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John, you have the floor. Everybody knows you and we are ready to hang on your words.

John Lipsky

Jean-Claude, you are too kind. Thank you very much. There are so many things we could talk about. However, I am going to try to limit myself to just two. One, my good friend, Akinari Horii, has described an outlook that I think is quite plausible. He has said that there are reasons to think that the outlook may be somewhat more benign than the consensus. If I understood correctly, you are not saying that worse outcomes are impossible, but rather that the consensus is a bit too pessimistic for the reasons you laid out, and I find myself in broad agreement. Under current circumstances, most commentary has focused on monetary policy. Of course, there are good reasons for this. Nonetheless, I think it is worth going back and noting that this follows a long period during which monetary policy in almost every advanced economy has demonstrated that it is less powerful in controlling the economy than had been thought.

To put it another way, in the wake of the global financial crisis, we have had a series of unexpected developments, especially in the advanced economies, that were not anticipated and that we still do not understand completely, but that have been much more powerful in shaping the financial and economic environment than policy measures alone have been. We have experienced a period of slow growth, low investment, lower than anticipated labor force participation and at the same time, unexpectedly strong corporate profits. That combination has been associated with sustained, unexpectedly low real interest rates. That produced the unexpected result that despite the very rapid growth of public debt in the context of the global financial crisis, debt service as a percentage of public sector revenues did not rise in the advanced economies, but actually fell. The result was an amazingly benign period in many ways.

Because of this combination of lack of pressure on public finances despite the rapid rise in debt and the unexpectedly strong corporate profitability, one result was the very strong performance of asset prices, especially equity prices. At the same time, and despite the generalized agreement on an inflation targeting format for central banks and essentially universal agreement on 2% annual inflation as a target, no central bank seemed capable of hitting that target. Instead, virtually all experienced inflation that persistently was below target.

Following this came the unanticipated shocks of Covid and the Russian invasion of Ukraine. The result was a sharp increase in inflation that caught central banks by surprise and demonstrated that, since their models failed to anticipate it, that underneath changes in the global economy in the wake of the global financial crisis that have not been well understood.

It leaves us with some important questions. Clearly, what we saw in inflation was a combination of strong support for demand through fiscal and other means, in a context of constricted supply. What Akinari Horii told us we are going to see now is recovery of supply and the waning of the effects of stimulus, which will correct the imbalances that produced the unanticipated increase in inflation. What we do not know is how quickly inflation will recede. So far, the run up in long-term interest rates has been less than had been anticipated. This could be interpreted as an indication that investors anticipate a recession. In this case, the road back to low inflation will be an unhappy one.

However, this outcome is far from certain, and it is possible that investors anticipate that just as inflation rose faster and farther than expected, its reversal will be more rapid and less painful than consensus forecasts currently imply. Of the aspects that will be critical in determining which view will prove to be more accurate the course of wage gains will be watched closely. So far, wages have lagged behind inflation, and the consensus view anticipates that wage gains are going to accelerate, resulting in a wage/price spiral that will be truncated only by conventional means of monetary policy tightening raising the risks of a downturn.

Regardless, we do not know is what has happened to inflation expectations after a decade of unexpectedly low inflation. Obviously, the interactions between inflation expectations and the labor market is going to be critical. This interaction will be important in deterring whether corporate profits will prove to be resilient, in which case asset prices also should be more resilient than is anticipated by the consensus forecast.

At the same time, the behavior of real long-term interest rates is going to be critical for the outlook for fiscal policy: If long-term rates rise notably, and remain elevated for any period, higher, there is going to be tremendous pressure on the fiscal accounts in the advanced economies, because debt service costs with rise inexorably as a percentage of revenues.

There are big unknowns, but I also end up a little bit more optimistic than the consensus but that may just reflect my own personality rather than analysis. However, I have been suggesting that the intense focus on monetary policy in public discussion of the economic and financial outlook seems to underemphasize analysis of the underlying fundamental forces that I think are the most important.

One other brief remarks, if I may: It is widely recognized that developing country debt is going to be a problem. We also know the outlines of the problem that currently is blocking the formation of an effective multilateral solution. In sum, it is the big change in the composition of the creditors of the developing economies that has occurred since the Global Financial Crisis, which has rendered the pre-existing Paris Club ineffective. New international cooperation is required in order to make progress toward a solution.

Recognizing that the Paris Club was no longer the appropriate venue, the G20 created the Common Framework for Debt Treatment. The Common Framework so far has been notable for its sluggish progress, not to be more critical than that. This is an issue that is a litmus test for the outlook for global policy cooperation. In other words, the G20's Common Framework must be made to work. For sure, compromises will have to be reached in order to make it work. Regardless of the specifics — for those worried about global inequality, and for those concerned about the unraveling of global governance — there needs to be a solution to the current impasse.

Thanks. I have talked too long.

Jean-Claude Trichet

Thank you very much, John. You are confident but with a lot of nuances, if I understand correctly.