Takahashi’s Lament: Europe’s Rush For The Helicopter (14/02/20)

[A quick reminder to those who think it is time to understand the tangle of politics, psychology and sociology that is financial history - The Practical History of Financial Markets Course will be run in London from March 5th to 7th. Practitioners with almost 200 years of practical experience will explain the key causes of the mean reversion of equity valuation, and much more, through the use of historical data and examples. Anyone seeking further information can visit didaskoeducation.org or email Russell Napier at: russell@sifeco.org]

As it will be in the future, it was at the birth of Man
There are only four things certain since Social Progress began:
That the Dog returns to his Vomit and the Sow returns to her Mire, And the burnt Fool's bandaged finger goes warbling back to the Fire;

And that after this is accomplished, and the brave new world begins
When all men are paid for existing and no man must pay for his sins, As surely as Water will wet us, as surely as Fire will burn, The Gods of the Copybook Headings with terror and slaughter return!

Rudyard Kipling - The Gods of the Copybook Headings

Helicopter money is coming and it is coming in Europe. The sooner it comes, the sooner European equity prices go up - led by banks. The later it comes, the more likely it is that it’s only being administered in the teeth of a crisis that will have considerably reduced European equity prices - led by banks. Despite a dramatic volte face by the ECB this week, bringing forward its monetary policy review conclusion to as early as this summer, your analyst continues to believe that it is to be crisis first and helicopter money second.

A move to helicopter money in the Eurozone changes the world. It is not just investors in euro-denominated assets that will be profoundly impacted by helicopter money when it comes. The timing for helicopter money in Europe has profound implications for global investors due to the likely extreme impact it will have on the euro exchange rate. If the first casualty of war is the truth, then history shows that the exchange rate is the first casualty of helicopter money. In a world of fractious trade relations a major decline in the euro exchange rate would not be greeted with equanimity by other global policy makers.

As it was in the 1930s so it might be again, with tariffs the retaliation for exchange rate depreciation. Also, in a world of an ever weaker euro, and thus an ever stronger USD, world growth and emerging market economic growth in particular would be under further pressure. Whether the ECB recognizes or accepts the exchange rate consequences and the global growth consequences of their resort to helicopter money, they will set the rotors in motion anyway. Theirs is a greater goal - the completion of the European project - than global economic stability, and it is their destiny to pursue it no matter the consequences.

Subscribers will know of the great structural schism at the heart of the Eurozone which will tear the euro apart unless debts in France can be inflated away (see When Debt Matters: Where to Expect Credit Crises in the Next Recession Q3 2019). For Eurozone policymakers the economic, social and political stakes have never been higher given the scale of France’s, and thus Europe’s, problem. In pursuit of the structural goal of finishing the European project, and given the potential pain of strategic failure, it will ultimately be no big deal to launch the helicopter. Why the timing of the helicopter launch is nearing, and the dire consequences for savers of that launch, will be the topic of the rest of this newsletter. Why helicopter money rapidly accelerates the move to financial repression in Europe, with the decay of the real purchasing power of savings, is where this sad tale of first political compunction and now political compulsion will end.
Dire economic data continues to issue from the Eurozone and this even before the impact of the new coronavirus had impacted economic activity. At the same time the urgent review into monetary policy launched by Christine Lagarde is being brought forward. An ECB announcement as recently as January 23rd announced that the review was ‘expected to be concluded by the end of 2020’. On February 11th, just twenty days later, there was a change of heart with ‘euro-area officials’ briefing Bloomberg that the project would be concluded ‘by the summer’.

The European Central Bank has set out an ambitious timetable for its strategic review that could see a decision on whether to change its inflation goal by the summer, according to euro-area officials.

Speaking on condition of anonymity, because the process is confidential, the officials described a rushed agenda under President Christine Lagarde, who reached her 100th day in the job over the weekend. Staff have started work despite some workstreams not yet getting formal approval by the Governing Council.

Bloomberg February 11th 2020

Something has changed at the ECB and it has changed quickly. Perhaps the recent poor economic data and the likely considerable negative impact from the new coronavirus are focusing minds in an organisation that has already reduced interest rates to below zero. If there is to be a new target, to justify a new policy, then it might need to be in place much more quickly than the ECB had earlier envisaged.

There is of course something else that could have recently focused minds at the ECB: the resignation as leader of the CDU of Annegret Kramp-Karrenbauer (aka AKK). The fall of Mrs Merkel’s hand-picked successor as head of the party opens up the prospect that a more right-wing candidate, Friedrich Merz being the most likely candidate, could win the leadership role of the party. While Mr Merz is no euro-sceptic, he would see the future for the CDU to the right of Mrs Merkel’s CDU and thus would have greater regard for the plight of the German saver. Helicopter money’s key aim is to inflate away debts and thus, in the process, to inflate away the purchasing power of savings. Germans in particular have reason to understand the consequences of such a policy, and also how controlling the monetary helicopter by politicians is not just as easy as the manual suggests. In a crisis, of course, any opposition from Mr Merz to helicopter money would very likely crumble, but crucially for investors his ascendancy could considerably delay the ECB’s move to endorse an inflation target that justifies Lagarde’s suggested monetary extremism.

While the ECB speeds up its rush to adopt a new inflation target in Germany, the Chancellor seeks to slow down the appointment of a new head of the CDU. Mrs Merkel is keen to postpone any decision on who will be the new leader of the party until the end of the year. However, the CSU, her key coalition partner, has already come out against such a long postponement. The CSU want a say in who will run the CDU and they want a new leader before Germany takes over the European Union Presidency in the second half of 2020. While Mrs Merkel will likely try hard to prevent the accession of Friedrich Merz to head of the CDU, the race is on at the ECB to make sure that the new monetary policy targets can be agreed before any move to the right in German politics can stymie the proposed monetary revolution.

The Solid Ground believes, based upon Christine Lagarde’s confirmation hearing before the European Parliament (see European Savers Beware: The Knitting is on The Wall, 24 September 2019), that the new head of the ECB is clearly in favour of using helicopter money to reach the new inflation targets she now seeks. For the avoidance of doubt, modern helicopter money is likely to come in the form defined by Ben Bernanke in his famous speech in November 2002:

A money-financed tax cut is essentially equivalent to Milton Friedman’s famous ‘helicopter drop’ of money.

Whether a money-financed tax cut or a money-financed government spend, the modern helicopter money takes the form of the central bank creating new money and crediting it to the government. Lagarde’s monetary policy review is aimed at creating a new inflation target that would justify resorting to such a policy to attain the new goals. Agreeing a higher inflation target or a ‘make up’ strategy, in which previous shortfalls in inflation below target are added to future inflation targets, will go a long way to justifying a move to helicopter money. There may be other more radical new targets for inflation. As The Solid Ground has argued before, the money-financed government spend is likely to be focused on green investment initiatives. All pills, particularly political ones, are best sugar-coated. Few know this better than the arch politician now running the ECB.

Not surprisingly, such a radical policy is likely to meet with considerable resistance in Germany and the other so-called ‘frugal’ states of the Eurozone. That resistance will ultimately crumble but how long will it last? For your analyst the question is not if helicopter money will be launched in the Eurozone but when. Can it be implemented proactively, as part of a response to the continued failure to meet inflation targets, or will it need a crisis in the Eurozone to get all nineteen governments to agree to the radical new steps that Christine Lagarde put before the European Parliament in September 2019? Financial markets have begun to bet that a proactive move to helicopter money is now possible.

The Eurostoxx Banks index bottomed very soon after Lagarde’s comments to the European Parliament and the euro exchange rate has just moved below its September 2019 low. The share prices of the most troubled banks have seen the greatest recovery, with Deutsche Bank’s share price rising almost 70% from its low of August 2019. Helicopter money virtually removes the short-term risk of bankruptcy for highly-gereared institutions and few are more highly-gereared than commercial banks. There are good reasons why equity prices might rise sharply when helicopter money arrives.

‘From March to August of 1921, the Frankfurter Zeitung stock average increased 40%. Indeed the Berlin Stock Exchange suspended trading in early September 1921 as speculation was producing volumes its members could not handle. On 9 September 1921 the WSJ suggested the decline in the value of the market was producing the bull-run.’

‘Early in July paper marks began to show such a tendency toward depreciation that the investing classes in Germany took alarm and there was a mad rush to invest their paper in industrial and other securities before currency dropped further.’

Russell Napier, Anatomy of The Bear: Lessons From Wall Street’s Four Great Bottoms

[To be discussed by the author with John Authers live on Bloomberg on March 3rd]

Equities benefitted from the move to the new monetary policy in local currency terms, but not ultimately in foreign currency terms. The euro is very unlikely to decline at the same pace as the paper mark, but investors tread a dangerous line in trying to secure hard currency returns in euro-denominated equities in such a scenario. In the 1921 Wall Street Journal letters to the editor praised the reflationary policy pursued in Germany and compared it unfavourably to the deflationary recession then under way in the United States. The seeming initial success, based primarily on a scale of exchange rate devaluation unlikely to be tolerated today, led, within two years, to economic ruin and not prosperity. Traders may well be able to secure decent hard currency returns in European equities when the helicopter launches but investors are likely to find it much more difficult.

In the opinion of this analyst it is too early anyway to bet on the whirr of the monetary rotor blades as an economic crisis becomes ever more likely in the Eurozone. Even if one is prepared to ride out the initial economic storm, there is a bigger problem - helicopter money leads to an acceleration in that war on savers known as financial repression.

Subscribers will be aware of the toxic smorgasbord of policy delights that awaits them under financial repression (see Capital Management in an Age of Repression 3Q 2016). Just how helicopter money
leads to the adoption of such destructive ancillary policies is clear in the go-to manual for those seeking to launch, and presumably land, the monetary helicopter - Modern Money Theory: A Primer on Macroeconomics for Sovereign Monetary Systems by L. Randall Wray. You will judge from the full title that the manual is a much broader economic manifesto than just a simple guide as to how to launch and how to land the monetary helicopter now called Modern Monetary Theory (MMT). Indeed, on the cover Stephanie Kelton, who was economic adviser to Bernie Sanders’ 2016 presidential campaign and formerly Professor of Economics at the University of Missouri-Kansas City, states ‘this book paves the way for another revolution in macroeconomics’.

The author of this revolution does spell out a few dangerous side-effects for savers, perhaps mere downdrafts, when the monetary rotors start to whirr. Let L. Randall Wray explain those downdrafts in his own words.

‘These principles also do not deny that too much spending by government would be inflationary. Further, there can be exchange rate implications.’

‘What if markets react against budget deficits, so the bond market “vigilantes” demand higher rates?….. As discussed, the central bank can set the overnight rate, plus the rate on any other financial assets it stands ready to buy and sell. It can peg the 10-year government bond rate, or the 30-year bond rate….. In the United States, policy used to set saving and demand deposit rates. (This was called Regulation Q, which imposed a zero interest rate on demand deposits…)’

‘We conclude that shifting portfolio preferences of foreign holders can indeed lead to a currency depreciation. But so long as the currency is floating, the government does not have to take further action if this happens.’

‘OK, if that happened there could be depreciation pressure on the dollar, in which case China loses since its dollar assets decline in value relative to the RMB. Fortunately, China does not want the dollar to crash.’

‘Capital controls offer an alternative method of protecting an exchange rate while pursuing domestic policy independence.’

‘Yes, Congress could have decided not to raise the debt limit. Default on commitments appeared to be quite close. There was no good economic reason to do it - but politics can lead to some crazy results.’

‘One solution for a troubled country is to leave the EMU and return to a sovereign currency issued by the government….. Default on euro-denominated debt would be necessary.’

‘In other words, there is no scientific basis for the claim that “free markets” are best. (That doesn’t “prove” it is impossible for the “invisible hand” to work - we simply do not know - but we should be highly sceptical of the possibility). In any case, these claims that free markets are best - even if true in some hypothesized economy - are irrelevant for the modern capitalist economies that actually exist.’

‘It is inherently “aspirational” in the sense that there is no endpoint as the frontiers of the public purpose will continually expand.’

‘Indeed, one could quite reasonably say that it is the budget deficit that “finances” domestic private sector saving.’

As you can see there is indeed more in heaven and earth than is dreamt of in savers’ philosophy of supply and demand - or as Donald Trump may once have said to Stephanie Kelton, “I guess we’re not in Kansas anymore”. As Randall Wray mentions in passing in his MMT manual, this is Keynes’s
“euthanasia of the rentier”. French can be so confusing, so for the avoidance of doubt that is you, dear reader - steward of savings - rentier to Mr Wray.

In general terms Mr Wray’s manual states that only government spending can create private wealth and there will be no limits on the expansion of ‘public purpose’. More specifically for savers, Mr Wray’s MMT admits to the likely need for the control of all interest rates, exchange-rate depreciation and capital controls and that is just the amuse-bouche that awaits savers from this proposed administrative banquet. Investors who might cheer the reflationary impact of helicopter money on equity prices need to realise the profound structural change it augurs for savers in the Eurozone. Helicopter money is financial repression and it is savers who pay the price for the relief of debtors. As things always sound so much less threatening in French, let’s just call it a coup de grâce for savers.

In the world of MMT, helicopter money drops while savers remain immobile or perhaps deliberately immobilised. Proponents of MMT gaze heavenwards at the beauty of the descending snow of money, seemingly unaware of the rumbling noise behind them as the accumulated years of chilled precipitation rushes upon them in an avalanche. The focus on the flow of the falling monetary snow simply ignores the scale of shift in savings' balances that this policy change has always brought. Savers will move their savings when helicopter money is dropping from the sky and the impact of such a shift in stock will almost certainly swamp the impact of the increase in the money flow.

Savers will seek to exit government securities as helicopter money seeks to destroy real returns from such investments. Savers will seek to exit local currency assets, for foreign currency assets, as they realise that the purchasing power of the local currency is being undermined as a matter of policy. As L. Randall Wray makes clear, any such shifts will ultimately have to be stopped, with savers penned into the killing zone of local currency assets and, in particular, in fixed-interest securities. In a new system where ‘public purpose will continually expand’, what room is there for the private enterprise that generate s the corporate profits that drive higher dividends and higher share prices? Given the scale of the likely decline in the euro exchange rate that follows helicopter money, what are the consequences for global policy and economic growth when the Eurozone embarks upon its new, but really rather old, monetary experiment.

Because there is nothing at all modern about Modern Monetary Theory. It has been tried many times before. It was tried by seventy-seven year old Viscount Takahashi Korekiyo who, in December 1931, was appointed to his fifth stint as finance minister of Japan. Takahashi, a policy maker with many decades of experience, may have been steeped in the orthodoxy of the gold standard but he was an old man prepared to take the risk of implementing bold new ideas. Appointed to relieve the deflationary contraction Japan faced in the Great Depression, he took the risk of launching the monetary helicopter and the central bank began to credit government accounts with newly-created money. The government spent it. In the face of a seemingly existential threat in the form of the Great Depression, it seemed like such a small step to take.

Within a year the yen had fallen 44% against sterling, a currency itself newly floating, and 60% against the US dollar, which was still linked to gold. That depreciation occurred despite the enactment of the Capital Flight Protection Act of July 1932 and the further capital controls that followed. The new lower exchange rate pushed inflation higher but it did stimulate exports and industrial activity.

‘Japanese cloth allegedly was sold in Germany at little more than half of local prices, in Norway for little more than the cost to Norwegian producers of imported yarn, in the Congo at prices 30 to 50 percent below those of Belgian competitors. For the first time Japanese electric light bulbs, machinery, rayon products and processed foodstuffs appeared in foreign markets. Industrial production recovered strongly, led by the growth of exports.’


On February 26th 1936 Takahashi was assassinated. Modern readers might think that he was murdered by savers aggrieved at their losses through a pernicious combination of the decline in the exchange
rate, rising inflation and enforced lower yields. However, Takahashi was not murdered by savers suffering from the introduction of helicopter money. He was murdered because he stopped helicopter money. Those recipients of the continually expanding ‘public purpose’, most noticeably but not exclusively the military, wanted Takahashi dead because he had landed the monetary helicopter. A policy initially disastrous for just savers, proved impossible to stop and soon it had taken flight again to finance the ‘public purpose’ of the subjugation of the peoples of Asia to Japanese rule.

In the Petri dishes of economic theorists, humanity and therefore presumably assassination are usually excluded from the experiment. Once our humanity is so excluded, experiments in flying and landing the monetary helicopter can run smoothly. In the real world the fusion of monetary and fiscal policy, as helicopter money has proved itself to be, is not just subject to the whims of humanity but the whims of that often desperate subset of humanity we call politicians. In the Eurozone these politicians are in what they see as a life and death struggle for the survival of the European project. In pursuit of such a strategic goal, the sacrifice of savers through the implementation of helicopter money and the ensuing financial repression will seem, to them, a small step to take.

There are few cards left to play in Europe for a political class that have built their lives around completing the European project. With growing opposition amongst Eurozone voters to the need to surrender further sovereign powers to EU institutions, it falls to an un-elected central banker to take the greatest gamble of all to complete the project. For this burnt finger to waggle its way back to the burning fire, it will need the agreement of nineteen governments to fuse monetary and fiscal policy. Your analyst believes that such agreement will indeed come - given the consequences for the European project should it not.

However, it is not likely to come until the crisis is upon us and both European equity prices and the euro are at considerably lower levels. Then terror and slaughter will be unleashed upon savings, and who then can really foresee the consequences when this key buffer between the citizen and uncertainty is being destroyed. No doubt the siren voices promising political certainty, with all the negative implications for liberty that entails, will be falling on even more fertile ground. Then indeed all ‘men are paid for existing’, as the proponents of MMT assert is possible, but how many will truly have lived.
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