lawrence Summers advocated the idea that these economies could be grappling with a chronic deficit in global demand, including the demand for investment, leading to economic stagnation that was long-term enough to be considered "secular".

The hypothesis of secular stagnation

The hypothesis of secular stagnation states that a change in savings and investment fundamentals can lead to a long-term deficit in global demand by lowering the "natural" rate of interest (defined by Wicksell, in 1898, as the interest rate compatible with full employment)[1] **below zero**. A negative natural rate of interest is a major obstacle to economic recovery, as it compromises the efficiency of conventional monetary policy, given the lower bound (at zero or effective) on nominal interest rates[2].

Since the 2008 financial crisis, a number of large central banks have reached their effective lower bound on nominal interest rates, while the macro-economic performances recorded in the majority of advanced economies have proved disappointing, with moderate and temporary cyclical rebounds, underlying inflation generally below central banks' objectives, and a downward trend in real interest rates – all developments that have underscored the pertinence of the hypothesis of secular stagnation in understanding the economic situation of the past few years.

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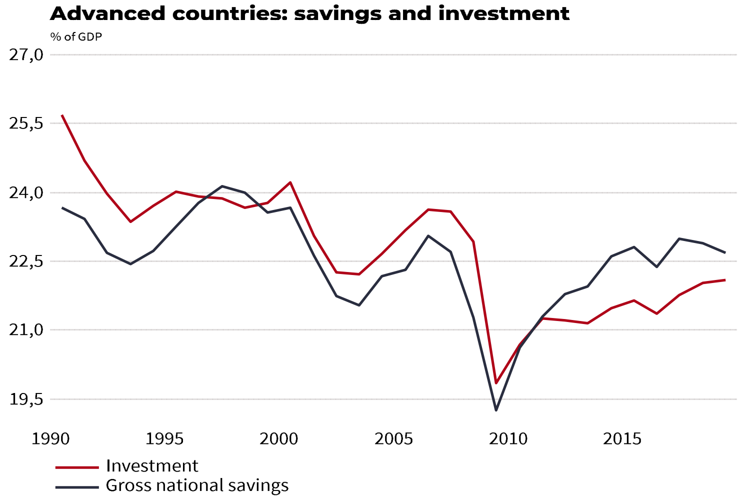
[1] See Marie-Hélène Duprat (2019), "The long-term equilibrium rate of interest", Economy for all, July.

[2] The key interest rate of central banks cannot be lowered (much) below zero, since economic actors always have the option of holding cash rather than negative-yielding assets. As it takes significant interest rate cuts to fight a recession, reaching the lower bound (at zero or slightly below zero) on nominal rates is a major constraint on monetary policy.

Excess savings on investment

It is generally considered that the evolution of the natural rate of interest is driven by changes in underlying savings-investment determinants. As such, the fact that the natural rate of interest, and along with it, the whole range of interest rates, has been trending downward for so long is seen as the result of an excess in desired savings relative to desired investment.



Explanations for the lack of "appetite" for investment relative to the "appetite" for savings have fallen into two broad categories: 1) The **deterioration of the growth potential in advanced economies** (itself the result of a series of factors, such as the deceleration in active population growth and low gains in productivity) and the consequent decline in the appetite for investment; 2) **the sluggishness of global demand** and the associated increase in the appetite for savings.

Several factors have combined over the course of recent decades to increase agents' propensity to save, such as the increase in the share of national income captured by high incomes, as high-income households have a stronger propensity to save than other households; a long cycle of debt reduction after the 2008 crisis; the increase in life expectancy and the uncertainty surrounding retirement pensions; and the accumulation of foreign exchange reserves by a number of central banks, primarily in Asia and Europe.

The shock caused by COVID-19 is aggravating the problem of excess savings

The Great Depression of 2020 has strengthened the forces that could lead to secular stagnation for at least three reasons: it has led to losses in potential production; it is likely to trigger an increase in risk aversion in the private sector, as households and companies could reduce their expenses in order to have a higher savings buffer in case of future crises; it has given a tremendous boost to the digital transition, which will contribute to widening social inequalities. Secular stagnation, however, is not inevitable; it can be combated by deficit-financed public spending that boosts investment and reduces national savings by absorbing the large supply of private saving and by structural reforms aiming to improve the productivity of factors.

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