CONVENTIONAL RESULTS OF UNCONVENTIONAL MONETARY POLICY

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Abstract: *The financial crisis of 2008 was a major crisis after 1929. It reminded once again us about the contradictory nature of fractional reserve Banking. The Great Depression taught us that the financial crisis of 2008 would result in a substantial reduction in economic activity and a sharp deterioration of key economic indicators. To "avoid" recessionary risks, the Federal Reserve System and other central banks of developed countries actively adopted monetary easing measures. A large amount of money was injected into the credit system. At the initial stage, the "explanation" of the mentioned measure was liquidity and recession risks. However, the time has shown us that the number of "colored papers" does not create wealth, it only distributes it in favor of those who have the privilege to "spend" it first, until a quantitative increase of money will be reflected in prices. As expected, the unconventional monetary policy gave very conventional results: inflation, stagnation, and an overheated credit system. The results would be more unambiguous without the Russia-Ukraine war, which affected inflation in the EU. The results of the monetary experiment conducted after the financial crisis of 2008 and its consequences, once again showed us that finance does not create wealth, it only promotes, distributes, and insures it. Therefore, every attempt to improve the picture of the real economy with monetary interventions is futile and cannot change the final result. With monetary interventions, it is only possible to postpone the consequences of the crisis, at the expense of their aggravation and intensification.*

Introduction: The 2008 financial crisis was a major global economic downturn since 1929. The crisis broke down widespread assumptions about "too big to fail". In this way, the Austrian business cycle theory once again demolished prevailing views about financial derivatives' miraculous futures. But, faith in miracles didn't end with it. Central banks start unprecedented, large-scale monetary interventions to revive the financial sector and economy as a whole. The legitimacy and theoretical coherency of this policy was settled down on faith (in monetary policy abilities) and fear (of the full-scale collapse of the system). In other words, central banks started the unconventional monetary policy with the hope to overcome liquidity issues in the financial sector and downturn tendencies in the real economy, without significant deterioration of market forces.

Reflection: To prevent history from repeating itself, central banks around the world implemented several unconventional monetary policies, including large-scale asset purchases of government and private-sector assets, forward guidance on interest rates, and policies targeted to directly stimulate lending. But the extent to which these different policies had a material impact on output and inflation is still not well understood**.** (Boneva, 2016)

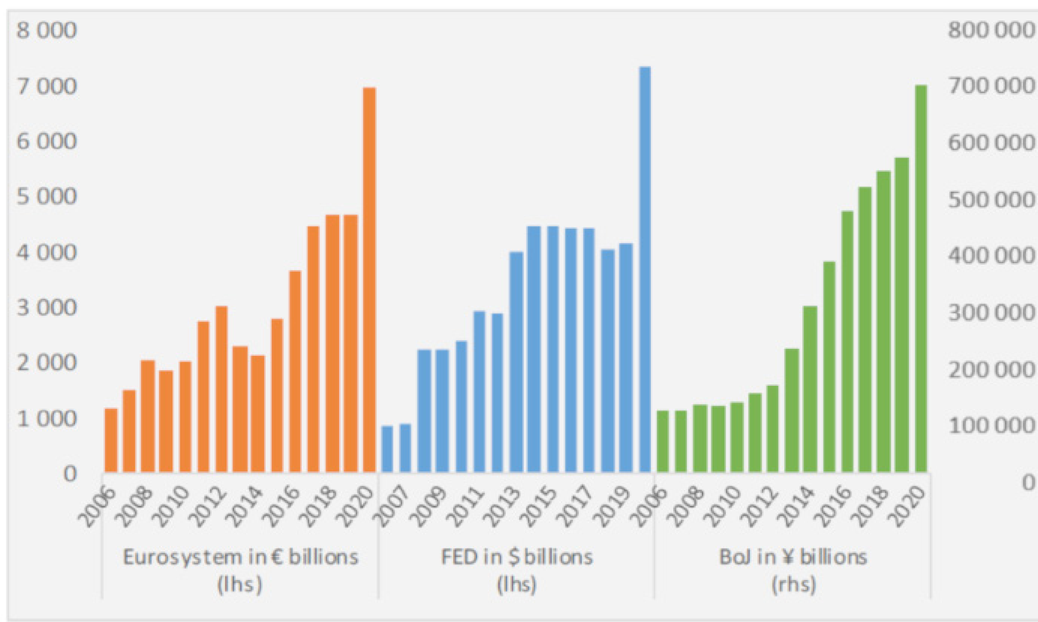
During this unprecedented monetary experiment balance sheets of major central banks increased more than twice and in some cases four-fold. (see chart 1). It was impossible to reach the same or proportional growth rate of GDP. Therefore, the missing artist in this "comedy" was inflation.

Monetary policy is in an unusual spot at this point in a record-long expansion. After a decade of unprecedented monetary stimulus around the world, actual inflation and inflation expectations remain stubbornly low in most major economies. Inflation is falling persistently short of central bank targets even in economies operating beyond full employment – notably the US. It is even more unusual to see a drop in inflation expectations in the late-cycle stage when concerns would typically focus on overheating. (Bartsch, 2019)

"The factor missing" has two main reasons:

- Printing money doesn't mean credit expansion. The secondary impact of a financial crisis is mistrust and uncertainty, which halts credit expansion and business activity consequently;
- Central banks can't control the money multiplier effect and the credit expansion process completely;

Chart1: Balance sheets of the Eurosystem, the FED,



and the BoJ

Source: ECB, FED, BoJ, Eurostat

As we know time is the best remedy of all and it is a valid thesis for shocks and uncertainties. As unconventional monetary policy becomes a new normal, credit expansion has taken momentum and inflation has become a key player in the "monetary amphitheater".

After all, debt ratios in advanced economies and most emerging markets were much lower in the 1970s, which is why stagflation has not been associated with debt crises historically. If anything, unexpected inflation in the 1970s wiped out the real value of nominal debts at fixed rates, thus reducing many advanced economies' public-debt burdens. Conversely, during the 2007-08 financial crisis, high debt ratios (private and public) caused a severe debt crisis – as housing bubbles burst – but the ensuing recession led to low inflation, if not outright deflation. Owing to the credit crunch, there was a macro shock to aggregate demand, whereas the risks today are on the supply side. We are thus left with the worst of both the stagflationary 1970s and the 2007-10 period. Debt ratios are much higher than in the 1970s, and a mix of loose economic policies and negative supply shocks threatens to fuel inflation rather than deflation, setting the stage for the mother of stagflationary debt crises over the next few years**.** (Roubini, 2022)

Ukraine Factor: 2022 Russian military invasion in Ukraine only exacerbated the looming inflation waves, especially in the case of the US, which has no dependence on Russian energy resources or tourists

from Ukraine. As was written down by Wall Street Journal: U.S. consumer inflation accelerated to 9.1% in June, a pace not seen in more than four decades, adding pressure on the Federal Reserve to act more aggressively to slow rapid price increases throughout the economy. (WSJ, 2022) The same problems we see in the EU and other developed economies. The key question now is about the possibility of a "soft landing". If FED and other key central banks will react aggressive manner and take rapid measures, there is a high probability of another financial crisis and economic downturn.

As 2022 continues to unfold, two major growth risks loom large against a backdrop of alarmingly high inflation. The first risk, centered in the US, is the prospect of a policy mistake as the Fed embarks on a tightening cycle to rein in inflation, which was already running at multi-decade highs before the tragic Russia-Ukraine conflict delivered a sizable commodity supply shock. Whether the Fed will be able to pull off a soft landing in such a challenging macro environment—or will instead end up triggering a recession—is a growing question. The second risk, centered in Europe, is the prospect that the Russia-Ukraine conflict deals a crippling economic blow given Europe's dependence on Russian energy, which could see Europe experience a stagflationary period of persistently higher inflation and low (or even negative) growth. How US and European policymakers navigate these risks. (Goldman Sachs, 2022)

Old lessons with new evidence: In monetary policy, there is not any possibility to start history again. Unlike natural science, there is not at least a second chance to do an experiment again and reset all previous conditions. So, we have some results of previous policy actions, and these results shape current conditions and some fixed determinants of future policy paradigms. Therefore, we have some limitations in planning future policy actions, but in any case, the final goal should be to return the market forces in-game.

Stagflationary winds are more likely to be a part of the global economy's upcoming journey than a feature of its destination. But how policymakers navigate this journey will have major implications for longer-term economic well-being, social cohesion, and financial stability (El-Erian, 2021)

From a scientific point of view, the coherent logic of research is to fully understand the phenomenon about what you try to make decisions. The ground for an effective policy-making process starts with putting all factors and forces together in one place, for making a full picture of the puzzle. Without a perfect understanding of money as a social institution, there is no way to find where fundamental deviations was and how to correct them.

There could be endless disputes, about the most important invention of mankind. But from my point of view, it is money as a social institution. The progress of mankind is based on labor division and specialization of the workforce. Internet, smartphones, cars, and other complex instruments are developed by scientists and made by plants with plenty of highly skilled workers. Therefore, money as a basis of the labor division process is a driving force of progress. (Khidasheli M, 2022)

The monetary system has a huge influence on business and progress as a whole. As I mentioned above the Austrian business cycle theory proved itself again in the last two decades. When mainstream media and influential pundits were toking about the impossibility of failing big financial institutions, we saw that Lehman Brothers were bankrupted and the whole financial sector was in a liquidity trap as ABCT predicted it. At the onset of unconventional monetary policy, Austrian economists explained that painted papers (fiat currency) printing didn't produce wealth, it is only about the distribution of existing wealth. As a result, we get more deteriorated wealth inequality in most developed economies where unconventional monetary policies were conducted.

In a free-market economy, where there is no fractional reserve banking practice, the source of credit resources is savings, temporarily free money funds, which, through the banks as the mediators, flow from the savings holders to business operators in the form of loans. The existence of savings is, on the one hand, the means for obtaining credit resources for business, and on the other hand, the indicator of the existence of additional demand, which should provide support for economic growth, as well as the application of the additional issue. Everything

changes in the conditions of a fractional reserve system, when the source of the loan is not real savings but a monetary multiplier (Khidasheli & Chikhladze, 2019)

Conclusions: Empirical observation showed us once again that There is no middle. The system should be managed by market forces or we have a socialistic planning model packaged with market cartoons. 2008 and 1929 we saw the consequences of failing fractional reserve banking and the inherent problems in credit creation out of thin air. If we are working for a sustainable monetary environment the cornerstone of the monetary policy paradigm should be more market forces in the credit creation and allocation process, and more restrictions for monetary interventions.

The faith and notions about "too big to fail" or "anticyclical monetary policy" were merely wrong and it is an empirical fact, but the truth is that both cases were predictable. Before 2008 financial derivative market created an illusion that finances are separated from the real economy and existed separately. After 2008 the same circus continued in different formulations, about monetary policy's ability to eliminate recession and outcomes of the financial crisis. Figuratively the plot is the next: "for filling the hole we have to dig dipper". Therefore, we have Conventional results of unconventional monetary policy: central banks' balance sheets are unprecedentedly high, credit markets are overheated, prices are skyrocketing and economic growth is slowing down globally. The same picture that we had in 2008 but in a bigger size.

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არატრადიციული მონეტარული პოლიტიკის ტრადიციული შედეგები

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რეზიუმე

2008 წლის ფინანსური კრიზისი იყო მნიშვნელოვანი მოვლენა, რომლის მსგავსიც 1929 წლის შემდეგ კაცობრიობას არ ენახა და რომელმაც კიდევ ერთხელ შეგვახსენა ნაწილობრივი დარეზერვების სისტემის წინააღმდეგობრივი ბუნება. 1929 წლის დიდი დეპრესიიდან მხოლოდ ის ვისწავლეთ, რომ 2008 წლის ფინანსური კრიზისი გამოიწვევდა ეკონომიკური აქტივობის არსებით შემცირებას და ძირითადი ეკონომიკური ინდიკატორების