JEAN-CLAUDE MEYER

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Jean-Claude Trichet, European Chairman of the Trilateral Commission, former President of the ECB

I turn to Jean-Claude Meyer. You have the floor and your experience is very complementary to all what has been said already.

Jean-Claude Meyer

Thank you, Jean-Claude. I will talk a little bit about the future of financial markets. Three years ago at the WPC in Rabat I was very pessimistic, maybe too much so according to Jean-Claude at that time, as we were at the end of a long 10-year cycle of growth, remembering then the paradox of Minsky: when things seem to go well it means that crisis is growing. I anticipated two scenarios then: a soft-landing scenario, which was good, or the scenario of a crash in 2020. The crash happened, but for reasons which I did not expect unfortunately.

Today in the pandemic context, the situation is of course totally different. We are at a crossroads with a lot of uncertainty, but there is a consensus, almost a cliché, that a global recovery is on its way, but the moving markets face the risks of inflation and higher interest rates. I must say this year I follow this cliché, with the risk of not being original but hopefully right. Recovery, as Serge said, is on its way, even if we are not yet out of the woods. Growth of the world economy should be roughly 6% this year, 4.3% in Europe and 6.2% in the US. The world economy should grow by 4.5% next year, which is extraordinary.

This recovery has been fueled by social measures of governments and huge flows of liquidities of all central banks, and we fear now a tapering, which could lead to a rise of interest rates. In the US, Jay Powell has just successfully announced a later gradual tapering, starting in November or December and running until 2023, without provoking a panicked market, as it was the case in 2013. The Federal Reserve will continue to maintain its monthly USD 100-billion asset program until the US reaches 2% inflation and maximum employment, emphasizing that tapering would not lead automatically to raising interest rates. In Europe, the European Central Bank said it would slowly buy fewer bonds in the future and move to a moderately lower pace in its 80-billion-a-month pandemic emergency purchase program, PEPP, [inaudible] tapering said Christine Lagarde until probably March next year.

Overheating and inflation are threatening as the Federal Reserve has shifted its stance to give more leeway to inflation and greater priority to employment. There is a risk of overheating, yes, but it can be transitory according to Jay Powell. The risk: inflation has reached, as we all know, 5% in the US and 3% in Europe and risks are there for various reasons. First, wages

could increase because China's workforce, which provided a long boom, is now aging. Second, oil and natural gas prices are up and that might continue for a long time. Third, a large segment of private savings is waiting to be spent. Fourth, near zero interest rates feed bubbles in stock markets, exceptional monetary growth and huge fiscal deficits. Fifth, the population is getting older with increasing demand from consumers and a less productive labor force. Sixth, we must point out that the Central Bank of Norway has just increased its rates by 0.25%, projecting a 1.5% interest rate in the next year. This gives a trend and maybe a turn alongside Norway, followed by Pakistan, Hungary, Brazil and Paraguay. Last week, US Treasury bonds went from 1.3% to 1.5%.

However, inflation could indeed be transitory. Only 235,000 jobs were created in the US in August versus the 750,000 that were expected, with still nearly 6 million unemployed, and wages have increased by 4.3%, which is less than inflation, and in August inflation in the US has been limited to 0.3%. However, if unemployment falls wages will increase, as will consumption, leading to inflation, a rise in interest rates and of course a shock to the market. Inflation could also be transitory because automation could partially replace the Chinese labor force. The present inflation is driven not by tightening demand but by a shutdown of offers, as we all know, particularly of goods having run into temporary bottlenecks, as in logistics, timber, semiconductors and so forth, and by a rise of raw materials. Fortunately, if we can say so, Delta is slowing the recovery and might favor a more cautious attitude from the Federal Reserve.

If this transitory inflation remains under control, interest rates will remain low, maybe for the next 10 years according to Olivier Blanchard, and thus stock markets could remain healthy. Inflation, worrying in June, is not so important compared to a year before, which was depressed because of a crisis and is just rising because the economy is emerging from the deep freeze it was in. I personally totally disagree with Larry Summers who believes that we are living in a recipe for disaster leading to hyperinflation, and I also disagree with Nouriel Roubini, who anticipates a stagflation. I foresee no hyperinflation and no stagflation.

Financial markets, as we all know, are a consequence of growth, inflation, the employment level and interest rates, which have led to a certain bubble of assets, shares, real estate and art. However, it could make us rather optimistic. It is indeed a certain bubble. Global equities are now at very high valuations according to the Shiller cyclically adjusted ratio of price earnings. American stocks are valued at a multiple of 22 versus European stocks at 17. This important decoupling might shrink in the future to the advantage of European stocks. Several fund managers fear that stocks are running too hot and that we are at the top of a bubble. In fact, there is no doubt there is a certain bubble as the S&P 500 is 30% above the level of February 2020 and the Nasdaq is 50% above. It all depends on the prospects for corporate earnings and for inflation and interest rates. If corporate profits remain strong and interest rates low, stock prices look reasonable. The big question is whether interest rates will jump, how soon and how much. Stocks are sensitive to the level of bond yields, with low yields of course making equities more attractive, and the only investment for the time being – there is no alternative – TNA.

However, risks are still there: a new wave of the virus; high volatility of the market leading to a possible overreaction; a financial crisis in China, where already 1.7 trillion has recently been

lost on the Chinese stock market, particularly in the Internet and real estate sectors; a war in Chinese waters because of Taiwan and other geopolitical risks; a collapse of some shares due to environmental concerns; a split of the US Internet companies due to antitrust measures; a crisis on some sovereign debts if interest rates rise considerably.

However, I am rather confident in the stock markets for the following reasons: above all, as high interest rates should regularly but slowly increase in the future in a moderate; as buybacks are now increasing, with USD 500 billion expected during the second half of this year, favoring shareholders over debt holders; as mergers and acquisitions are booming thanks to cheap long-term financing; as the level of employment is still lower than before the crisis and, as we know, for the time being at least, as investors buy the dip.

To conclude, thanks to robust growth, moderate inflation and interest rates rising slowly and thanks to the continuous good fine-tuning of the central banks I expect no boom and no crash, but bumpy markets with ups and downs every day as it has been the case and as it was the case this week, which was not good. In brief, next year I think there will be a slow increase of the markets, or plateauing gently, but we are at a crossroad, and we should remain careful.

Jean-Claude Trichet

Thank you very much indeed, Jean-Claude. I found, as you said, that you are much more optimistic, while of course remaining reasonable and calling for vigilance in any case. It was very interesting and stimulating.