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In this week's recap: New COVID-19 infections drive market anxieties, despite anticipated vaccines; Fed Chair Powell warns that continued infections may limit economic activity for months.

Weekly Economic Update

Presented by Edward Papier, CIMA® CFF, November 23, 2020

THE WEEK ON WALL STREET

Despite news of another COVID-19 vaccine candidate, stocks were mixed amid investor anxiety over an increase in new infections and economic lockdowns.

The Dow Jones Industrial Average fell 0.73%, while the Standard & Poor's 500 declined 0.77%. The Nasdaq Composite index rose 0.22% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, gained 1.42%.[1,2,3]

GROUNDHOG WEEK

The announcement of another potential COVID-19 vaccine ignited strong gains to begin the week. But, like the week that preceded it, the gains sparked by the vaccine news were eroded in the following days as worries over the economic impact of new infections moved to the fore.

The market has been grappling with conflicting narratives. One is the optimistic view that, with COVID-19 vaccines apparently near at-hand, the return to economic normalcy grows ever closer. That hopeful outlook has been offset by anxiety over new infections, rising hospitalizations, and some local and state lockdowns.

These crosscurrents kept stocks range bound for the week, with the technology sector and small and mid-size stocks lending support to the overall market.

POWELL SOUNDS A WARNING

In a speech last week, Federal Reserve Chairman Jerome Powell warned that the nationwide increase in COVID-19 cases could hamper economic activity in the upcoming months. He expressed concern that consumer spending may trend lower despite efforts to control the spread of infections.[4]

Powell once again voiced his support for additional fiscal stimulus to assist small businesses, state and local governments, and the unemployed. He also said that even after full economic recovery, some businesses and workers may wrestle with an economic landscape altered by the coronavirus.

THE WEEK AHEAD: KEY ECONOMIC DATA

Tuesday: Consumer Confidence.

Wednesday: Durable Goods Orders, Gross Domestic Product (GDP), Jobless Claims, Consumer Sentiment, New Home Sales.

Thursday: Jobless Claims.

QUOTE OF THE WEEK

"Reality is merely an illusion, albeit a very persistent one."

ALBERT EINSTEIN

Market Index	Close	Week	Y-T-D
DJIA	29,263.48	-0.73%	+2.54%
NASDAQ	11,854.97	+0.22%	+32.12%
MSCI-EAFE	2,026.37	+1.42%	-0.52%
S&P 500	3,557.54	-0.77%	+10.11%

	Treasury	Close	Week	Y-T-D
	10-Year Note	0.83%	-0.05%	-1.09%

Sources: The Wall Street Journal, November 20, 2020; Treasury.gov, November 20, 2020
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ

Composite Index is measured from the close of trading on Friday, November 13, to Friday, November 20, close. Weekly performance for the MSCI-EAFE is measured from Friday, November 13, open to the Thursday, November 19, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

In today's environment of ultra-low interest rates and massive monetized fiscal deficits, the dangerously naive policy prescriptions offered by Modern Monetary Theory are being realized more or less by default. Whether central banks will be able to regain control after the current crisis is an open question.

Many people are now proclaiming that the COVID-19 pandemic has provided proof positive that Modern Monetary Theory (MMT) is the only way forward for governments. To the uninitiated, MMT probably sounds extremely sophisticated – even scientific. Its representatives speak as though they have developed a new economic paradigm comparable to the Copernican Revolution in astronomy. Yet behind the sleek title and confident policy pronouncements lies a message that is as simple as it is dangerous, particularly now that governments around the world are spending freely to keep their economies afloat during the pandemic.

According to MMT, governments can spend what they want on whatever they want until full employment is achieved, and without ever having to worry about the financing, because the central bank will provide the money by simply operating the printing press at no cost to the government. Whether this contribution to economic thought even deserves to be called a new "theory" is debatable, considering the unoriginality (and banality) of its central concept.

The first publications on MMT – such as *Modern Monetary Theory: A Primer on Macroeconomics for Sovereign Monetary Systems*, by the economist L. Randall Wray – appeared several years ago. They were met with near-unanimous criticism from economists across the political spectrum. Nonetheless, the debate about MMT continues, primarily because it has been picked up by politicians like the former UK Labour Party leader Jeremy Corbyn and US Senator Bernie Sanders.

During the Democratic primaries – both in 2015-16 and 2019-20 – Sanders was advised by Stephanie Kelton, one of the best-known exponents of MMT, and the author of a new book on the topic, *The Deficit Myth: Modern Monetary Theory and the Birth of the People's Economy*. In his most recent campaign, Sanders put MMT at the center of his economic-policy program, ensuring that it would gain wider purchase on the left of the Democratic Party. Whether the next administration will adopt the theory's central idea remains to be seen.

In any case, many around the world will remain smitten by MMT, because they are convinced that it holds the key to pursuing a long list of public projects to boost employment, protect the environment, advance social justice, and so forth. The proposal for a federal job guarantee promises full employment and "good" jobs that pay a living wage for work geared toward useful public purposes.

But one wonders if MMT's adherents would still favor it if it had been embraced with similar gusto by US President Donald Trump, perhaps to pay for his promised wall on the border with Mexico. If financing government expenditures at no cost knows no limits, whoever is in power is living in the land of milk and honey. But this would be a temporary paradise, because a government spending spree inevitably would lead to high inflation, at which point the window of opportunity would close, and citizens would be left to pay the bill via rising unemployment and weaker real wage growth.

Recognizing this problem, MMT proposes that the governments increase taxes when necessary in order to remove enough money from circulation to avoid inflation. Imagine that: whereas previously there had been no financial restriction whatsoever on government spending, now suddenly there are such restrictions – and taxes must be raised to claw back the excess money that had been put into circulation! It is hard to envisage an idea of democratic politics more naive than that implied by MMT.

To be sure, advocates of MMT are technically correct when they point out that any country able to pay its debts in its own currency cannot become insolvent, because there is no limit to the sums of money that it can create. But the idea that foreign investors would remain willing to invest in that currency under such circumstances doesn't hold water. At some point, foreign capital would become effectively shut out, with serious implications for the financing of private ventures. Again, MMT claims to have accounted for this problem: in the US case, they pretend that the government cannot lose control of its interest rate.

Still, as many studies have shown, the higher the degree of central-bank independence, the lower a country's inflation rate. That is why all leading economies saw fit to institutionalize central-bank independence in the first place (mainly in the 1990s). MMT, however, would revoke the central bank's control over the printing press, and put that power in the hands of the government. As history shows, in times of emergency, the normal rules would be suspended. MMT is an approach that would create such chaos.

In today's environment of near-zero or even negative interest rates and massive central-bank purchases of government securities, we are witnessing a move in the direction of MMT. If governments can rely on their central banks to buy unlimited amounts of government securities to prevent interest rates from rising, they have effectively already wrested control of money creation from the central bank.

In principle, an independent central bank has the power to end this process at any time, by reducing or even stopping purchases of government securities. But there would be significant political pressure weighing against such a move. Once a central bank de facto ends up in the position that MMT's advocates seek, its ability ever to regain control becomes an open question.[5]

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CITATIONS:

1. The Wall Street Journal, November 20, 2020
2. The Wall Street Journal, November 20, 2020
3. The Wall Street Journal, November 20, 2020
4. CNN.com, November 17, 2020
5. project-syndicate.org/commentary/mmt-myth-threat-to-central-bank-independence-by-otmar-issing-2020-11?

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