Understanding today's stagnation

By Robert J. Shiller
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Ever since the "Great Recession" of 2007-2009, the world's major central banks have kept short-term interest rates at near-zero levels. In the United States, even after the Federal Reserve's recent increases, short-term rates remain below 1%, and long-term interest rates on major government bonds are similarly low. Moreover, major central banks have supported markets at a record level by buying up huge amounts of debt and holding it.

Why is all this economic life support necessary, and why for so long?

It would be an oversimplification to say that the Great Recession caused this. Long-term real (inflation-adjusted) interest rates did not really reach low levels during the 2007-2009 period. If one looks at a plot of the US ten-year Treasury yield over the last 35 years, one sees a fairly steady downward trend, with nothing particularly unusual about the Great Recession. The yield rate was 3.5% in 2009, at the end of the recession. Now it is just over 2%.

Much the same is true of real interest rates. During the Great Recession, the ten-year Treasury Inflation-Protected Security yield reached almost 3% at one point, and was almost 2% at the recession's end. Since then, the ten-year TIPS yield has mostly declined and stayed low, at 0.5% in May 2017.

The fact that people are willing to tie up their money for ten years at such low rates suggests that there has been a long trend toward pessimism, reflected in the recent popularity of the term "secular stagnation" to describe a perpetually weak economy. After former US Treasury Secretary Lawrence Summers used the term in a November 2013 speech at the International Monetary Fund, the *New York Times* columnist Paul Krugman picked it up, and it went viral from there.

Although secular stagnation became a meme five years after the 2008 financial crisis, the term itself is much older. It first appeared in Harvard University economist Alvin Hansen's presidential address to the American Economic Association, in December 1938, and in his book published the same year.

Hansen described the "essence of secular stagnation" as "sick recoveries which die in their infancy and depressions which feed on themselves and leave a hard and seemingly immovable core of unemployment." When Hansen delivered his speech, he expected the US economy's economic stagnation to persist indefinitely. The depression that had started with the stock-market crash of 1929 was approaching its tenth year, and World War II had not yet arrived. Only after the war began, in 1939, did the stagnation end.

Hansen's Great Depression-era theory of secular stagnation was based on an observation about the US birth rate, which was unusually low in the 1930s, after having already declined dramatically by the late 1920s. Fewer births perpetuated the stagnation, Hansen surmised, because people did not need to spend as much on children, and felt less need to invest in the future. Indeed, according to World Bank statistics, the global average birth rate has also fallen since the 2008 financial crisis. But low fertility had nothing to do with that crisis in particular, given that birth rates have been steadily declining for the better part of a century.

Another explanation is that the 2008 crisis is lingering in our minds, in the form of heightened fear that rare but consequential "black swan" events could be imminent, despite moderately strong consumer-confidence measures and relatively low financial-market volatility (with some exceptions). A recent paper by New York University's Julian Kozlowski, Laura Veldkamp, and Venky Venkateswaran argues that it is rational to harbor such fears, because once a formerly unthinkable event actually occurs, one is justified in not forgetting it.

My own theory about today's stagnation focuses on growing angst about rapid advances in technologies that could eventually replace many or most of our jobs, possibly fueling massive economic inequality. People might be increasingly reluctant to spend today because they have vague fears about their long-term employability – fears that may not be uppermost in their minds when they answer consumer-confidence surveys. If that is the case, they might increasingly need stimulus in the form of low interest rates to keep them spending.

A perennial swirl of good news after a crisis might instill a sort of bland optimism, without actually eliminating the fear of another crisis in the future. Politicians and the media then feed this optimism with rosy narratives that the general public is in no position to sort through or confirm.

Since around 2012, the equity and housing markets have been hitting new records. But the same sort of thing happened regularly in the Great Depression: the news media were constantly reporting record highs for one economic indicator or another. A Proquest "News and Newspapers" search for the 1930-1939 period finds 10,315 articles with the words "record high." Most of these stories are about economic variables. In 1933, at the very bottom of the depression, record highs were reported for oil production; wheat, gold, and commodity-exchange-seat prices; cigarette consumption; postal deposits; sales or profits of individual companies; and so forth.

Such rosy reports may give people some hope that things are improving overall, without allaying the fear that they could still suffer an economically catastrophic event. Barring exceptionally strong stimulus measures, this sense of foreboding will limit their spending. Narrative psychology has taught us that there is no contradiction: people can maintain parallel and conflicting narratives at the same time. When people are imagining disaster scenarios, policymakers must respond accordingly.

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