I’d like you to take away three key points from today’s conversation. One, we’re entering a sharp global recession. Two, policymakers are responding rapidly with forceful measures to try to prevent this sudden stop in economic activity and its resulting liquidity crisis from turning into a solvency crisis. And three, I think the authorities are only going to be partially successful at this and the recovery is likely to be weaker than many people think.

**Entering a Sharp Global Recession**

I think many of you are aware that the economic hit from Covid-19 and the measures to contain the virus’ spread are going to be massive. We expect to see largest quarterly economic contractions of the post-World War II period. Slide 2 shows the manufacturing and service sector PMIs for the major advanced economies and the emerging markets. PMIs are diffusion indexes, measuring whether sentiment is better, worse or the same as the previous month. As you can see, service-sector PMIs collapsed and are now the weakest in the series’ history, which reflects the sudden stop in service-sector activity as we’ve moved to social distancing. On the manufacturing side, PMIs haven’t fallen as dramatically; this reflects that supplier delivery times, which is one component of the manufacturing PMI, have lengthened. Usually, lengthening in supplier delivery times is a good thing because it reflects strong demand, but in this case it reflects supply-chain disruption. So my expectation is these manufacturing PMIs will decline from here.

PMIs are useful data points because they’re the first monthly data that’s released, they’re forward-looking and they correlate with GDP. But they really don’t do a good job of illustrating the depth of contraction; they really just measure change. For instance, while China’s PMIs came in above the 50 mark in April, suggesting expansion, this doesn’t necessarily mean that conditions are good; it simply means that more firms saw an improving outlook compared to March.

**Slide 2: Covid-19 Is a Massive Global Shock**

The left side of Slide 3 shows weekly economic activity index for the US, a relatively new indicator that the New York Fed put out to try to track the US economy in real time. This is going to give you a better sense of just how steep the contraction in activity is. As you can see, the US economy is already slowing rapidly, and it’s nearly as weak as the weakest part in the global financial crisis. More recent data from the Fed shows that we’ve dipped below the low point in the global financial crisis.
The already-slowing US economy is especially vulnerable to job losses given high levels of income inequality.

One of the challenges facing the US economy is high income inequality, as 90% of US households are income-constrained. This means that their net savings rates are negative and thus they are dependent on their paychecks to make ends meet. So, the US economy, which is overwhelmingly driven by consumption and service-sector activity, is vulnerable to workers losing jobs. Unfortunately, as I’m sure you have seen, initial unemployment claims came in at 10 million for the two weeks ended March 28. This is going to be a huge blow to the US economy.

Slide 4 shows our forecast for growth across the G7 and the BRICs, presented in two ways. The left chart depicts real GDP growth on a quarter-on-quarter, seasonally adjusted annualized rate, while the right chart shows the same real GDP, but in level terms. It’s a little complicated, so I’ll explain.

The forecast for 2020 and 2021 are those of the First Eagle Global Value team. I think it’s very important to be humble about the forecast. We’ve never seen an event like this before. And in addition to all the uncertainty on the economic side, there’s so much we don’t know about the virus, let alone how the economy is going to respond to social distancing and the eventual removal of these policies. One of the key uncertainties is whether we will have a second wave of this virus. As people go back to work, are there new infections, and does that necessitate another shutdown of the economy? Our forecasts assume that this doesn’t occur, though many respected epidemiologists believe that it’s a strong possibility. One of the things we’re watching is what happens as China and other Asian economies relax social distancing and go back to work: Do we see renewed cases? This will be one of our key watch points going forward.

In terms of the forecast, we think the depth of the contraction is going to be much larger than the global financial crisis. How much larger I don’t know; some of this is just a shot in the dark. And you might think that we’re expecting a V-shaped recovery from the left graph because of the sharp bounce-back in activity, but we are not. We do expect growth to rebound as the economy moves from being shut to being open; for example, if the economy moves from operating at a 50% rate to an 80% rate, that’s a big quarterly increase. But in level terms the economy is still extremely weak.

The graph on the right tries to illustrate this weakness. The dashed lines are the trend growth rates that prevailed before the global financial crisis and then those that have prevailed since then until the Covid-19 crisis. As you can see, in the wake of the global financial crisis economies did not return to the paths that they were originally on. They did not return to that pre-crisis dotted line. In other words, there was a large, permanent output loss. While the loss was very large in the G7 economies, it was much smaller in the BRICs because of the massive stimulus China enacted in the aftermath of the crisis. We expect that to once again be the case, but this time you’ll see very large permanent output gaps in both the G7 and the BRIC economies, as we talk more about later.
You’ll also notice that the slope of the dotted line is flatter post-financial crisis than pre-
financial crisis, meaning the economy’s potential growth rate slowed in the wake of the
crisis. We think such a slowdown is another strong possibility going forward. So, we may
end up with both large, permanent output losses as well as slower potential growth rates.

Slide 4: Entering a Global Recession

The crisis may result in both large, permanent output losses as well as slower potential growth rates in the future.

Monetary Policy Response*

Let’s turn to how the authorities are responding to this crisis. On the monetary policy
side, central banks in most economies around the world have responded rapidly and
forcefully with interest rate cuts, programs to provide liquidity and restore market
functioning, quantitative easing and regulatory forbearance. (A summary of central bank
measures appears on Slide 5.) I would argue that the response of central bankers to the
current crisis is faster and larger than their reaction to the global financial crisis. Central
banks are moving quickly because they want to prevent this temporary stop in household
and business income from turning into a permanent solvency crisis in which firms go out
of business, workers permanently lose jobs and both end up defaulting on obligations.

Slide 5: Direct Central Bank Support and Regulatory Forbearance

Central banks have moved quickly
to try to prevent the temporary
pause in business and household
income from becoming a
permanent solvency crisis.

I think this central bank response reflects three things. One is central bank ideology.
The current thinking among central banks is that if your tools are limited, they can be
maximized if they’re used early and in size. Second, this playbook was created during
the global financial crisis. A lot of the same people work in the central banks now that
worked in them during the global financial crisis, so they know how to set up some of
these facilities and respond to some of these crises. Third, the financial system is in a

* Comments made prior to the Fed announcement of new facilities on April 9 and details of the main street lending facility.
much healthier position today, and there is scope to relax capital and liquidity rules. This time around, banks are going to be part of the solution to the crisis rather than the cause.

As you can see on Slide 11 major central banks have all cut the policy rates to the zero lower bound, though the zero lower bound is near zero in the US and UK and negative in the euro area and Japan. The ECB, BOE and BOJ are all providing low-cost loans to support the private sector, while the Fed has rolled out a host of lending facilities. And then of course all the central banks have expanded QE.

**Slide 11: Monetary Policy: Constrained, but Still Responding**

Major central banks have all cut policy rates to the zero lower bound, though inflation expectations remain subdued.

As I mentioned, the central banks are trying to prevent a temporary liquidity crisis from turning into a permanent solvency crisis. In the euro area, there’s an additional dimension: preventing a resumption of the euro area debt crisis. After an initial misstep, the ECB has responded forcefully with the €750 billion Pandemic Emergency Purchase Program (PEPP) to allow it more flexibility in purchasing sovereign and private sector bonds, ensuring the smooth transmission of monetary policy and allowing fiscal authorities time to come up with their own policy response.

I want to spend a few minutes discussing the Fed, in particular. The Fed has been the most active in setting up facilities to respond to this crisis, which it needs to do because legally it can only purchase Treasuries and MBS, unlike the other major central banks, which are allowed under all circumstances to purchase any asset class they desire. However, the Fed, under 13(3) of the Federal Reserve Act, can in “unusual and exigent circumstances” set up broad-based facilities to purchase whatever assets it wants as long as it has the approval of Treasury and as long as it protects taxpayers from losses.

On Slide 6, you can see that the Fed has restarted most financial crisis-era facilities, which are the boxes shaded in red. The Fed also have announced four new ones, to date, which are shaded in green. Two are focused on the investment grade corporate bond market: One is a primary market facility to serve as a funding backstop for investment grade corporate bond issuers, and the second is a secondary facility to improve the market functioning in the investment grade bond market. The third new facility is the Fed’s Main Street Lending program; though details haven’t been released at this time, the program is designed to support lending to small- and medium-sized enterprises. The fourth new facility allows foreign and international monetary authorities (FIMA) to repo their Treasuries to the Fed for dollar liquidity without having to sell Treasuries in the market. The result of all these facilities and, more important, the resumption of very large-scaled Treasury and MBS asset purchases to stabilize those markets, is a very sudden increase in the Fed’s balance sheet, to nearly $6 trillion.
The Fed has responded forcefully thus far and likely will continue to if current measures aren’t sufficient.

What should you take away from the Fed’s actions? The central bank has responded forcefully, and I think it will continue to respond if current facilities aren’t working. One of the important constraints it does face is the requirement to protect taxpayers from losses. The recently passed CARES Act by Congress provides $454 billion to the Treasury that it can use to backstop Fed facilities. The Fed can lever up this backstop to provide significantly more support to markets. The tradeoff, though, is that the more the Fed lends to riskier borrowers, the less leverage it can provide and thus the lower the level of its overall support.

On the regulatory side, the authorities have temporarily relaxed capital and liquidity requirements, have relaxed or postponed plans to tighten accounting standards and (in the euro area and UK) have delayed bank stress tests and recommended delaying dividends and buybacks; a summary of these actions appears on Slide 7. The financial system caused the crisis in 2008–09, but now financial institutions are part of the solution, as governments and central banks are using them as a channel to direct liquidity to borrowers. I think, going forward, we should expect the authorities will continue to exercise leniency and to encourage the financial system to support the recovery.

Governments and central banks are using financial institutions to channel liquidity to borrowers.

I want to make one last point on central bank actions. Coming into this crisis, the BOJ and ECB had the least room to act. Interest rates were already at or near their lower bound, which is why the ECB has only cut interest rates 10 basis points while the BOJ has not cut interest rates whatsoever. On the QE side, central banks’ balance sheets were already very large, particularly in Japan. And so, the BOJ has also done the least in expanding QE.
I think this episode shows that central banks, despite being constrained, will take actions, especially to restore market functioning. However, I do think we have to recognize that central banks do not have much room to support economic recovery going forward.

**Fiscal Policy Response**

Governments are responding with very large fiscal policies to fund healthcare, provide household income support, and to support the corporate sector. In the US, the federal government has already passed three fiscal packages. Slide 8 illustrates the Congressional Budget Office’s (CBO) original forecast for the US federal budget and the federal debt held by the public. The solid blue line represents the CBO’s original projections, and the dotted lines are where I think the deficit and debt could go based on our forecasts for growth, the usage of different programs and interest rates. Obviously, we need to take these numbers with some degree of uncertainty.

However, we do know that the deficit is going to be much larger than during the global financial crisis for three reasons; the economic hit has been greater, the fiscal package has been much larger, and the deficit started out in a much worse place. I do think a fourth fiscal package is likely and that these deficit and debt figures that you see for the US are probably lower bounds on where they will go.

**Slide 8: US Enacting a Large Fiscal Response**

Current deficit and debt forecasts likely represent the lower bounds of where they may go.

Countries around the world have also responded with major fiscal packages. In many cases, fiscal deficits are going to increase less than headline packages suggest because they’re operating through off-budget entities or comprise guarantee programs that will take time to hit the fiscal accounts. Nonetheless, I think we should expect very large increases in government debt, from already very high levels, and that’s because both deficits are increasing and nominal GDP is shrinking.

The chart to the left on Slide 9 shows you gross general government debt for major economies before the financial crisis and then at the end of 2019. Outside of Germany, debt levels were already at non-wartime peaks heading into this year, having increased dramatically since financial crisis. In addition, most of these countries are aging quite rapidly and unfunded pension and healthcare liabilities represent another contingent claim on governments, represented by the red dots in the chart. So, government debt levels are already very high, and then there are all these contingent claims on pension and healthcare systems.

This raises the question of whether governments should worry about their indebtedness. As the chart to the right on Slide 9 shows, interest payments on government debt as a share of GDP have declined over this period, outside of China, reflecting a decade of central bank policies that have kept interest rates low across the yield curve, or two
decades in Japan’s case. How long is this sustainable? I don’t know. Its sustainability reflects a willingness of investors to hold these sovereign assets that offer low returns and a deteriorating risk profile. The fact that central banks are and will remain very large purchasers in these markets certainly helps. But I would caution that central bank purchases alone may not be sufficient. We’ve already seen from the euro area that some form of government-led fiscal solidarity may be necessary to stabilize Italian bond yields.

Slide 9: Government Debt Surging from High Levels, Low Interest Rates Facilitate

The sustainability of high sovereign debt levels reflects the willingness of investors to hold an asset that offers low returns and a deteriorating risk profile.

A Weak Recovery

The last point I want to make that I think these very forceful actions by central banks and governments will only be partially successful in preventing this liquidity crisis from turning into a solvency crisis. This comes back to our growth forecast earlier, and our expectation for large output losses and weaker potential growth.

There are a few different reasons for this. One, as I already highlighted, is that I think monetary policy is largely exhausted. Yes, central banks can and will respond aggressively to market-functioning problems, but they really don’t have much scope to lower interest rates further to stimulate the recovery. The second is that public and private sector indebtedness is going to be much higher going forward and could weigh on recovery, as it did in the wake of the global financial crisis. Third is that this massive economic shock is hitting the entire global economy at the same time. The recovery following the 2008–09 global financial crisis was supported in part by China, which adopted a massive stimulus effort that boosted growth there and around the world. We’re just not going to see that this time around.

Finally, I worry that this crisis may add to de-globalization pressures. As you are all well aware, before the virus struck, trade tensions between the US and China were causing firms to build in more redundancies into their supply chains, making them somewhat less efficient. I worry that this crisis may cause more governments to move supply chains for key sectors into their countries, which would further exacerbate some inefficiencies and weigh on potential growth.
Macroeconomic and Market Volatility Q&A

Q: How much of a concern is a second wave of Covid-19 to global financial markets? Is this being priced in yet?

Idanna Appio: My concern is that a second wave isn’t being priced in. When we look at how markets have behaved recently, I think they are pricing in an all-clear based on some encouraging news that social-distancing policies have been effective.

I do worry that, as we begin to relax the social distancing and people get back to work, we could experience a second wave of the crisis. And developments that we’ve seen recently in Singapore and in Japan are worrisome on this front. I’m no expert, but when I listen to epidemiologists they caution that this is a very real risk, a very likely risk, given the way the virus has propagated. So, I don’t think this is in most people’s base case—as I said, it’s not in our forecast—but I do think it is a real concern.

There is a question whether policymakers will respond in the same way. Will governments respond by shutting down their economies once again if a second wave comes through? Or will they try some different strategies, such as keeping elderly and vulnerable populations isolated while allowing other populations to go back to work? I don’t know. But I think that’s a real risk and just a real risk that we’re getting too ahead of ourselves and too optimistic on this front.

Q: Given the great fiscal deficits and indebtedness that are arising, would you see taxes increasing in order to pay back that indebtedness?

Idanna: I don’t think that’s happening anytime soon. Right now we’re still in the stimulus phase. But I think this is a good point. When we come out of this, let’s say, two or three years from now, debt is going to be substantially higher. If you go back to my forecast on the US, you’re looking at federal debt held by the public that might be 40 percentage points higher as a share of GDP than it was before—maybe even higher than that.

How will governments respond? After all, each government is made up of elected leaders. In the wake of the global financial crisis, new people were elected into office and there was a lot of pressure to narrow expanded deficits by cutting spending and raising taxes. So, it is definitely possible and plausible that governments will have to respond to enlarged deficits by raising taxes in the future or by slashing benefits. And I think we may see that different countries are going to act differently depending on their political inclinations.

Q: Can you speak to how the Fed and Treasury might change their functions—for example, MMT-type actions—and how and when this might play out?

Idanna: In some respects we’re already almost here, right? Central banks are keeping interest rates at very low levels through their purchases (as shown on Slide 11 on page 4). I think it’s definitely possible that the Fed moves down a path of yield-curve control like we’ve seen out of Japan, basically ensuring that yields across the curve are kept at whatever level—maybe around zero—for, call it two or three years. That provides Treasury with significant space to issue as much as it wants without being concerned about pushing up borrowing costs for the private sector.

Where I don’t think we are yet, but we may get to, is the more direct cooperation between monetary and fiscal authorities where money is directly printed and given to the Treasury to spend, or a direct link between “we’ll provide this amount of stimulus for the government to go out and do certain things.” But there are proposals along those fronts from many well-respected economists. So, I would not be surprised if we see some governments and central banks move down that path in the future.
I am worried about central banks losing their independence. Are they forced to do what governments want? As long as they maintain their independence, then perhaps we can believe that they’re going to be acting to achieve a certain inflation and economic mandate, as opposed to acting purely to support governments.

But I do think we will get some type of more direct central bank/treasury cooperation in the future, given that monetary policy is going to be out of ammunition. There’s going to be more and more pressure put on treasuries and governments to support the recovery.

Q: Do you believe that policymakers around the world are genuinely coordinated in their actions at this time? Or are they just following simultaneous policies? Does it matter either way?

Idanna Appio: I think we are seeing more simultaneous actions—monetary policy, fiscal policy—and not much coordination amongst the largest economies. And I do think that it matters and that it is important.

I haven’t really spoken much about the emerging markets. But I think this is a crucial point here: More coordinated actions would allow the major economies around the world to consider how they plan to protect and support recovery in all countries, not just the major economies. That’s going to be very important. Because after all, if we have virus infections raging in certain parts of the global economy—in emerging markets and low-income economies—it increases the risk that these infections are going to sweep back through the major developed economies as well. I think it’s in every country’s interest to try to eradicate this virus and provide supportive measures.

Maybe just a couple of additional words on emerging markets. I am worried about the emerging world here. Fundamentals are generally not as strong as they were in the runup to the global financial crisis. As you recall, heading into the global financial crisis most emerging markets had benefited from this decade-long commodity super-cycle and the integration of China into global supply chains. Since the global financial crisis, emerging market countries, like most other countries around the world, has had to take on debt, whether in the public or private sector, to support their economies.

I do think fundamentals are much stronger than during emerging market crisis periods of the late 1990s or early 2000s. But emerging markets and low-income economies are facing such a large and multifaceted shock this time: the disruption from Covid-19 in their economies, the lack of demand from developed economies and China, low oil prices and the large capital outflows. I worry that without the coordination and support of the major economies, these countries are going to be left out. And they don’t have quite the same monetary and fiscal tools that many developed markets have.

Q: Could you elaborate a bit more on your concerns about onshoring supply chains?

Idanna: Speaking as an economist, most of us don’t think tariffs are useful and they’re a dead-weight loss. One of the things I was hearing from businesses in response to the US-China trade battle was a desire to protect against future tensions by bringing production back onshore or by shifting to multiple supply chains. If you think about that from a pure efficiency perspective, maintaining multiple supply chains is less efficient and should weigh on business profitability and, ultimately, potential growth.

Will this prompt more countries to onshore certain critical supply chains to their own economies? This might be the right sort of step to take; there might be value in having more critical medical supplies or drugs produced within your own economy. But if everyone did this rather than relying on global trade it would probably make the global economy somewhat less efficient and weigh on potential growth. So it might be the right response for each particular country, but on the whole it could add to already existing de-globalization pressures.
More generally, we have to consider whether people will, as Covid-19 restrictions are lifted, go back to traveling and operating in a global dimension in the same way that they did before? We’ll have to see how behavior may or may not change in the wake of this crisis.

Q: Are you worried that the significant level of intervention and involvement by the government will have a negative impact from a social perspective, not just an economic perspective?

Idanna: I think that’s definitely possible. We are going to have to see how some of these programs play out. Positively, governments have been responding very quickly to developments, and I think they recognize that in light of the size of this massive shock they need to act to provide income to businesses and households.

That said, there’s probably many, many things in these programs that are going to have negative consequences. For instance, in the US, I think the extended unemployment insurance is a great idea. The extra $600 that the federal government is giving out is going to take the average worker up to nearly 100% of their wage before they lost their job. But that’s for the average worker. There will be some workers that will be making more money under unemployment insurance than they made working. Does this lead to adverse incentives that encourage people to stay out of the labor market? We just don’t know.

Similarly, to the extent government policies change incentives on businesses, on employment or on repaying loans, could they have adverse consequences? Definitely. And I think some of the programs require the governments to take an equity stake. The direct-lending programs under the CARES Act require some form of government participation. My expectation is it will be very similar to what happened after the global financial crisis. These are going to be non-voting stakes. They’re not going to play a role in the management of companies. But over time I think we’ll have to see how government intervention in different businesses and markets plays out and consider whether it changes incentives.

Further, one could imagine a future where there’s public blowback against certain industries that received government support, as there was with bankers after the global financial crisis.

Q: What’s your outlook for the US dollar against other developed market currencies, both shorter and longer term?

Idanna: We run the currency hedging process for the Global Value team at First Eagle. Generally, our view is we want to increase exposure to currencies we think are under-valued and reduce exposure to those we think are overvalued so that the underlying returns of the businesses we invest in are preserved.

In this framework, we use four different currency valuation models, and they all suggest the dollar is extremely overvalued at this time. This is not surprising. The dollar is the world’s reserve currency, and entities around the world are seeking its safety. So that’s pushing up the value of the dollar. But we do see the dollar as overvalued, particularly against euro and yen; sterling, less so.

So we’ve been slowly reducing our hedge ratios on euro and yen on periods of euro and yen weakness. Our view is that as dollar-funding strains ease—and we think they will eventually ease given the FX swap lines and now the FX repo facility and all the other facilities—the US interest rate differential with the rest of the world will shrink, causing the dollar to depreciate.

We finally see sterling as somewhat undervalued. For a very long time we saw sterling as overvalued, even with the depreciation following the Brexit vote, reflecting the fact that the current account deficit hadn’t narrowed over time despite a very weak sterling

* Comments made prior to the Fed announcement of new facilities on April 9 and details of the main street lending facility.
currency. That was one of the reasons keeping us somewhat more cautious on sterling. Now we see sterling as perhaps somewhat undervalued, but really we’ve only lowered our euro and yen hedge ratios.

We see many emerging market currencies as extremely undervalued, but with the caveat that realizing that value might take some time. I think we’ll need more certainty to have a sense of how the coronavirus spreads through these countries and their policy response before we would be comfortable.

Q: Can quantitative easing truly be unlimited?

Idanna: As you can see on Slide 12 the Bank of Japan has pushed quantitative easing to a limit far beyond any other country. The central bank balance sheet is roughly 100% of GDP. They own almost half of the JGBs outstanding. They own these large stocks of the corporate bond market, the commercial paper market, the ETF market, J-REITs. The central bank has a very large presence in all of these markets.

What has been the result of this? Well, they certainly haven’t created inflation. So they haven’t achieved their objective. But at the same time, it hasn’t proved to be destabilizing. So I think there is definitely room for central banks to expand their balance sheets much further.

But to what end? Does it really promote economic activity? Once interest rates come down across the yield curve, does additional quantitative easing really provide substantial stimulus to the economy? It might provide some support for asset prices—and we’ve certainly seen that—but does it generate real economic activity? I’m skeptical, but it remains to be seen.

Slide 12: Monetary Policy: Constrained, but Still Responding

It’s unclear whether massive levels of QE can continue to stimulate economic activity once rates are low across the curve.

Q: You mentioned worry over income inequality and the difference in savings rates across the population. Would you expect any sort of policy response to this in the future?

Idanna: I think it’s definitely possible. We’ve already seen some of this coming through the US electoral cycle and the Democratic primaries, and there certainly more and more talk about income support policies and minimum levels of support. To some extent you could argue that the government is doing some of this right now by providing unemployment insurance and the one-time payments to households. And in light of the income inequality that we do have in this country, I wouldn’t be surprised to see more discussions along these lines, not only to make the situation more equal but also as a way to stabilize the economy.

So I think it’s definitely possible. It will be tied to the political cycle and everything else that’s happening. Whether it’s ultimately good for economic activity or not is a whole
other set of questions. But I would not be surprised to see more time spent on it, because at the end of the day we’re going to see a very large number of people lose their jobs in the US and in other countries, and there are going to be real questions about how to support them most efficiently now and in the future.

**Q:** Do you see the impact of this crisis and all the policy responses as being inflationary or deflationary in the future?

**Idanna:** This is clearly going to be a near-term deflationary shock. Large output gaps are opening up. We’re seeing demand destruction, as well as a sharp fall in oil prices. This is going to weigh down inflation way more than any upward pressures we may be facing from supply-side constraints.

I think policymakers, and central banks especially, are hoping the monetary and fiscal stimulus proves inflationary over the medium term, but the experience of the last decade suggests that it probably won’t be the case. The market, for its part, is expecting inflation to be much lower in the years ahead than it was in the past.

The one other thing I would note is that before this shock major central banks were engaged in a review of their monetary policy strategies. The Fed was planning sometime this summer, I think, to announce the results of that review. And I think we were going to get some form of “soft” inflation averaging in which the Fed would say, “We’re going to look at what inflation has been over the past several years, on average, as opposed to just what inflation is currently. And if it’s been below 2% over the last several years, then maybe we need to run the economy a bit hotter to get inflation up.”

As a result, I think central banks are going to keep their policies highly stimulative until inflation is durably above their targets. But that could take a very long time to occur, especially given the limited central bank stimulus available.

It’s possible that we get inflation in the very long term from these stimulative monetary policies coupled with fiscal expansion—especially if we keep using fiscal expansion, and we don’t eventually raise taxes or cut spending to narrow deficits—but I think that’s a very long time in the future. The thing we need to worry about in the near term is deflationary pressures. Government debt levels will rise dramatically, and private sector debt levels may as well given forbearance on loans and the potential for concessional low interest rates that encourage consumers and businesses to take on new loans. Indebtedness may grow dramatically, and the risks of those very high debt burdens would be exacerbated by very low inflation or deflation.

So, I think low inflation is likely the near- and medium-term worry. Very long term, maybe you have to worry about inflation. But the world is going to evolve a lot in ways that we can’t imagine between now and then.
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High yield securities (commonly known as “junk bonds”) are generally considered speculative because they may be subject to greater levels of interest rate, credit (including issuer default) and liquidity risk than investment grade securities and may be subject to greater volatility. High yield, lower rated securities involve greater price volatility and present greater risks than high rated fixed income securities. High yield securities are rated lower than investment grade securities because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities.

Investments in bonds are subject to interest-rate risk and can lose principal value when interest rates rise. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner, or that negative perception of the issuer’s ability to make such payments may cause the price of that bond to decline.

Bank loans are often less liquid than other types of debt instruments. There is no assurance that the liquidation of any collateral from a secured bank loan would satisfy the borrower’s obligation, or that such collateral could be liquidated.

The principal risk of investing in value stocks is that the price of the security may not approach its anticipated value or may decline in value.

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