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Flash Economics

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Crises are always triggered by US monetary policy

Since the late 1990s, financial crises and the associated recessions have systematically been triggered by US monetary policy.

- In the second half of the 1990s, the Federal Reserve let the US equity bubble inflate without reacting; the bursting of this bubble in 2000 triggered a global recession;
- From 2002 to 2007, the Federal Reserve allowed a property bubble to inflate in the United States without reacting and allowed the development of mortgage loan securitisation with abnormally low risk premia; the bursting of the property bubble from 2007 triggered the global subprime crisis;
- In 2013, the Federal Reserve's announcement that it would end quantitative easing in 2014 triggered capital outflows from emerging countries and a steep deterioration in these countries' economies.

The Federal Reserve has therefore triggered global recessions either through laxity in the face of bubbles and debt or by conducting a monetary policy without looking at its effects on other countries.

What risks of such a nature are now found in US monetary policy? Probably the risk of the Federal Reserve causing the bond bubble that it allowed to swell burst in the future.

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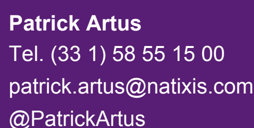

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ECONOMIC RESEARCH

Our theory: For more than 20 years, global crises and recessions have stemmed from US monetary policy

US monetary policy:

- **Has been lax:** it allowed the **equity bubble** to inflate in the second half of the 1990s; the **property bubble** (and associated credit) to inflate from 2002 to 2007; and the **bond bubble** to inflate since 2010;

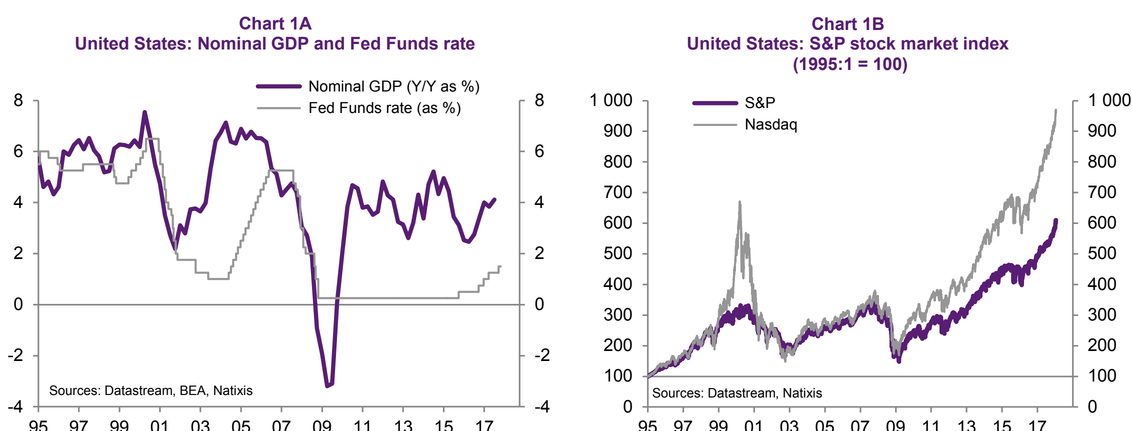
- Has made changes to US monetary policy **without considering the consequences for the rest of the world**. This was the case in the recent period with the announcement of the end of quantitative easing.

We think that **both characteristics of US monetary policy are behind the global crises and recessions of the past 20 years.**

US monetary policy and global recessions

1- The second half of the 1990s

In the second half of the 1990s, US monetary policy remained quite accommodating **(Chart 1A) and allowed an equity bubble to inflate in the United States (Charts 1B** and **C).**



The bursting of the equity bubble in 2000 triggered a global recession due to the correlation between equity markets **(Chart 1D)**, the corporate deleveraging set in motion by the fall in share prices **(Chart 1E)** and the loss in value of companies and the acquisitions they had made, resulting in a global recession in 2000-2001 **(Chart 1F).**

Chart 1C
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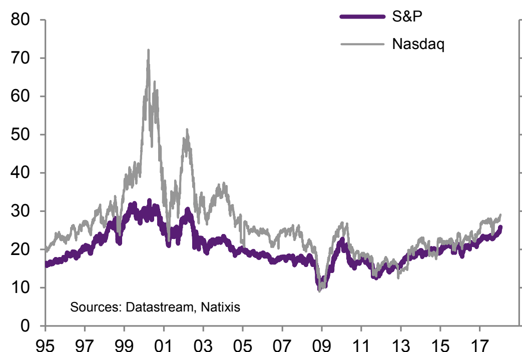


Chart 1D
Stock market indices (1995:1 = 100)

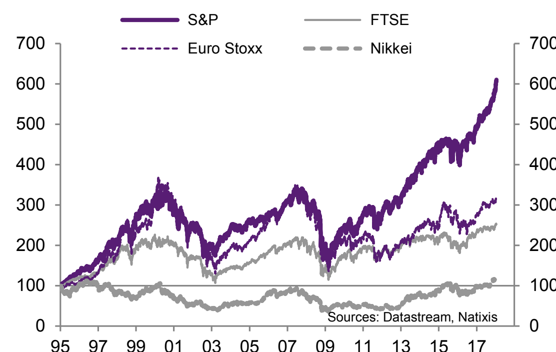


Chart 1E
Business loans (Y/Y as %)

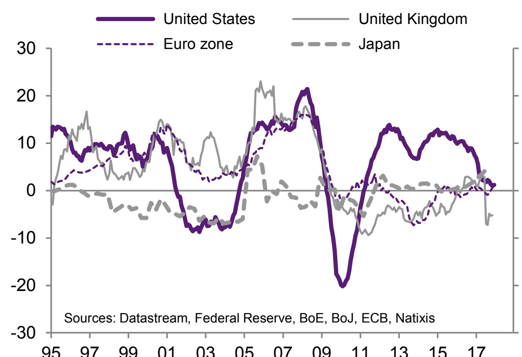
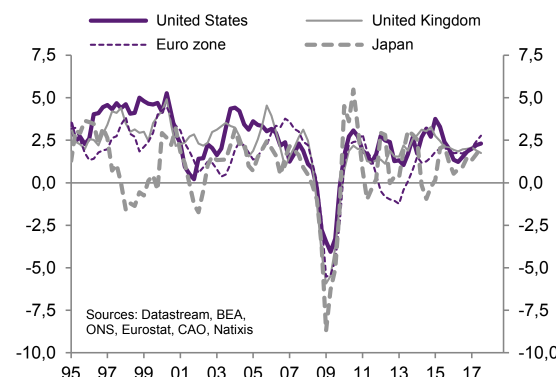


Chart 1F
Real GDP growth (Y/Y as %)



2- The period 2002-2007

From 2002 to 2007, the Federal Reserve's monetary policy was again accommodating (**Chart 1A** above): **it let property prices (Chart 2A) and household debt (Chart 2B) rise, and allowed the development of securitisation**, particularly of mortgage loans with abnormally low risk premia **(Charts 2C** and **D).**

Chart 2A
United States: House prices and commercial real estate prices (1995:1 = 100)

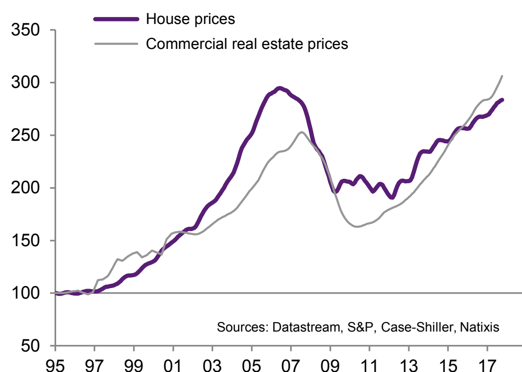
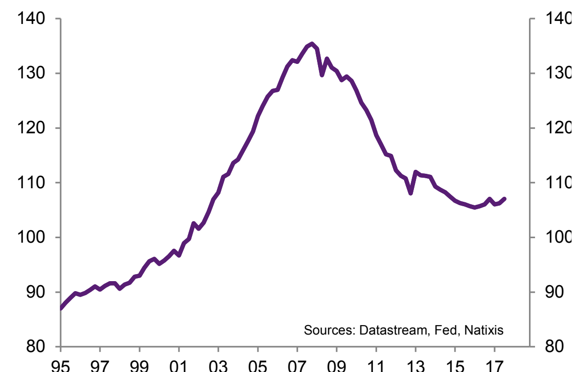
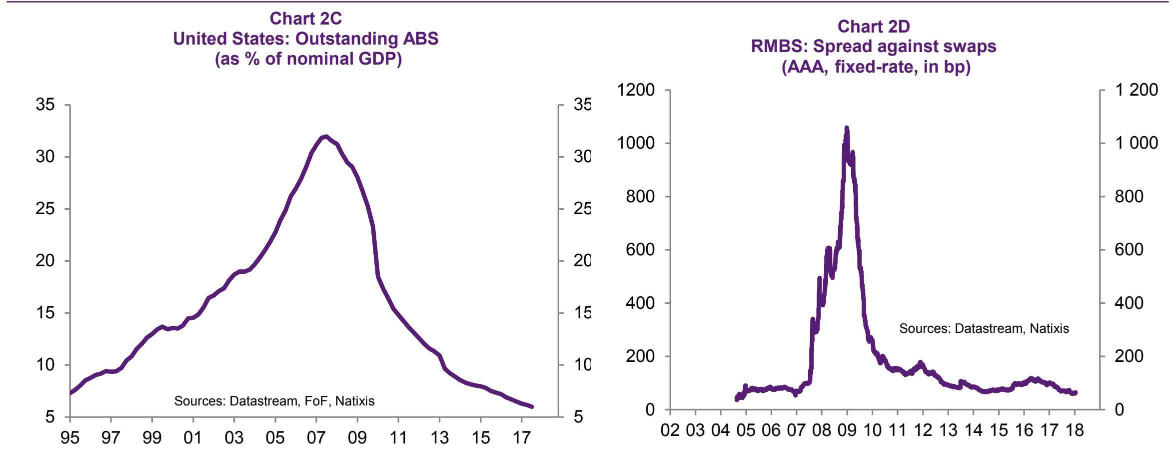
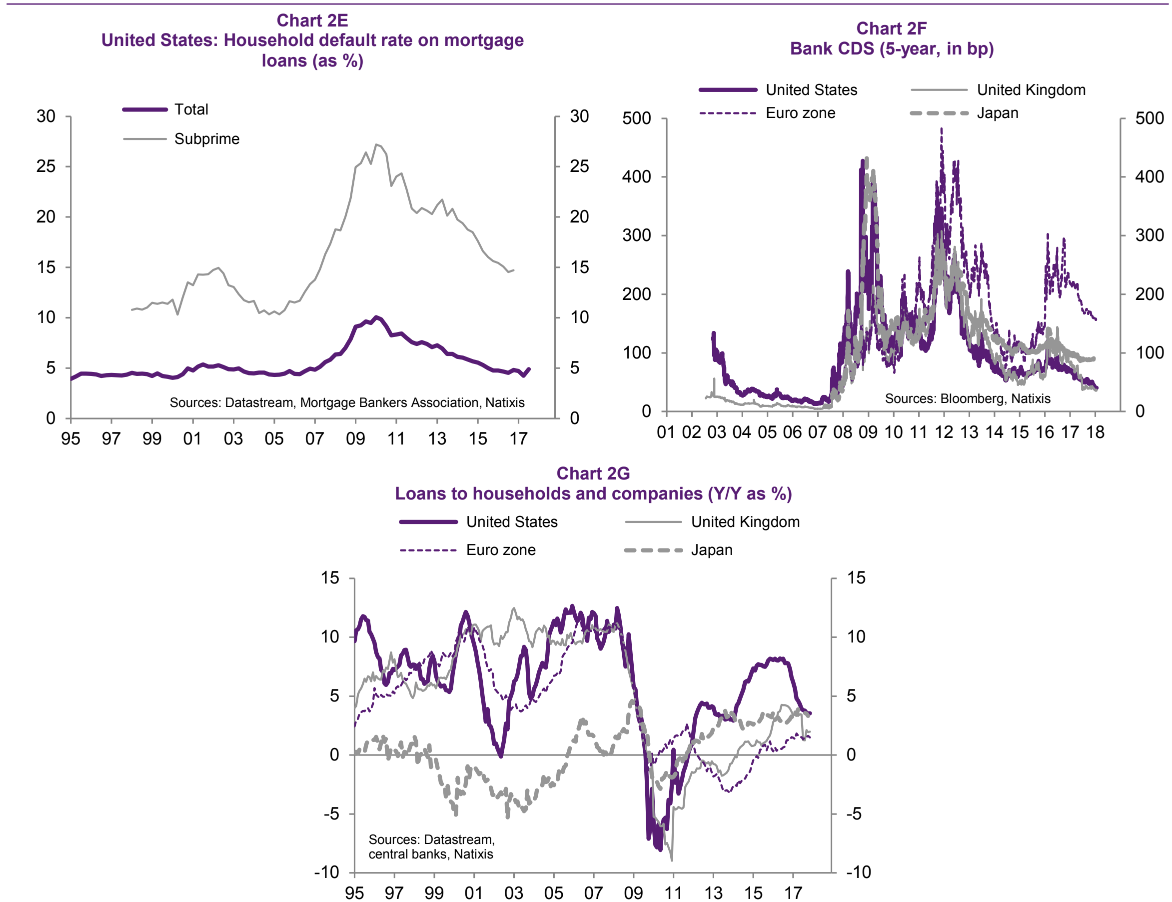


Chart 2B
United States: Household debt (as % of household GDI)





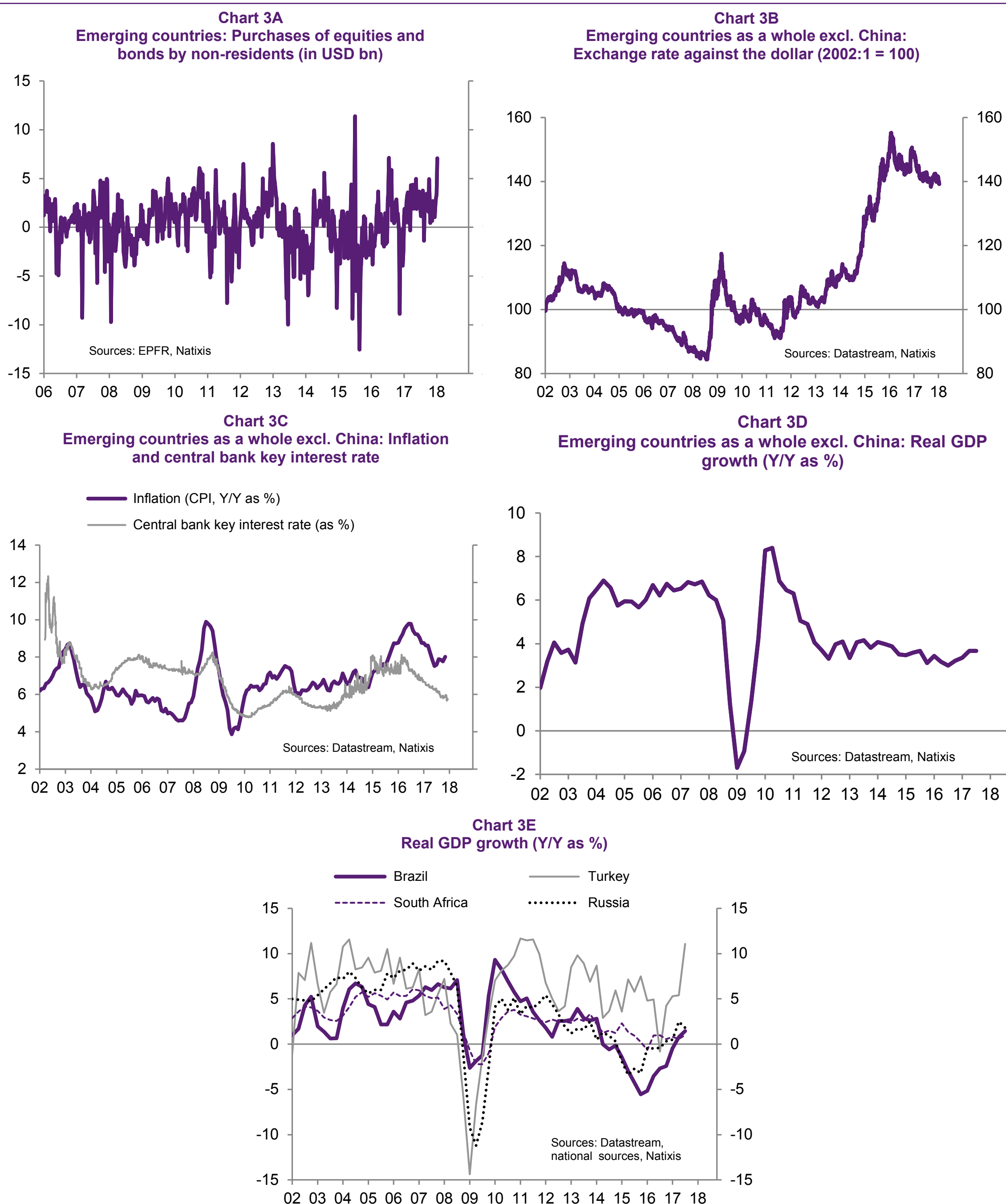
The rise in household default rates **(Chart 2E) caused the property bubble to burst and led to a repricing of risk in the assets created via securitisation,** leading to a global crisis that stemmed from banks **(Chart 2F),** due to the losses on their securitisation portfolios, which triggered a global fall in credit **(Chart 2G)** and a global recession (**Chart 1F** above).



3- The emerging country crisis from 2013

In the spring of 2013, the Federal Reserve announced that it would end quantitative easing in late 2014 without worrying about the effects of this **monetary policy change on the rest of the world.**

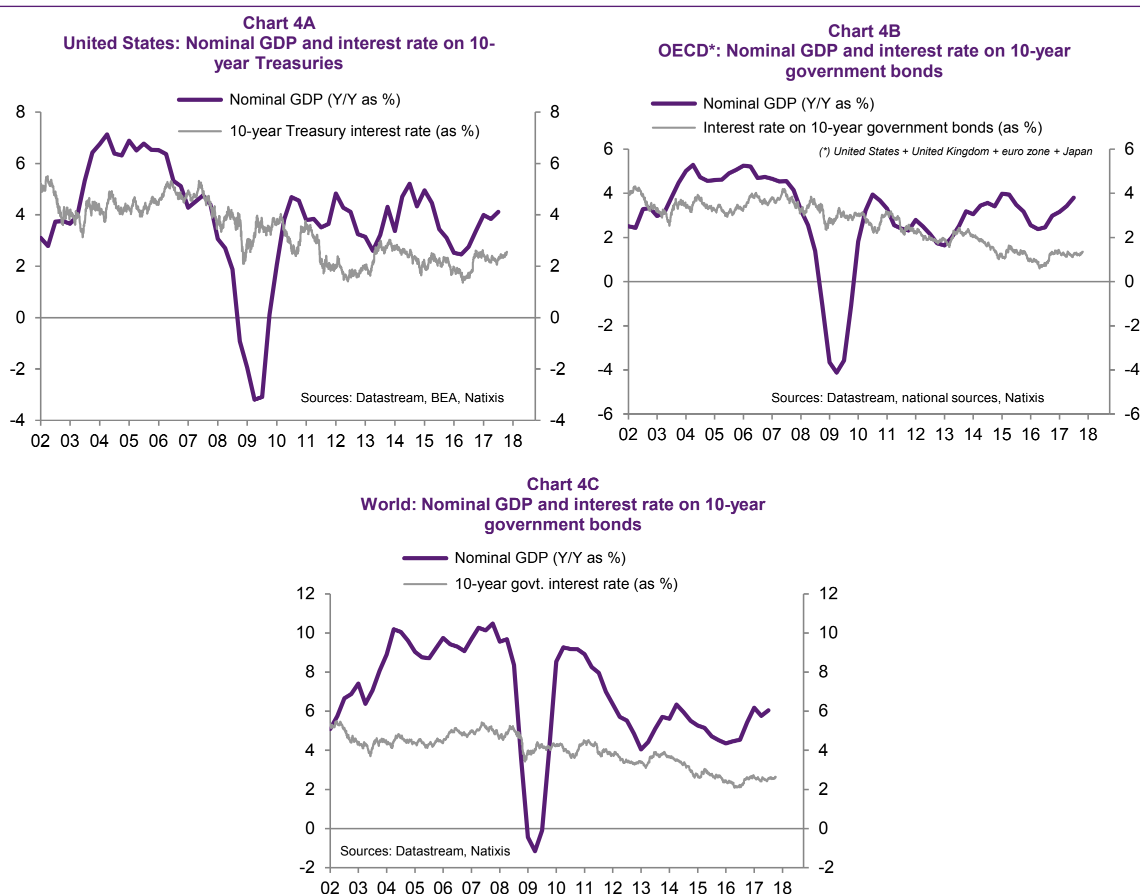
Due to expectations of a contraction in liquidity and an increase in US interest rates, **this announcement triggered a crisis in emerging countries,** with capital outflows from 2013 to early 2016 **(Chart 3A)** and currency depreciation **(Chart 3B),** driving up inflation and interest rates **(Chart 3C)** and weakening growth **(Chart 3D)**, especially in Brazil, Turkey, South Africa and Russia **(Chart 3E).**



Conclusion: What will cause the next global crisis (recession) triggered by US monetary policy?

US monetary policy triggers global crises and recessions either because of the financial imbalances that result from US monetary laxity or because the Federal Reserve does not consider the effects of its decisions on other countries.

What will the next crisis of this nature be? **The highly expansionary monetary policy conducted in the United States since the crisis** (**Chart 1A** above) **has given rise to a bond bubble in the United States and globally (Charts 4A, B** and **C)** due to the high correlation between countries' long-term interest rates and US long-term interest rates.



It would therefore be reasonable to predict that the next global crisis will stem from a monetary policy change in the United States that burst the global bond bubble, resulting in a loss of wealth, difficulties for borrowers, a fall in investment, etc.

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