Global Letter Imperfect historical parallels

History does not repeat itself precisely; and only some of it rhymes.[1]

We frequently get asked for the historical episode that we regard as the closest parallel to the present. But there is none such. When constructing our *World View* we take elements from various historical experiences: but equally we ignore many that do not.[2]

Key episodes

The Korean War of the early 1950s. Take: the way that the initial commodity-price shock led to a sharp rise in nominal wages and thereby in general inflation. **Don't take**: the full extent of the abruptness with which inflation then decelerated as commodity prices fell back.[3]

The 1960s era of accelerating inflation. **Take**: the way in which persistent excess demand in the US, (a consequence of the Vietnam War and LBJ's Great Society programmes) and in the UK (in its pursuit of full employment) led, together with policy-induced inflexibilities, to a progressive acceleration of price and wage inflation.[4]

The 1973/74 and 1978/79 oil price shocks. Take: the way in which adverse supply and thereby price shocks transferred income to groups (most notably OPEC) that initially saved a high proportion of their newly gained income, in turn generating recession. **Don't take**: the extent to which wage inflation accelerated, because that was exacerbated by high levels of trade union membership and cost of living clauses in wage agreements. [5]

The Volcker era interest rate hikes. **Don't take**: the remorseless way that, through highly restrictive reserve tightening, Paul Volcker attacked inflation head-on from October 1979.[6] This time inflation does not embody an embedded expectations-driven element: and while the Fed is talking tough, it is likely that it will slow the pace of its rate hikes in order to establish what effects they are having.

The mid-1980s oil price collapse.[7] **Take**: the fact that the effect initially proved to be less stimulative of world demand and output than many had supposed at the time, because income losers (principally OPEC), having largely spent their earlier surpluses, were obliged forthwith to cut expenditure. But in due course lower oil prices wreaked their customary longer-term effect: in the latter part of the decade OECD economies recovered strongly, and inflation picked up considerably.

The Latin American and Asian debt crises. **Take**: the fact that rising world interest rates and a strong US dollar expose entities that have borrowed in hard currencies; and that the consequences can ripple out, in particular to less developed economies, through financial channels. **Don't take**: that this happened primarily to sovereign borrowers (Latin American crisis) or the banking sector (Asian crisis): this time it is the corporate sector that seems at greatest initial risk.[8]

The 2000 dot-com collapse. **Take**: the way that optimistic tech stock valuations can be cruelly exposed when interest rates rise and growth expectations falter. **Don't take**: the extent of the fall, because this time once-bitten investors have become more cautious about valuing tech stocks.[9]

The 2008 Global Financial Crisis. **Take**: the fact that leveraged financial entities can cause havoc. **Don't take**: the fact that in 2008 the problem arose in the (investment) banking sector. Every time is different: this time problems could originate in the non-bank, so-called shadow banking, sector.

The 2020 COVID crisis. Take: the way that relative price changes can lead to general inflation.

Putting it together

GDP. The recent adverse supply shocks and consequential hikes in official interest rates worldwide are set to cause recession – shallow in the energy- and food-self-sufficient US; deeper in the food- but not energy-sufficient EU; deeper still in the UK, which is self-sufficient in neither.

Inflation. Commodity price inflation seems likely to fall sharply in 2023, not least from a simple base effect, and even more if the Ukraine war ends. Wage inflation seems likely to moderate in many countries in the manner of 1950s, rather than of the 1970s – except in the US and the UK, where tight labour markets are likely to slow the pace of moderation.

The paradox of course is that the resulting 'story' risks not striking many as credible, because there is no historical parallel! ■

[1] "*History doesn't repeat itself, but it rhymes*." Frequently attributed to Mark Twain, probably wrongly – see for example Talk:History - Wikiquote .

[2] A story told by my Welsh grandfather illustrates the point. A Welshman is marooned on a desert island for many years. Finally, he is spotted by a passing schooner. The Captain comes ashore and observes that, in addition to having built himself a shelter, the Welshman has also built himself a chapel. And indeed not just one, but two. The captain asks why. "*Oh! it is simple*," says the Welshman. "*One is the chapel I go to. The other is the chapel I don't go to*."

[3] Moreover, disinflation in the US was initially assisted by a downward nudge from price controls. (Recounted to the author in the 1970s by J. K. Galbraith, on the occasion of one of his visits to Cambridge.)

[4] See OECD, 1970. *Inflation: the present problem. "The problem of inflation today arises in part from the very successes of post-war economic policies in other directions – notably the unparalleled success in achieving high levels of employment*." And the publication recommended a range of what today are called 'supply-side' policies, including: trade policy reform, including tariff reductions; more emphasis on competition policies; reduced price support for agricultural commodities; reductions in industrial protectionism; and reform of social policies.

[5] Trade union membership in the US peaked in the 1950s at about one-third of the workforce; fell to about 26% in the late 1970s; and then collapsed in the 1980s under the Reagan presidency . Today it stands at only about 12%. See What Percentage of U.S. Workers Are Union Members? (gallup.com) Similarly in the UK, Trade Union density peaked at more than 50% of the workforce in the late 1970s; and fell steadily thereafter. It is now about 25%. Trade Union membership also was concentrated in many of the industries (not least those that were nationalised) that set the wage agenda.

[6] The Volcker policy was in effect a variation of monetary base control. The sharp rise in short-term interest rates, to around 20%, was a consequence of this strategy, which Volcker maintained until inflation had been crushed.

[7] From $145 in April 1980 to $83 in November 1984 and then to $29 in March 1986. See: https://www.macrotrends.net/1369/crude-oil-price-history-chart

[8] Although naturally there is a risk that this will feed back into the banks and hence the sovereigns. For more, see Philip Turner and John Llewellyn, 2021. *The growing Latin American debt risk*. Llewellyn Consulting – Independent Economics, March. Available on request; and Philip Turner and John Llewellyn, 2021. *Seeds of the next financial crisis – EM dollar borrowing*. Llewellyn Consulting – Independent Economics

[9] Though not, apparently, crypto stocks!