Weekly Commentary 12 – Mar 2023

The paths of evolution of the banking crisis…

Is the banking crisis over? All the authorities say it is. But given what has happened in the last few days, it is possible to argue it has not. Let us examine it to see if a case can be made for it to be declared it's over, or to argue that it's got a long way to go.

There is indeed a case to be optimistic. The US Federal Reserve continued to increase interest rates in the last week, after the three banks in the US went under. The positive way to read this event is that the US government is quite sure that if it went ahead to raise rates, the adverse impact of this move would not trigger a continued run on banks.

Biden was out in front to take credit. According to CNN, he said his administration has done a "pretty damn good job" working to resolve the banking crisis and said he thought it will "take a little while for things to just calm down." Of course, he would say that. But did he admit to pumping the economy with so much money during the New Monetary Theory fiscal expansion that the excess money went into the banking system forcing banks to deal with hugely expanded liabilities which required unplanned and aggressive asset expansion? Did he also admit to causing the 40-year record inflation that followed the huge expansion of the money supply, and his foreign policies that disrupted global supply chains and which led to bonds going into a collapse which blew a hole in the banks' balance sheets.

Of course he didn't.

In fact, he even said, as reported by the same pro-Administration CNN report, "I don't see anything on the horizon that's about to explode but I do understand there's an unease about this and these midsize banks have to be able to survive and I think they'll be able to do that" citing the policy that the Federal Deposit Insurance Corporation will use the power it has to "guarantee those loans above $250K like they did already."

That's Biden, without even giving a passing nod to the moral hazard issues that his Administration will face when more banks come under pressure. This is the same type of empty promise given to the Ukrainians that they will get support "as long as it takes". As it turns out, NATO has run out of supplies to provide to Kyiv, and those poor fellas on the frontline are facing an ammo shortage as the Russians prove to be far better equipped. This is the nature of Biden's presidency, marked by overestimation of his own capabilities and ultimately an inability to keep to its promises.

And that's the optimistic interpretation of the banking events.

If Biden is wrong, then more banks will fail. In his promise, Biden did not say that the government will save the banks. They will only save the depositors. As we have already seen in the case of Credit Suisse, the banks can still go under even if the depositors are kept whole. It would just be a limited form of bailout, and not in the way which happened after the 2008 crisis when the banks were saved by zero interest rates, allowing them to rebuild their balance sheets.

In my humble opinion, there is still a lot more work to be done, for the current banking crisis not to worsen to the extent that happened between 2008-2012. I am not the only one who thinks so. Here is an article in USA Today:

SVB, Signature Bank collapse puts Joe Biden's leadership to the test

WASHINGTON – President Joe Biden knew earlier this month that he needed to project command and confidence as he prepared to deal with a brewing banking crisis that would rattle financial markets.

He had learned that lesson the hard way a decade and a half ago, during the nation's worst financial crisis since the Great Depression.

Just days after he became vice president in 2009, amid a financial crisis that had started the previous year, Biden mused that even if the new administration did everything right, "there's still a 30% chance we're going to get it wrong." The comment did little to bolster economic confidence, and Biden's boss, President Barack Obama, had to fix the blunder by clarifying that the then-vice president had not meant to cast doubt on the wisdom of the administration's rescue plan.

In today's crisis, Biden seems intent on avoiding any ambiguity. He has sought to reassure financial markets, make sure banking customers have access to their money and, just as important, try to convince the public that government intervention to rescue the failing banks is not a bailout.

"Americans can have confidence that the banking system is safe – your deposits will be there when you need them," Biden said from the White House Roosevelt Room as he outlined steps his administration would take to quell the crisis.

"No losses," he added, "will be borne by the taxpayers."

Whether Biden's getting it right this time remains to be seen.

Biden's handling of the economy has been his biggest test as president and is what he'll be judged on most if he runs for reelection as expected.

A new poll illustrates what he's up against. Less than one-third of the public approve of Biden's handling of the economy, according to an Associated Press-NORC Center for Public Affairs Research poll released Thursday that showed his overall approval rating close to the lowest point of his presidency. Even among Democrats, there's a 13-percentage-point gap in how Biden is viewed overall versus his economic stewardship.

The poll was taken after the failure of two regional banks – Silicon Valley Bank and Signature Bank – this month. The threat that the failures could spread to other financial institutions convinced Biden of the need to step in. The Federal Reserve, the Treasury Department and the Federal Deposit Insurance Corporation took the extraordinary step last week of guaranteeing the deposits at the banks after regulators closed both.

And while Treasury Secretary Janet Yellen said Tuesday that the "situation is stabilizing," the administration is not out of the woods.

The banking meltdown complicated the Federal Reserve's efforts to tame inflation by raising interest rates, and stocks fell Thursday after Fed Chair Jerome Powell refused to commit or hint at rate cuts later this year.

Still, Powell and the White House said the U.S. can get inflation back to acceptable levels while avoiding a recession.

"We do not see a recession or a pre-recession," White House press secretary Karine Jean-Pierre said Wednesday. "We see a strong economy."

Yellen calls banking system `sound' but says U.S. could aid other small banks if needed amid SVB crisis

Memories of 2008 financial collapse

For many, the collapse of the Silicon Valley Bank and Signature Bank revived painful memories of the financial collapse of 2008. Biden and members of his inner circle were well aware of the comparisons as they huddled in the Oval Office on Friday, March 10, to consider their options.

Yet Biden and his team felt that what was happening this time was vastly different from 2008. Senior banking executives responsible for the banks' difficulties would be fired. This time, the government intervention would not involve taxpayer dollars but would instead rely on bank premiums and interest earned on funds invested in U.S. government obligations.

Over the next 48 hours, Biden's team worked behind the scenes to analyze the latest data they were getting and to figure out a course of action. Biden spoke multiple times with Yellen. He talked with California Gov. Gavin Newsom about the collapse of Silicon Valley and its impact.

Among the administration's chief concerns was stopping widespread panic if people with deposits at those two banks were unable to access them on Monday morning, sparking fears of a run on other banks if depositors rushed to cash out their accounts, a senior White House official who spoke on the condition of anonymity told USA TODAY.

"This idea that if you put money in the bank that you should have access to that, that was really important to him," the White House official said, referring to Biden's approach to handling the crisis.

One of the possibilities discussed was that another financial institution might step in and buy Silicon Valley Bank. When that failed to materialize, regulators knew that a public announcement by the president would be needed about the steps to be taken to stabilize the financial system and avoid wider panic.

It's not clear whether Biden can avoid the taint of being accused of bailing out banks. Biden takes pride in the role he played in the Obama administration in – as he wrote in his memoir – "shaping and executing the plan that helped President Obama take the country from crisis to recovery."

But he also got a firsthand look at the political unpopularity of the government purchasing failing assets of big banks and other financial institutions ahead of the Great Recession.

"It seems his communications are greatly informed by that experience," said Steven Kelly, an expert on financial crisis management at Yale University's program on financial stability. "He was quick to underline that this is not a bailout. Stockholders are being penalized. This is really about protecting the average depositor."

'We've got to act with speed'

Notwithstanding Biden's response, criticism has come from both the left and the right.

South Carolina Sen. Tim Scott, the top Republican on the Senate banking committee, who is considering a presidential bid, told Fox News the decision to insure all deposits at SVB is "the greatest form of corporate cronyism that we've seen in a very long time."

Vermont Sen. Bernie Sanders, who had accused Biden at a presidential campaign event in 2020 of having bailed out "crooks on Wall Street," warned about "more socialism for the rich."

California Rep. Ro Khanna, a leading progressive Democrat whose district is in the heart of Silicon Valley, said it's important for Biden to keep pushing to hold executives of the failed banks accountable and for stronger regulation.

"But I think he will do those things," Khanna said, and will "come out looking well because he took the decisive action and showed leadership in the timeframe that was necessary."

Khanna had urged the administration to act quickly, both publicly calling out Yellen on CBS' "Face the Nation" and privately buttonholing Steve Ricchetti, a top Biden adviser, at the annual white-tie Gridiron Dinner attended by politicians and journalists held the weekend the administration was weighing its options.

"I understood, because I represent Silicon Valley, how fast the situation was unfolding," Khanna told USA TODAY. "I understood how many small businesses were being pressured to move their deposits."

Khanna had been frustrated with his conversations with FDIC officials who he thought were "hiding behind bureaucratic language." And he wanted to impress on the White House the importance of not just insuring every deposit at SVB but announcing that decision before the markets opened on Monday.

"Steve Ricchetti got it," Khanna said. "He said: `Well, I understand. I get we've got to act with speed.'"

Speed was particularly important, according to Kelly, the Yale expert on financial crisis management, because changes put in place after the 2008 financial crisis limited the ability of the executive branch, the Federal Reserve and the FDIC to keep a crisis at bay.

"It's incredibly important that they don't let a fire burn for too long before they respond to it," Kelly said. "They did the right thing from a risk management play of looking at the risks that were out there and saying, `OK, while this bank might not be the biggest bank, it might not be super-systemic, we don't have the tools we need if it dominoes to the next big bank.'"

Campaign contributions: *Biden, Democratic National Committee will return political donations from Silicon Valley Bank executives*

But Aaron Klein, who worked on financial regulatory reform at the Treasury Department during the Obama administration, believes it wasn't the right decision to protect all SVB depositors.

"The government isn't here to bail out wealthy venture capitalists who put tens of millions of dollars in a troubled bank," he said.

Klein doesn't fault Biden for that, pointing the finger instead at the independent Federal Reserve, which, he said, failed to properly supervise SVB.

Blaming Biden, Klein said, would be like asking what the paramedics could have done differently to help a heart attack victim after his cardiologist had prescribed a McDonald's diet.

And Klein gives Biden credit for wanting to hold bank executives accountable.

Congress reacts: *In wake of SVB collapse, lawmakers float raising FDIC deposit insurance cap of $250,000*

Hearings the House and Senate will convene next week will illuminate whether the administration deserves any blame, said Doug Heye, a Republican political strategist who worked in Congress and in the George W. Bush administration.

"What did this administration do right or wrong? Was it just this administration, or were there mistakes that were made by the previous administration, warning signs that were missed or ignored?" Heye said.

Whether the crisis becomes front of mind for voters will depend on how deep the problems are and how long they persist.

"We just need to wait and see," Heye said, "how all of these issues surrounding banking play themselves out over the coming not just weeks but months."

Maureen Groppe and Michael Collins cover the White House. Follow Groppe on Twitter @mgroppe and Collins @mcollinsNEWS.

But while guaranteeing all depositors will be an effective solution to the problem of a run on the banks, as I said in my blog last week, it is not the end of all problems. The run on deposits has been contained. That's true. But there is still the problem of the gaping hole between asset values and liability values on the balance sheets of the medium sized banks in the country. And more importantly, even the contagion of fear, rather than the contagion of failure (not exactly the same thing), will lead to a slowdown in economic activity as we can see below:

How the Banking Crisis could ripple through the economy

By Courtney Brown 25 Mar 2023, Axios.com

The U.S. banking system appears to be stabilized, for now, following extraordinary government actions to head off an all-out disaster after Silicon Valley Bank's failure.

Yes, but: *Wall Street economists and the Fed increasingly expect fallout from that collapse to linger in the months ahead, as regional and community banks ease up on lending activity.*

Why it matters: *The economy runs on credit and loans. Should that activity slow or grind to a halt, there would be domino effects for hiring, spending and more — particularly if banks that are the most active lenders to small and midsize businesses are forced to retrench.*

The backdrop: *Before the banking turmoil in recent weeks got underway, banks were already tightening up on lending.*

- *A quarterly survey of loan officers by the Fed showed that a net 40% reported tighter standards for loans to businesses in the final quarter of last year. Excluding the onset of the pandemic, that's the highest share to say so since 2009.*

The big picture: *Banks face the risk of a two-pronged problem. Unfortunately, those are assets and liabilities.*

- *That is to say, credit conditions could tighten as people pull bank deposits (which are liabilities) and because of further losses on loans and securities (assets).*

State of play: *Total bank deposits have been falling for nearly a year — to $17.6 trillion last week from $18.1 trillion last April — as Americans shift money out of bank accounts that pay little interest to higher-yielding savings vehicles, like Treasury bills and money market mutual funds.*

- *If that accelerates due to fears for deposit safety, it would cause affected banks to shrink the asset side of their balance sheet, mostly by making fewer loans.*
- *A shift away from smaller banks toward bigger ones leaves overall numbers steady, but would still restrict the availability of credit for the kinds of smaller business and real estate investors that rely on community banks.*

What they're saying: *"Banks might basically say, 'we can't make as many loans' because they fear they won't be liquid enough to pay out the deposits," says Kathy Bostjancic, chief economist at Nationwide.*

- *Banks might also worry that after the banking crisis, regulators and supervisors may scrutinize them even more closely, making them more wary of expanding their balance sheets.*

Between the lines: *Businesses would have a more difficult time accessing the cash necessary to hire more workers or spend on new equipment needed to expand the business. Consumers, too, might have a more difficult time getting a loan.*

- *On a large enough scale, that would ripple out to the labor market and consumer demand, and in turn may help cool price gains.*

The bottom line: *No one knows, however, how big of a credit crunch is ahead and to what extent it will crimp economic activity.*

- *Economists at Goldman Sachs say that tighter lending would result in a drag of as much as a half-percentage point on U.S. growth over his year.*
- *But economists there warn the drag could be greater, "particularly in the event of further bank failures, significant regulatory changes, or continued deposit outflows that increase the sensitivity of lending to bank capital."*

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Alright…seems like we are dealing with too much information, too much analysis here…

Let's summarise the above as follows:

1) There is still a problem, but not the one of depositors pulling out of smaller banks or what is known as the classic bank run. That has been solved, but with the US government taking on the moral hazard of guaranteeing all deposits, it will create new problems in the future when another badly run bank keels;
2) Even as of today, the need to nip the contagion of fear will lead to the new problem of tightening credit conditions as discussed above by Courtney Brown in the Axios article, which should have a dampening effect on the economy.
3) The shrinking of the asset side for these banks will imply a shrinking demand for US Treasury bonds, which in the face of declining Treasuries demand everywhere due to de-dollarization, will lead to increasing difficulty to fund the budget deficit.
4) The inflation problem cannot be solved unless Problem 2 gets so bad that the entire economy tanks. But that way of solving inflation is called a hard landing.

These are all serious problems that need to be solved but won't be in the current circumstances.

And the above is just the optimistic outlook.

What is the pessimistic outlook? That's when the guarantee to bail out the depositors don't save the banks, ie exactly what happened at Credit Suisse.

We can all remember that when the Swiss regulators tried to save Credit Suisse, they also extended them a 50 billion SFR line of credit. If that could save Credit Suisse, it would. But it didn't. The slide continued, not because depositors pulled out but because shareholders did. The biggest investor in CS, which was the Saudi National Bank, said "absolutely not" to the question of whether it would invest further to replenish the bank's capital and it emphatically denied any plans to do that. So that's the other way American banks can go under. In case you haven't got it, here are the two ways a bank can go bankrupt :

1) The bank loses all its deposits. like in the case of SVB; or
2) The bank loses all its capital, like in the case of CS.

In a bank run, it is the first that occurs when the bank loses all its liabilities. In the failure of CS, it is the latter which caused it to fail so that the regulators had to merge a sound bank to the failing bank. This is also what I call the Japanese bank problem which is when the bank loses all its assets, through bad loans and lousy investments and the bank cannot exist anymore.

In all that Biden and his administration's officials including Janet Yellen have done, he has only given the assurance that they will assure depositors to not worry about getting their deposits back. Indeed, that is a bigger problem to solve. The amount of deposits is likely to be many times (probably in excess of 20 times) the amount of capital which a bank has. So yes, it is critical to solve the bigger problem immediately. But if the smaller amount, ie the capital, is also lost, the bank cannot function either. We have seen how CS disappeared in one single day. If we are kind, we can say that this (loss of capital) will not happen to banks in the US in the next two years, but it does not rule out the possibility that the banking system can fail over a period of some twenty years, as we have seen in the Japanese debacle during the period of 1990 – 2012. The two problems are completely different and solving one does not necessarily solve the other.

In my previous commentaries, I had agreed that the tools used by the US authorities would be effective to solve the no-confidence deposit flight problem. I was right. But the same tools did not work in Switzerland. Those were good tools that were applied to the CS problem and yet the bank went down.

That's why I have not said that I have confidence that the US government can solve the second problem of banks losing their capital as the economy weakens in the months ahead.

What exactly do I mean?

Let's face it. J Powell has been so obsessed that he wants to own the legacy of being Volcker 2 as resolute inflation fighter that in the face of the still shaky banks, he continued to push ahead with another ¼ point rate hike and refusing to say when this will stop. Unless he brings the interest rate regime to zero, as the previous Chairman of the Fed, Ben Bernanke, did in the years following 2008, the lack of capital problem is not over. When it is time to follow in the footsteps of Bernanke, Powell sticks to following Volcker. I think this is a grievous misjudgement of the economic situation. He cites that employment is still strong, but I don't know if he needs to change his spectacles in reading the data because the unemployment in the tech and banking sectors have been bad for some months now and are obviously going to get worse with the collapse of SVB. Can the past interest rate hikes and the new ones cause the two best sectors of the US economy to weaken further and threaten the entire economy? I would put it at even chance.

The worst scenario in my mind is therefore the enactment of the Japanese problem in America, updated thirty years. When it happened, Japan was riding the crest of economic prosperity with the Nikkei reaching 40,000, and a handkerchief dropped on a Ginza payment would cover $20,000 worth of real estate value (yes, I heard that analogy way back then). Who would have thought that when the Japanese economy reacted to interest rate hikes brought about by the Bank of Japan in 1990, the economy would slump for 20 years, and in that period, brought down ten of the largest banks in the world, and left only three no-longer-the-largest banks still standing. Worse still, the deflation that consumed Japan led to 9 years of Abenomics, a program launched by Prime Minister Abe aimed at ending the deflation which continued for nearly 20 years, focusing on massive monetary stimulus to build up self-sustaining expectations of moderate inflation. Abenomics was expected to be a turning point.

Has Abenomics worked? Not really, when you deflate a malicious balloon, it will probably go limp forever and land in the sea…It might have been better to just let the innocent balloon float away. The Japanese economy is still struggling at a growth rate of 1-2 percent.

Here is an analysis of why the Japanese economy has now experienced thirty years of inadequate growth:

Abenomics: The Reasons It Fell Short as Economic Policy

By Kaya Keiichi, published in NIPPON, Jan 19 2022

Abenomics, the policy approach rolled out by Abe Shinzo and continued by Suga Yoshida, is on the way out with Kishida Fumio's advocation of a "new capitalism." A look at what Abenomics involved, its effects on Japan's economy, and the question of whether Abe achieved his intended objectivs.

The Meaning of the Three Arrows

The administration of Prime Minister Kishida Fumio advocates a "new form of capitalism" that prioritizes income redistribution. Even as he was running for the presidency of the Liberal Democratic Party, Kishida called for a transition from the neoliberal polices that have continued since the reforms carried out by the 2001–6 administration of Koizumi Jun'ichirō, making it clear that he intends to draw a line with the economic policies of his two predecessors, Abe Shinzō (2012–20) and Suga Yoshihide (2020–21). To properly evaluate Kishida's new capitalism, we must first clarify what economic policies Abenomics consisted of.

Opinion is divided about Abenomics, the key policies in the economic realm of the Abe administration. These underwent major changes during the Abe years, and they were not consistent from beginning to end. Despite these shifts, they retained the label of Abenomics, making a consistent evaluation difficult.

At the start of his new administration in 2012, Prime Minister Abe announced economic polices featuring three policy "arrows." The first arrow in the quiver, aggressive monetary policy, would have the Bank of Japan implement quantitative easing. The second arrow, a flexible fiscal approach, anticipated massive public works spending. The third arrow was a strategy aiming for sustainable growth.

The BOJ's quantitative easing policy, which it continues to implement, is the injection of vast amounts of liquidity into the economy through aggressive purchases of Japanese government bonds. The aim is to instill expectations that prices will rise among market participants. Should these inflationary expectations strengthen, the real interest rate (the nominal interest rate minus the expected rate of inflation) will theoretically decline; the hope was that higher capital spending would follow in turn. Deflation and low interest rates have persisted for many years in Japan, and there is little room for reducing the nominal interest rate further. For this reason, quantitative easing was seen as a way to lower the real interest rate by way of higher prices.

There is no guarantee, however, that prospects for higher prices will be sufficient to place the economy on a growth path. Prime Minister Abe believed that a fundamental overhaul of Japan's economic system was needed to achieve sustainable growth. Policies for achieving this aim were growth strategies, the third arrow of Abenomics.

Abe, picked by Prime Minister Koizumi Jun'ichirō as a promising future leader, strongly supported the structural reforms advocated by Koizumi. Hence, Abenomics at the onset assumed that the reform of Japan's rigid economic system would drive economic growth.

Structural reforms, however, will be accompanied by considerable pain as workers are forced to change occupations and as subsidies are terminated. Since the results of these reforms will not materialize immediately, fiscal expenditures, the second arrow of Abenomics, were needed to fill the gap as mitigation measures.

To summarize, Abenomics at the onset aimed to surmount deflation through monetary policies, to support the economy through fiscal expenditures for the time being, and to implement painful structural reforms at the same time to return the economy to a growth path.

In other words, quantitative easing and fiscal expenditures were meant to be temporary measures, and structural reforms were positioned as the core policy for achieving economic growth—at least, that is thought to be Abe's initial thinking. Whatever people's views about this policy package, they had to admit it had a logical basis for achieving sustained growth.

Structural Reforms Disappear

Following the start of the Abe administration, the content of Abenomics underwent gradual changes. The greatest change was the disappearance of structural reforms, which at one time were meant to be the core of the policy package. While repeatedly promoting these reforms at first, Prime Minister Abe eventually stopped mentioning the phrase, perhaps out of concern for his approval rating. What came to be presented as structural reforms were various subsidies and support for companies. Although such measures were important, they were no longer measures for achieving a fundamental overhaul of the economy.

The three policy arrows were designed as the premise for painful measures to achieve structural reforms. Should structural reforms disappear, quantitative easing and fiscal expenditures lose their purpose. In the case of fiscal expenditures, with budgetary constraints an ongoing problem for the government, fiscal authorities are basically reluctant to make large expenditures.

As a result, Abenomics came to depend solely on the first arrow of quantitative easing. In what we might call the latter era of Abenomics, depending on how exactly we define the policy, it became nothing more than QE. While opinion is divided about Abenomics, if we take it to be only this, there is little doubt that it fell short as economic policy.

When Abenomics was first implemented, inflationary expectations materialized in foreign exchange and stock markets, which resulted in rising share prices and a depreciating yen. The consumer price index (all items), which was negative in January 2013 immediately after the start of the Abe administration, rose to 1.7% in May 2014. The index then turned negative, after which it rebounded to 1.5% in 2018. The index subsequently revisited negative territory toward the end of the Abe administration, influenced in part by the COVID-19 pandemic.

Viewed from the discipline of economics, Abenomics can be said to have been effective in generating inflationary expectations in the market and in reducing the real interest rate. Economic policies, however, are meaningless if they do not change the real economy. There is no avoiding the conclusion that the policy to surmount deflation was never realistic and ended in failure.

Dismal GDP Growth

During the years of the Abe administration, real GDP growth averaged only 0.9% (2020 is excluded because of the COVID-19 pandemic). Corresponding figures were 1.0% for the 2001–6 Koizumi administration, 1.5% for the 2009–12 period when the Democratic Party of Japan was in power, and 0.9%, when Prime Ministers Hashimoto Ryūtarō (1996–98) and Obuchi Keizō (1998–2000) were engaged in massive public works spending. And not only does the Abe administration rank the lowest in GDP growth (annualized rate based on quarterly real GDP), personal consumption also recorded negative growth during the Abe years.

Some commentators maintain that Abenomics can be commended for reducing the unemployment rate and for increasing exports. The unemployment rate, however, simply held to its low level without joblessness becoming a social issue. While exports rose in value, they increased very little in volume, and it is plain to see that the growth of exports merely reflected the depreciation of the yen.

Since structural reforms were abandoned early on, it cannot be said that Abenomics contributed to dramatic changes in the export competitiveness of Japanese companies. Low wages are considered a

problem in Japan, which means that citing the unemployment rate and exports as achievements of Abenomics misses the mark.

Objectively speaking, the unavoidable conclusion is that Abenomics failed. In reaching this conclusion, however, it is not the author's intention to deliberately denigrate Abenomics. While Abenomics may rank last in numerical terms, GDP growth was low for all administrations under consideration. In all cases, sufficient growth was not achieved, a reality that deserves a closer look in terms of the study of economics.

The policies of the Hashimoto and Obuchi administrations can be understood as classically Keynesian, since they centered on massive public works spending. Quantitative easing, the one lasting portion of Abenomics, is plainly monetary policy. While it is difficult to identify a clear economic theory behind the structural reforms of the Koizumi administration, it is possible to classify them together with the supply-side economic policies adopted by the United States in the 1980s.

Setting aside the period of DPJ rule, which featured no prominent economic policies, successive administrations have implemented economic policies straight out of economics textbooks: Keynesian policies that work through demand, supply-side policies that strengthen the supply side, and monetary policies. What does it mean that none of these were able to place Japan's economy on a growth path?

The Root Problem: Consumer Uncertainty

When Abenomics began to be implemented, many economic analysts argued that monetary policies would not be effective unless Japan's rigid economic system were changed. These voices were disregarded as they were overshadowed by the enthusiastic support gathered by Abenomics. Their criticism similarly applies to public works spending. Although the massive outlays of the Hashimoto and Obuchi administrations led to a surge in government debt, the multiplier effect was insignificant.

The multiplier effect is commonly used to examine the effectiveness of fiscal expenditures. Theoretically, this effect is dependent on the propensity to consume. When many citizens are hesitant to consume, the effect of fiscal expenditures becomes vanishingly small. The huge uncertainties of Japanese consumers are restricting the growth of consumption, and it is highly probable that this situation is limiting the effectiveness of economic policies. The same can be said for the expectation that monetary policies would enable the growth of capital spending.

Keynesian economics assumes that people spend a certain portion of their income. Keynes also believed that consumption was strongly influenced by subjective factors. In his General Theory of Employment, Interest, and Money, he argued that people would refrain from spending income depending on the relationship between expected future income and needs. In other words, economic policies will not be fully effective unless the current weakness of consumer sentiment is replaced with confidence.

There can be no doubt that pensions, healthcare, and other social security issues are at the root of the uncertainties plaguing Japanese society. These uncertainties will not be eliminated without systemic reforms. What the administrations under consideration have in common is their failure to undertake the fundamental reform of the social security system. This, I believe, is the main reason for the stagnation of Japan's economy.

(Originally published in Japanese.)

So what's my point here?

Here are my updated thoughts on the banking crisis and the directions over which it may evolve:

Saving depositors do not necessarily solve all the problems. The solutions that the Biden Administration has pronounced deal with a single aspect of the crisis. That is the problem of bank runs. Yes, I don't doubt they have solved this problem. But there are many other problems to solve, including the survivability of the banks from losses due to declining capital arising from bad loans in a lousy economy. That was the problem of the lost decades in Japan which eventually shrunk the banking sector significantly and is continuing to drag on the economy.

If the US also enters into two decades on pathetic growth, as the high interest rates that are still being relied upon by the Fed Reserve to shrink inflation will do, then the policy options available to new people in future Administrations will be very limited. If deflation latches on to the US economy, then economic behaviour may end up like in Japan. Inflation like the Chinese meteorological balloon, once brought down cannot rise again. Japan was, and is still exactly like that. From the massive asset inflation suffered in the 1980s when stock and property prices were in the stratosphere, after that was collapsed, the economy went the other way and suffered decades of deflation which hindered growth.

And Japan is different from America. Japan is a high savings economy and even in its deflation, the standard of living was not low. People just spent savings. In America, that will not happen. Most families have negative savings, ie they owe money everywhere – student loans, mortgages, credit cards. Too many small businesses rely on loans. If the inflation ends and the economic buoyancy is deflated, the ability to spend spirals downwards very quickly and the economy will slow much faster than Japan did. The banks will not fail from the bank run problem. They will be impacted by the slowing loan activity, bad loans and inevitably some will fail. This will compound the weakening economy and lead to a period of slow or no growth in the US economy. We don't want to get there.

As such, my fear about the banking crisis is not another SVB. Nor even a CS. I am thinking we may get a slow drawn-out death like we saw in Japan between 1990 and 2010. But rolling out faster than it did in Japan due to the lack of savings to cushion the fall.

If that happens, the global economic and geopolitical implications will be staggering.

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Un-Influencer in a World full of Hubris