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The Market Speaks

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Four years ago, as a newly elected president began his efforts to rescue the economy and strengthen the social safety net, conservative economic pundits — people who claimed to understand markets and know how to satisfy them — warned of imminent financial disaster. Stocks, they declared, would plunge, while interest rates would soar.

Even a casual trawl through the headlines of the time turns up one dire pronouncement after another. “Obama’s radicalism is killing the Dow,” warned an op-ed article by Michael Boskin, an economic adviser to both Presidents Bush. “The disciplinarians of U.S. policy makers return,” declared The Wall Street Journal, warning that the “bond vigilantes” would soon push Treasury yields to destructive heights.

Sure enough, this week the Dow Jones industrial average has been hitting all-time highs, while the current yield on 10-year U.S. government bonds is roughly half what it was when The Journal published that screed.

O.K., everyone makes a bad prediction now and then. But these predictions have special significance, and not just because the people who made them have had such a remarkable track record of error these past several years.

No, the important point about these particular bad predictions is that they came from people who constantly invoke the potential wrath of the markets as a reason we must follow their policy advice. Don’t try to cover America’s uninsured, they told us; if you do, you will undermine business confidence and the stock market will tank. Don’t try to reform Wall Street, or even criticize its abuses; you’ll hurt the plutocrats’ feelings, and that will lead to plunging markets. Don’t try to fight unemployment with higher government spending; if you do, interest rates will skyrocket.

And, of course, do slash Social Security, Medicare and Medicaid right away, or the markets will punish you for your presumption.

By the way, I’m not just talking about the hard right; a fair number of self-proclaimed centrists play the same game. For example, two years ago, Erskine Bowles and Alan Simpson warned us to expect an attack of the bond vigilantes within, um, two years unless we adopted, you guessed it, Simpson-Bowles.

So what the bad predictions tell us is that we are, in effect, dealing with priests who demand human sacrifices to appease their angry gods — but who actually have no insight whatsoever into what those gods actually want, and are simply projecting their own preferences onto the alleged mind of the market.

What, then, are the markets actually telling us?

I wish I could say that it's all good news, but it isn't. Those low interest rates are the sign of an economy that is nowhere near to a full recovery from the financial crisis of 2008, while the high level of stock prices shouldn't be cause for celebration; it is, in large part, a reflection of the growing disconnect between productivity and wages.

The interest-rate story is fairly simple. As some of us have been trying to explain for four years and more, the financial crisis and the bursting of the housing bubble created a situation in which almost all of the economy's major players are simultaneously trying to pay down debt by spending less than their income. Since my spending is your income and your spending is my income, this means a deeply depressed economy. It also means low interest rates, because another way to look at our situation is, to put it loosely, that right now everyone wants to save and nobody wants to invest. So we're awash in desired savings with no place to go, and those excess savings are driving down borrowing costs.

Under these conditions, of course, the government should ignore its short-run deficit and ramp up spending to support the economy. Unfortunately, policy makers have been intimidated by those false priests, who have convinced them that they must pursue austerity or face the wrath of the invisible market gods.

Meanwhile, about the stock market: Stocks are high, in part, because bond yields are so low, and investors have to put their money somewhere. It's also true, however, that while the economy remains deeply depressed, corporate profits have staged a strong recovery. And that's a bad thing! Not only are workers failing to share in the fruits of their own rising productivity, hundreds of billions of dollars are piling up in the treasuries of corporations that, facing weak consumer demand, see no reason to put those dollars to work.

So the message from the markets is by no means a happy one. What the markets are clearly saying, however, is that the fears and prejudices that have dominated Washington discussion for years are entirely misguided. And they're also telling us that the people who have been feeding those fears and peddling those prejudices don't have a clue about how the economy actually works.