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Research

The lessons of history: which historic period is most like today?

#PositiveImpact

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Something we're often asked is which era in history is most like this one. Perhaps the obvious answer is the 1970s, given the energy shock and high inflation. Others have pointed to the late-90s and early-2000s, when the dot com bubble burst and big tech valuations fell substantially. Or maybe it's more like the 1960s, another era where policymakers moved to fine-tune economies amidst low unemployment, but which saw inflation get increasingly out of control.

Today we find ourselves experiencing unusual volatility. Of course, every age is inherently "uncertain", but over the last three years we have had a major pandemic, the biggest peacetime stimulus in history, inflation at multi-decade highs, Russia's invasion of Ukraine, and the fastest monetary tightening in a generation. This is clearly not a "normal" or subdued period of history.

With all this happening, it can be hard to make predictions. But there are several lessons and observations from history above that do seem appropriate to our own time:

1. Unlike previous inflationary episodes, there has been no attempt today to use fiscal policy as a stabilisation tool to slow the economy and reduce inflation. So if monetary policy struggles to do the job, or there is resistance to further rate hikes (e.g. from mortgage holders), then more of the burden could fall on fiscal policy.

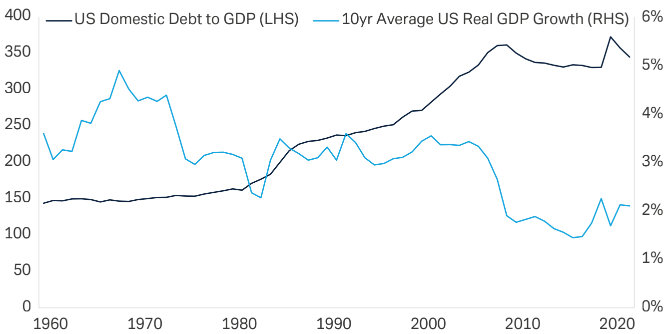
2. Historically, reducing inflation has needed real policy rates in positive territory. As in the 1970s, it will be difficult to get a grip on the situation if the real cost of funds is negative.

3. When deficits have been run at unsustainable levels and debt interest payments are rising, there is usually pressure to get them under control again. Given the current debt trajectory across much of the advanced economies, at some point we could be in store for this again.

Finally, something that becomes apparent across the decades is how growth is trending down and debt is trending up. That's a big problem, since higher growth is what ultimately drives living standards and means we are wealthier today than previous generations. It also makes it harder to solve other problems, like the demographic challenge of ageing populations, or inequality, since a growing economic pie makes redistribution easier. At the same time, higher debt means that the major economies are more vulnerable in the event of a shock, particularly in an environment of rising interest rates like today.

This question of growth and its interaction with debt is the biggest long-term macro conundrum. How it's resolved will ultimately be one of the biggest influences on how we write about future decades.

Recent decades have seen a slowdown in growth and an increase in debt



Source: Haver Analytics, Deutsche Bank

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