



## **The Economics of Populism | CFA UK Society**

---

**Alberto Gallo, CFA**

Portfolio Manager, Algebris Macro Credit Fund (UCITS), Head of Macro Strategies

Contact us

Call +44 203 196 2450

Email [AlgebrisIR@algebris.com](mailto:AlgebrisIR@algebris.com)

Visit [www.algebris.com](http://www.algebris.com)

# A Story of Dreams, Greed, Fear and Hope

1950-1970	Rise of post-war debt-based democracies
1970-2008	Leverage, de-regulation, globalisation
2008-2017	Global QE to the rescue
2017-now	Financial fragility and populism



Source: Algebris (UK) Limited

## Debt-based Democracies

---

*“Politicians are resourceful people. ...*

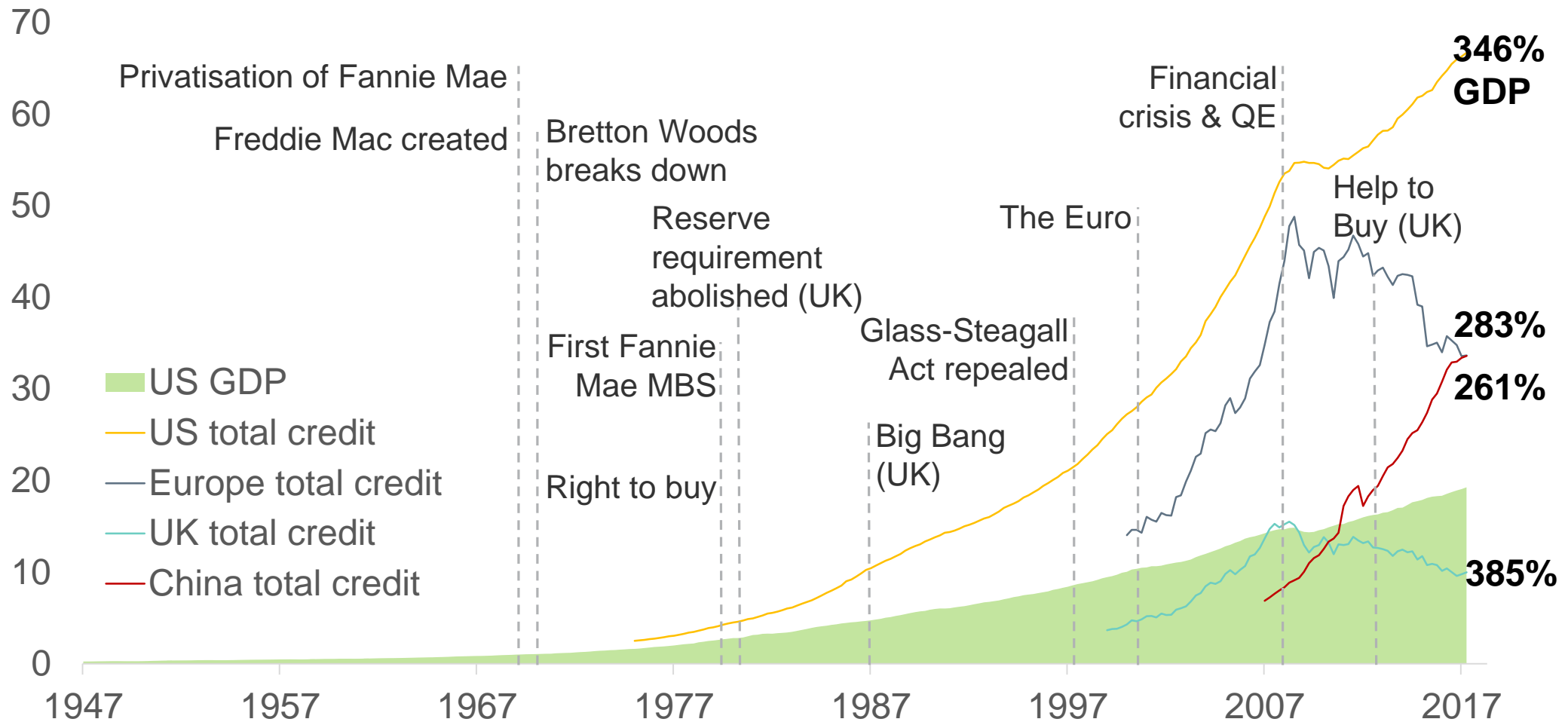
*A smart politician can see that if somehow the consumption of middle-class householders keeps rising, if they can afford a new car every few years and the occasional exotic holiday, and best of all, a new house, they might pay less attention to their stagnant monthly paychecks.*

*And one way to expand consumption, even while incomes stagnate, is to enhance access to credit.”*

Raghuram Rajan, Former Governor of the Reserve Bank of India, August 2010

# The Debt Supercycle: from Fiat Money to Fiat Credit

## Total Private Credit in US\$ Trillion (lhs)



Source: Federal Reserve, European Central Bank, Bloomberg, FRED, PBoC. Private credit calculated as the sum of household loans, corporate loans and bonds and bank debt

## Rising Inequality

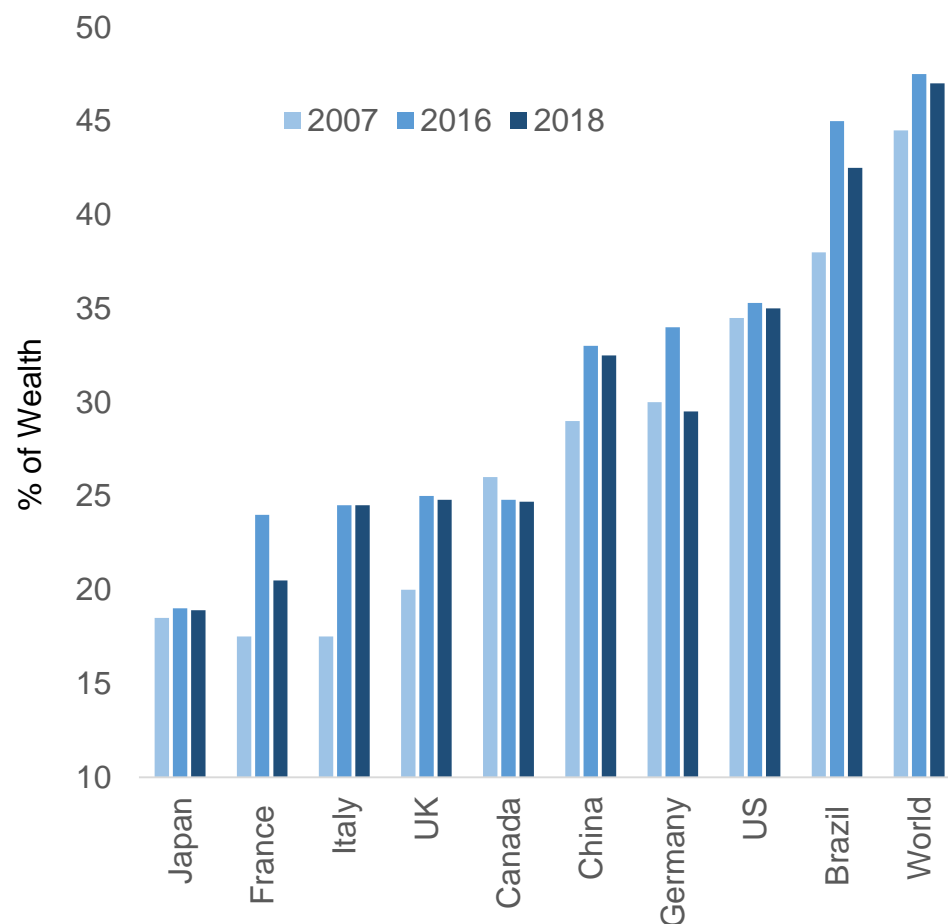
---

*"Our results suggest that the overall effect of monetary policy on standard relative measures of income and wealth inequality has been small"*

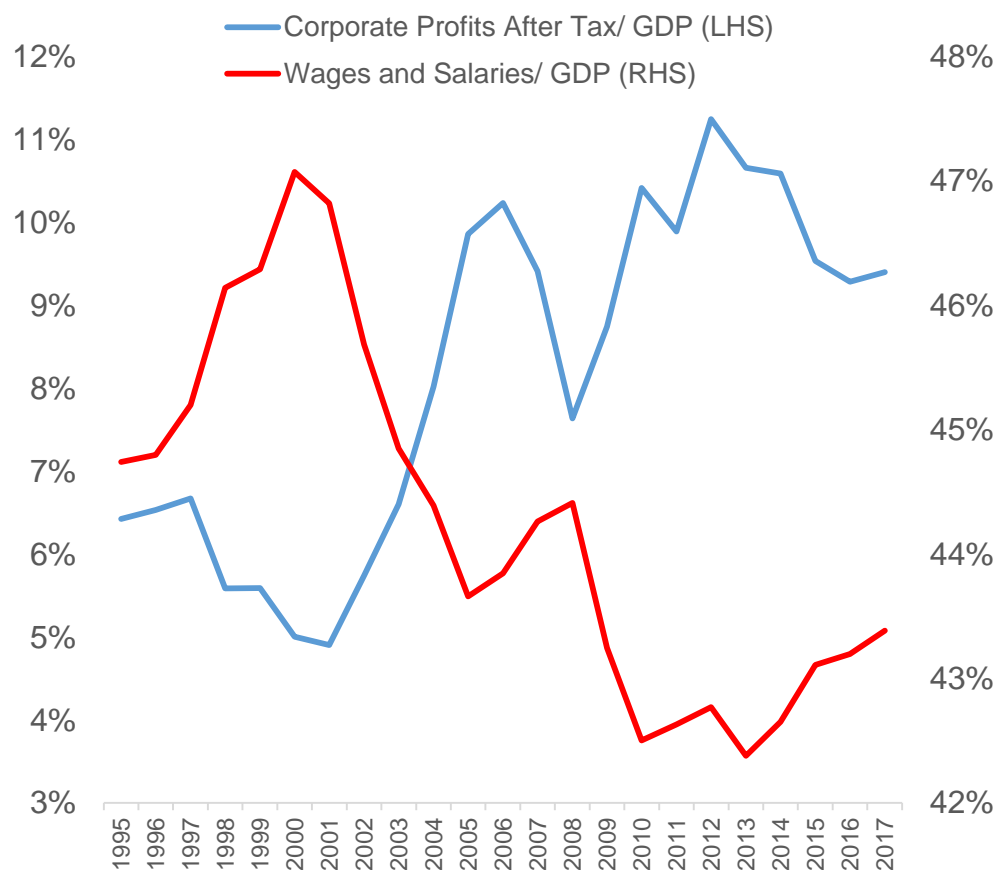
The distributional impact of monetary policy easing in the UK between 2008 and 2014, Bank of England, March 2018

# Rising Wealth Inequality

### Share of Top 1% of Wealth Holders Since 2007



### Corporate Profit vs. Wages as Percentage of GDP

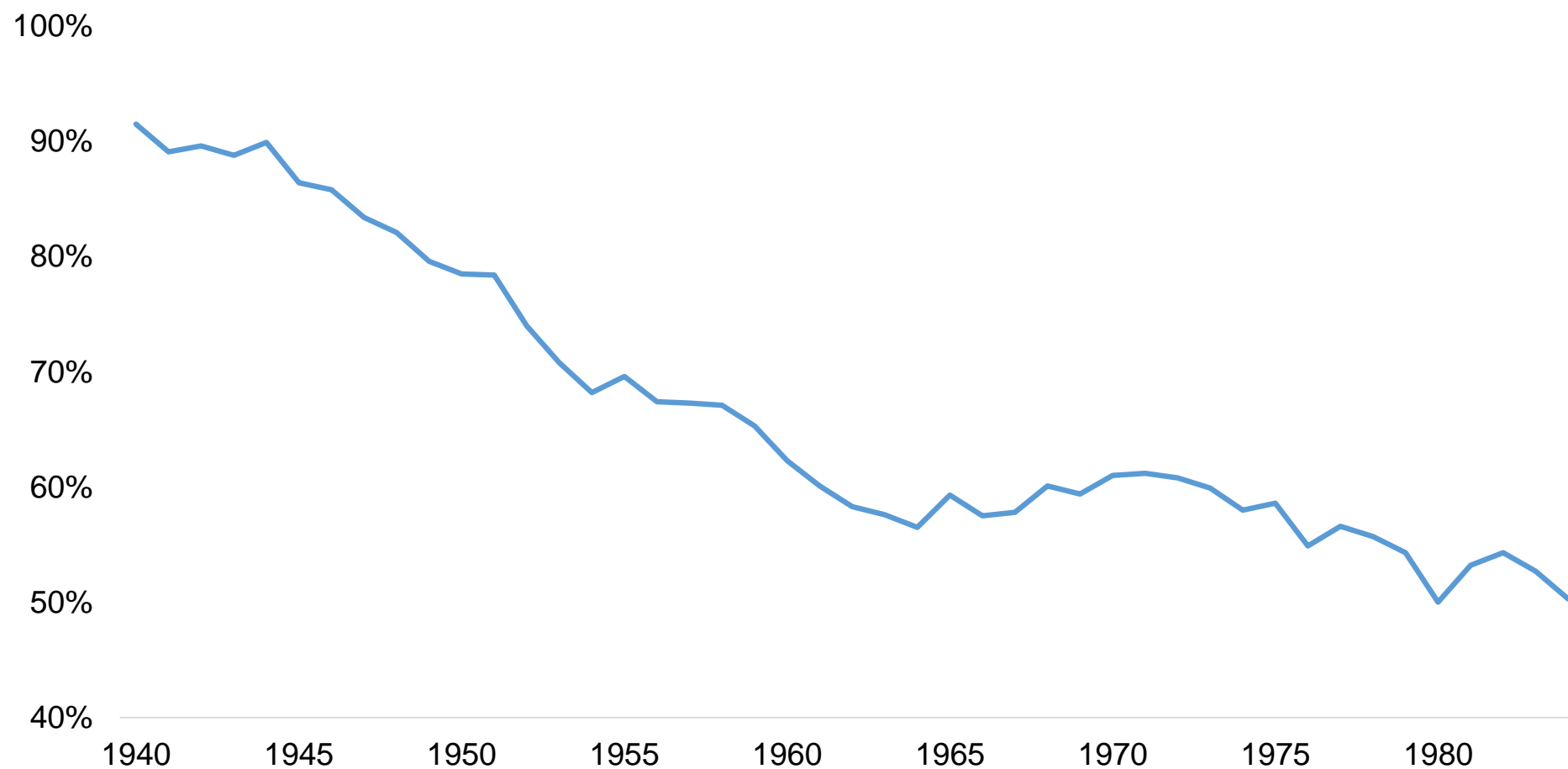


Source: Algebris (UK) Limited, Credit Suisse Global Wealth Databook 2018

Source: Algebris (UK) Limited, FRED

# The American Dream is Broken

The Fading American Dream  
Fraction of children earning less than their parents, by birth year

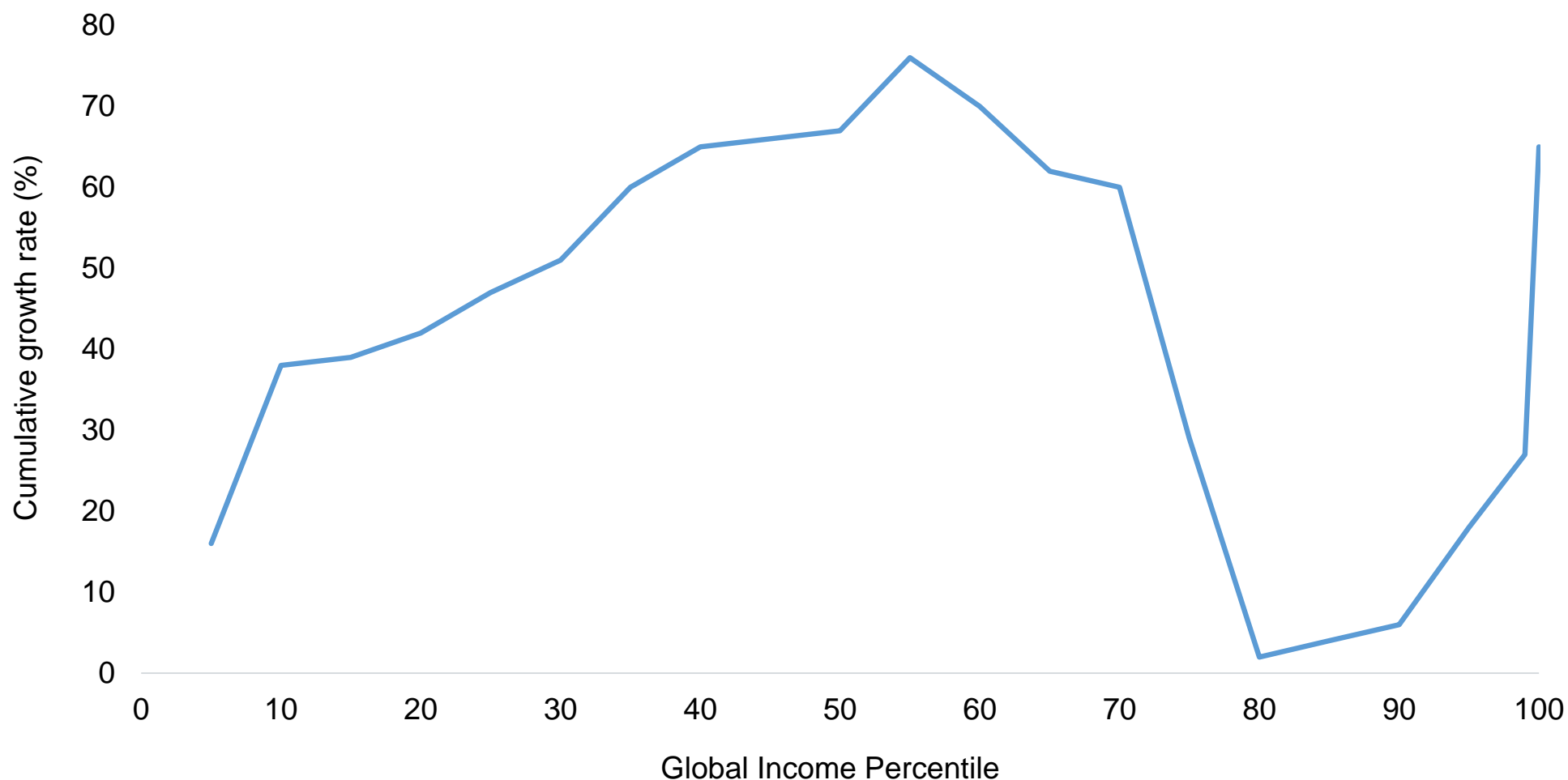


Source: Algebris (UK) Limited, The Equality of Opportunity Project

# The American Dream is Broken

## Income Inequality – The Elephant In the Room

Global Growth Incidence Curve, 1988-2008  
Increase in real income by percentile of global income distribution



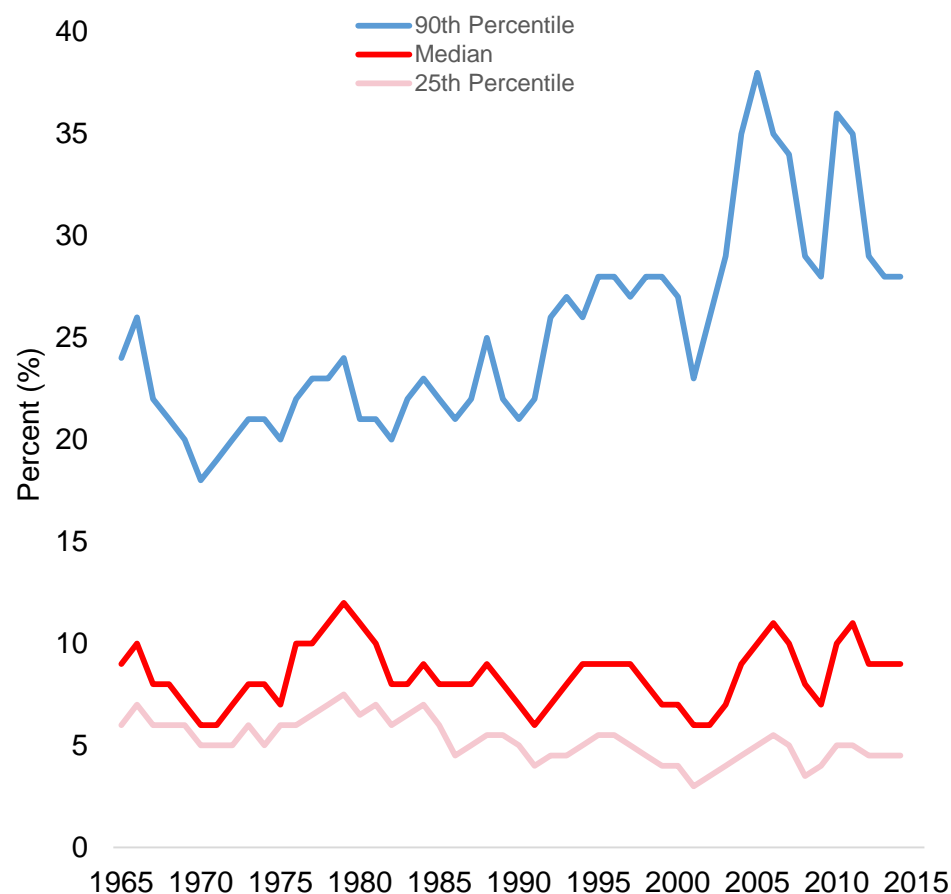
Source: Algebris (UK) Limited, The World Bank (Dec 2013)



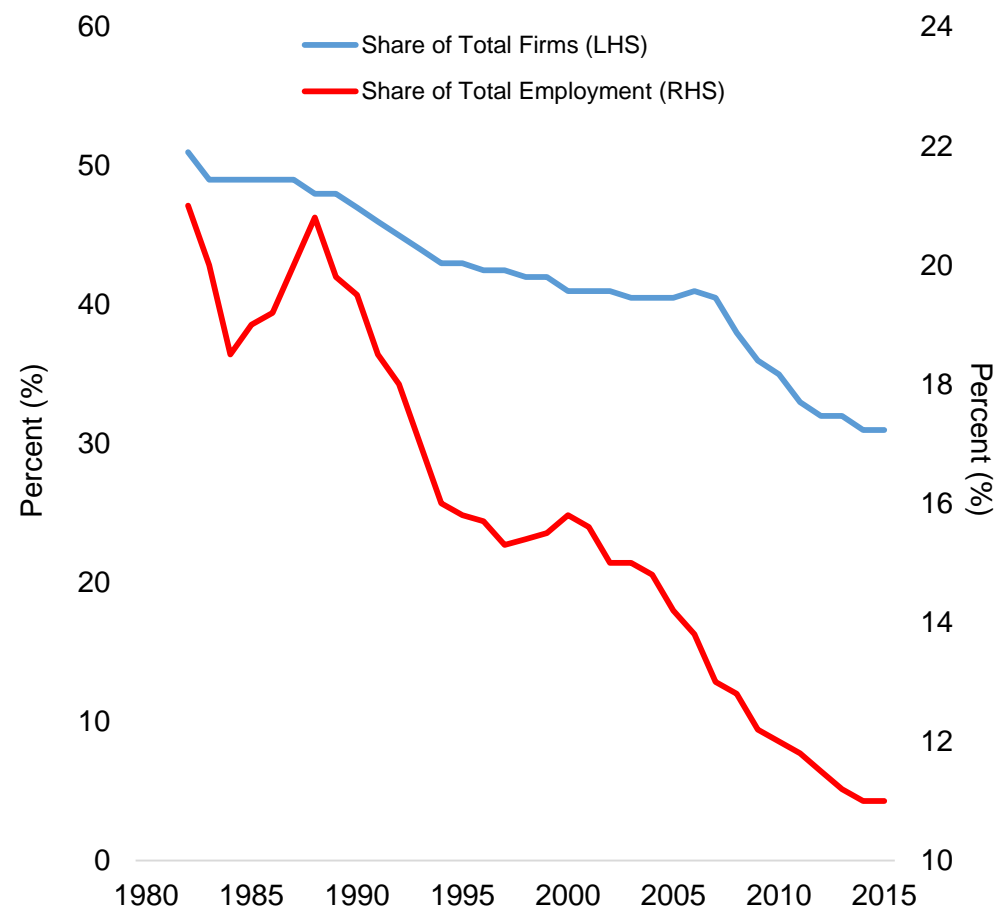
# The American Dream is Broken

## Corporate Inequality

Return on Invested Capital (including Goodwill)  
US Publicly-traded Non-financial Firms



Young Firms as a Share of the Economy  
1982 - 2015

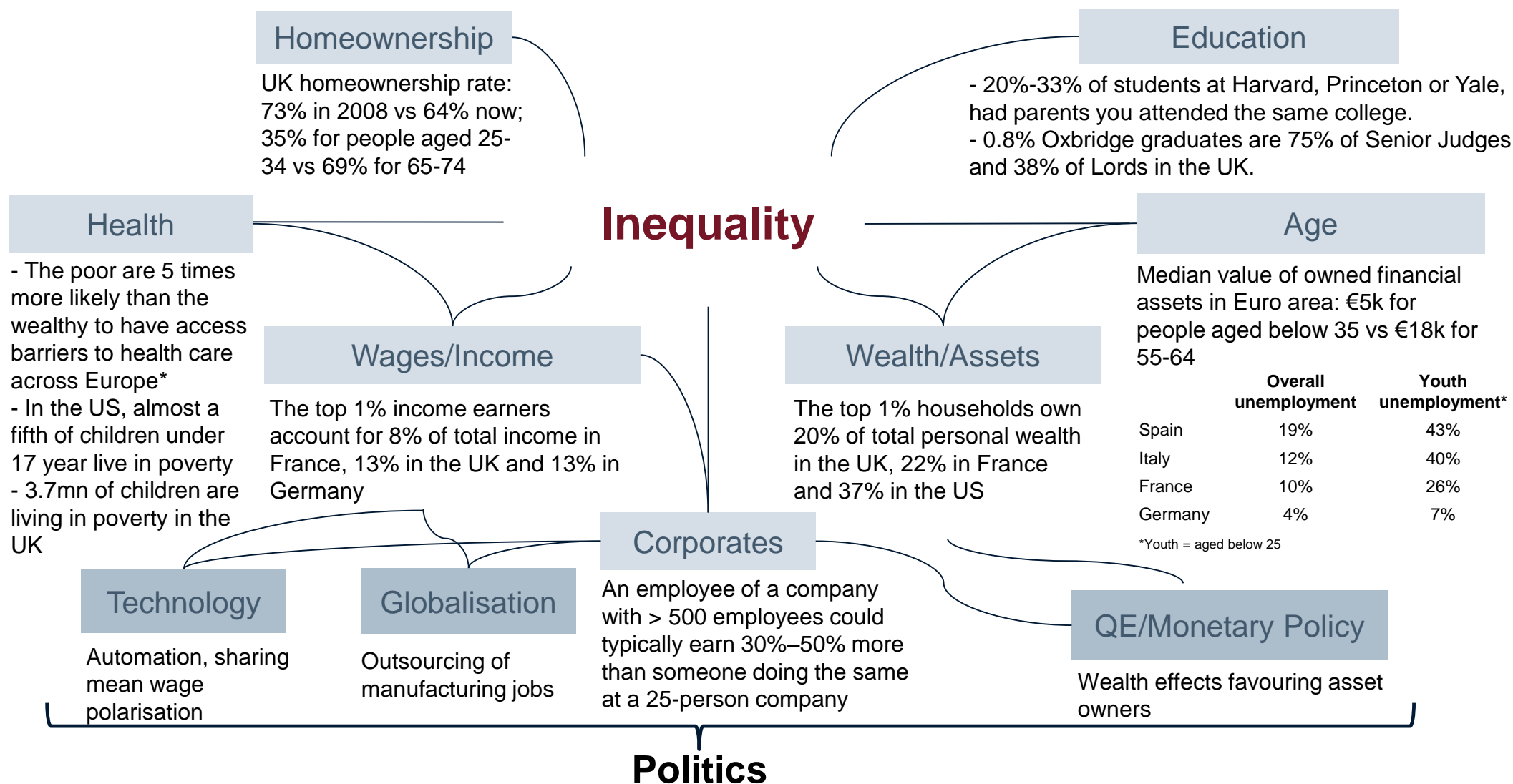


Source: Algebris (UK) Limited, Furman J., Market Concentration , OECD (May 2018)

Source: Algebris (UK) Limited, Furman J., Market Concentration , OECD (May 2018)

# Fragile Society

## Inequality and the Politics of Rage



Source: Algebris (UK) Limited, the National Association of Community Health Centers, UK Government, Bloomberg, Eurostat, ECB, World Wealth and Income Debate. \*Cylus, J., Papanicolas I., [An analysis of perceived access to health care in Europe: How universal is universal coverage?](#), Health Policy 119 (2015), July 2015; Cobb, J., Lin, K., Gabriel, P., [Growing Apart: The Changing Firm-Size Wage Effect and Its Inequality Consequences](#), 27 May 2016

## The Rise of Populism

---

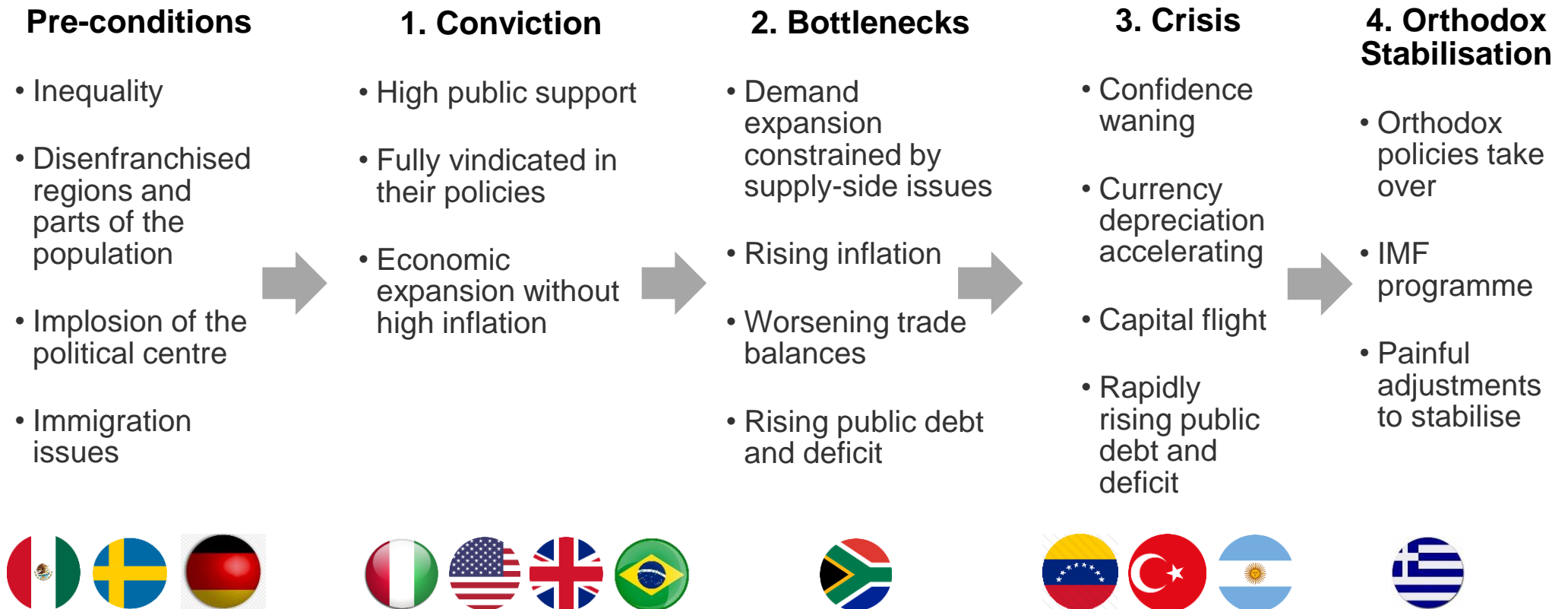
*“The price paid by good men for indifference to public affairs is to be ruled by evil men.”*

Plato

		UK/Brexit	US/Trump	Italy/5S & NL
1. Dream	Economic Political	£350mn a week Take back control	Revive manufacturing MAGA	Jobs Contract with Italians
2. Enemy	Foreign Domestic	Europe Immigration	Mexico, China, NK Immigration	EU/ECB Immigration
3. Policies	Militarism Nationalism Protectionism	Spain/Gibraltar/Russia Tax haven Tariffs	Defence spending Wall, Buy American Border Adjustment Tax	Police spending UBI Flat tax
Results	Large deficits Resource misallocation Rising public debt	}		<b>Financial Repression (Inflation, Taxes &amp; War)</b>

Source: Algebris (UK) Limited

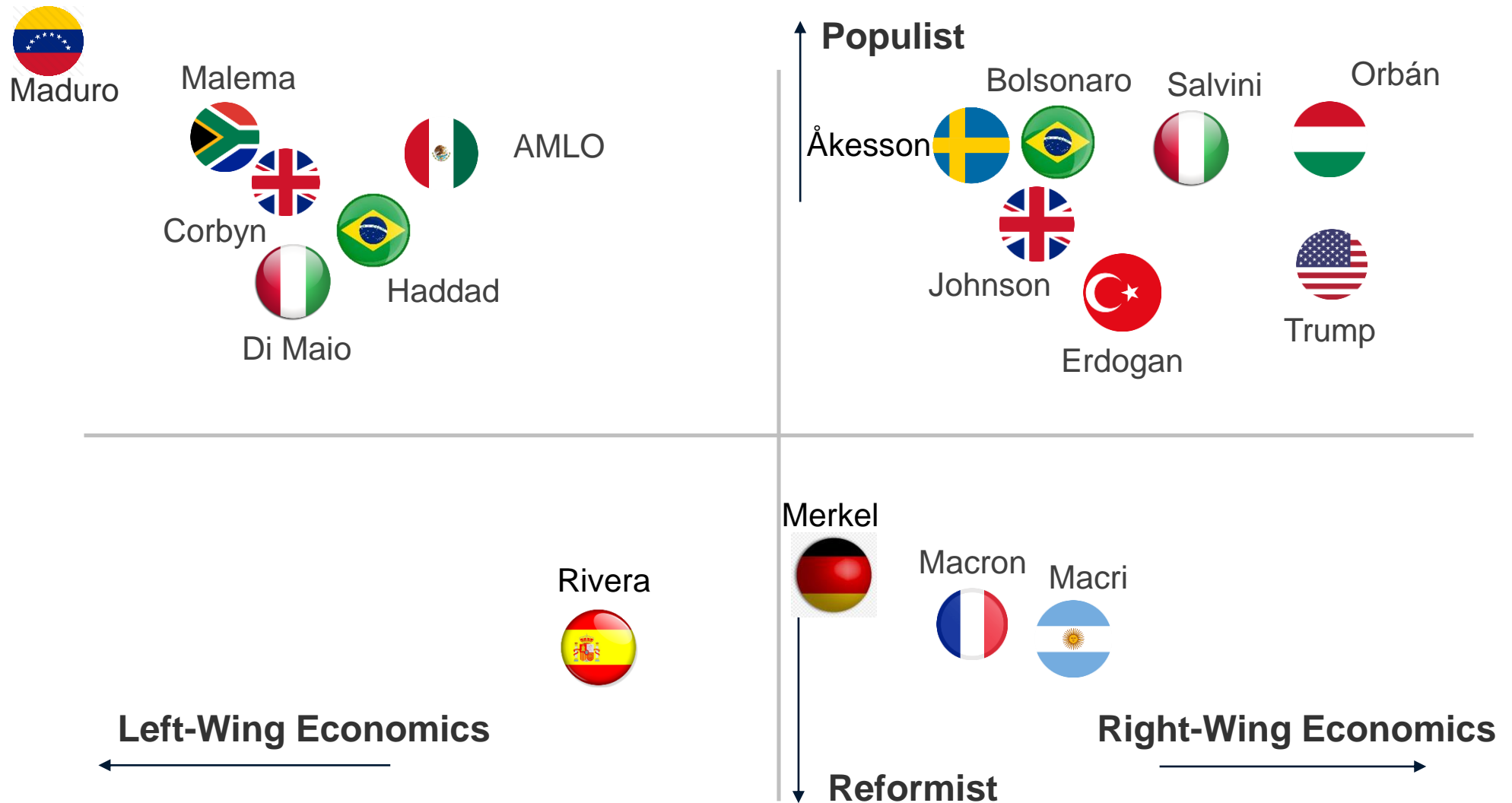
# The Populist Trap: An Economic Tragedy in Four Acts



Source: Algebris (UK) Limited, Dornbusch, R. and Edwards, S., The Macro Economics of Populism in Latin America (1991)

# Populism

## The Populist Playbook



Source: Algebris (UK) Limited

## Italy and the UK

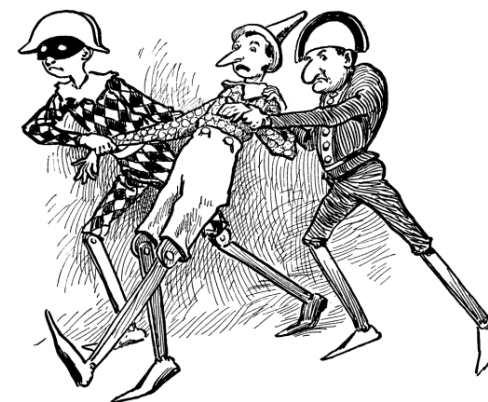
---

Lamp-Wick *“In the Land of Toys, every day, except Sunday, is a Saturday”*

Pinocchio: *“And if the Fairy scolds me?”*

Lamp-Wick: *“Let her scold. After she gets tired, she will stop.”*

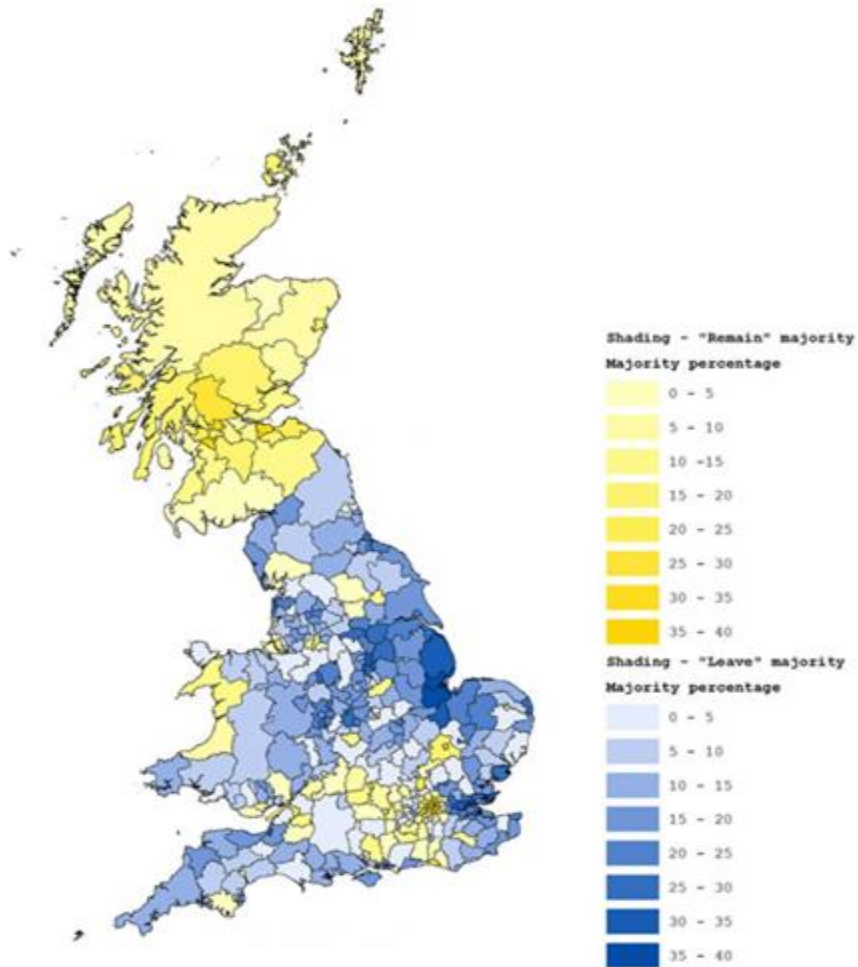
Pinocchio, Carlo Collodi, 1940



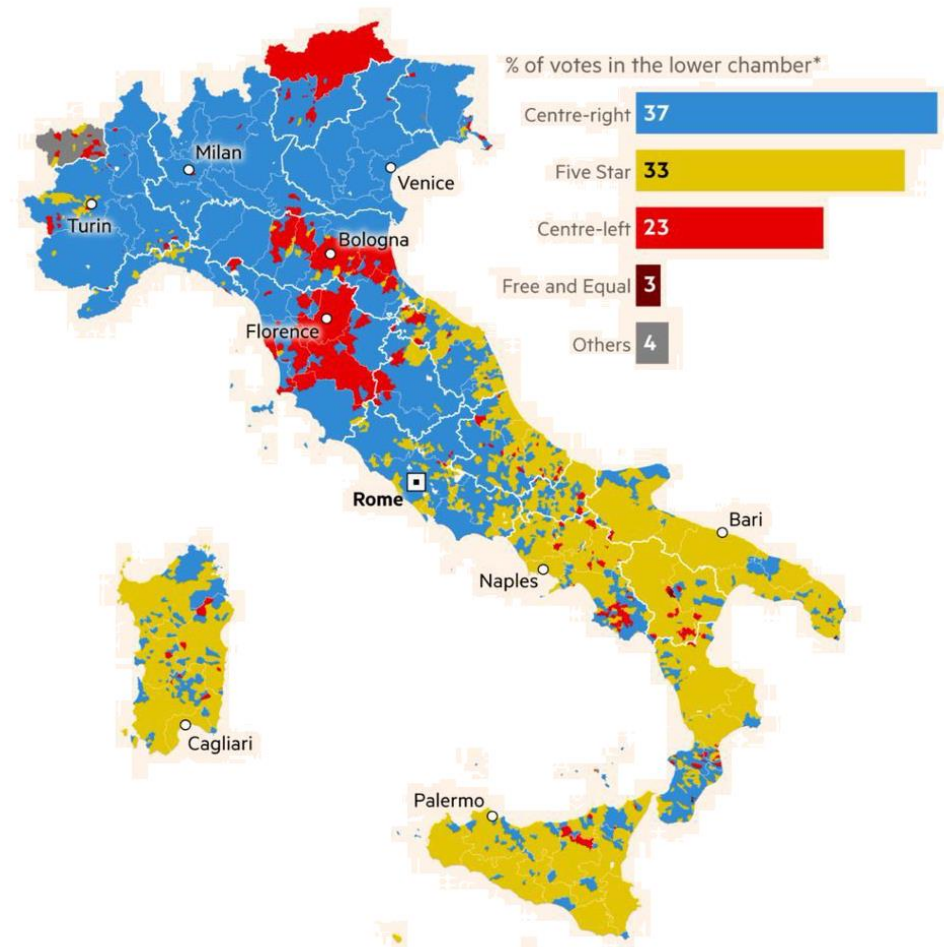
# Fragile Politics

## Geographical Income and Political Polarisation

2016 Brexit Referendum: Remain vs Leave



2018 Italian Elections: Leading Party by Region



Source: University of Oxford

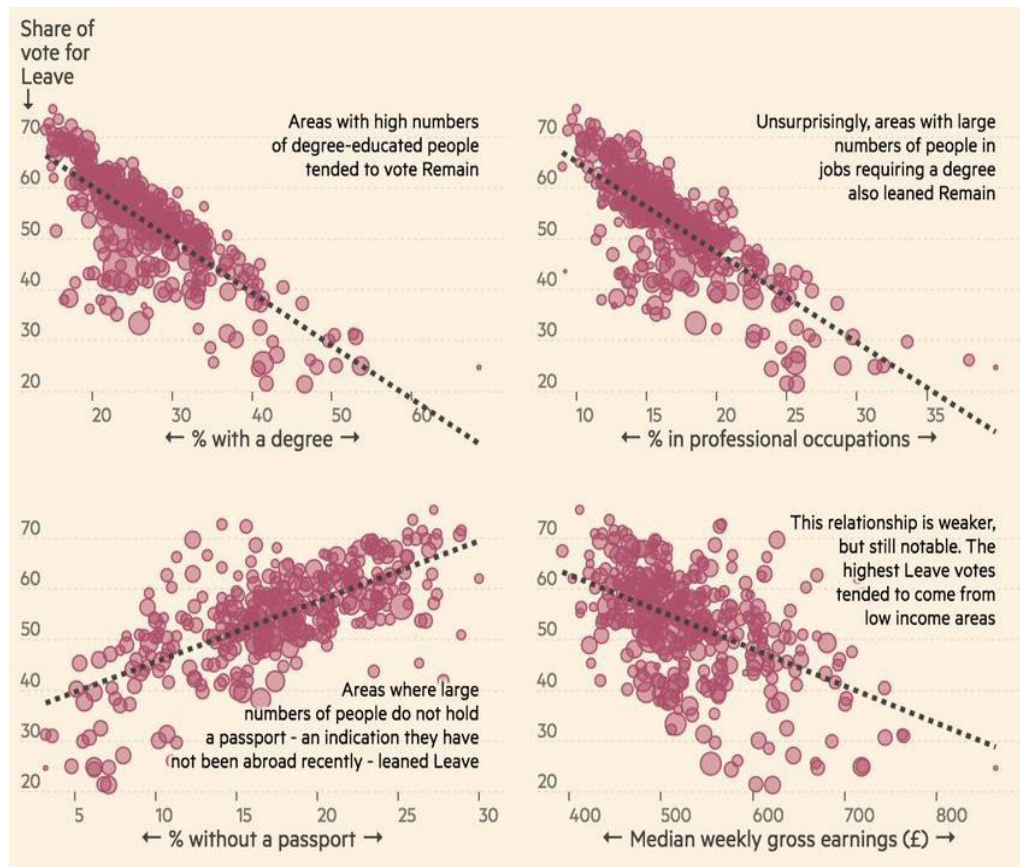
Source: FT



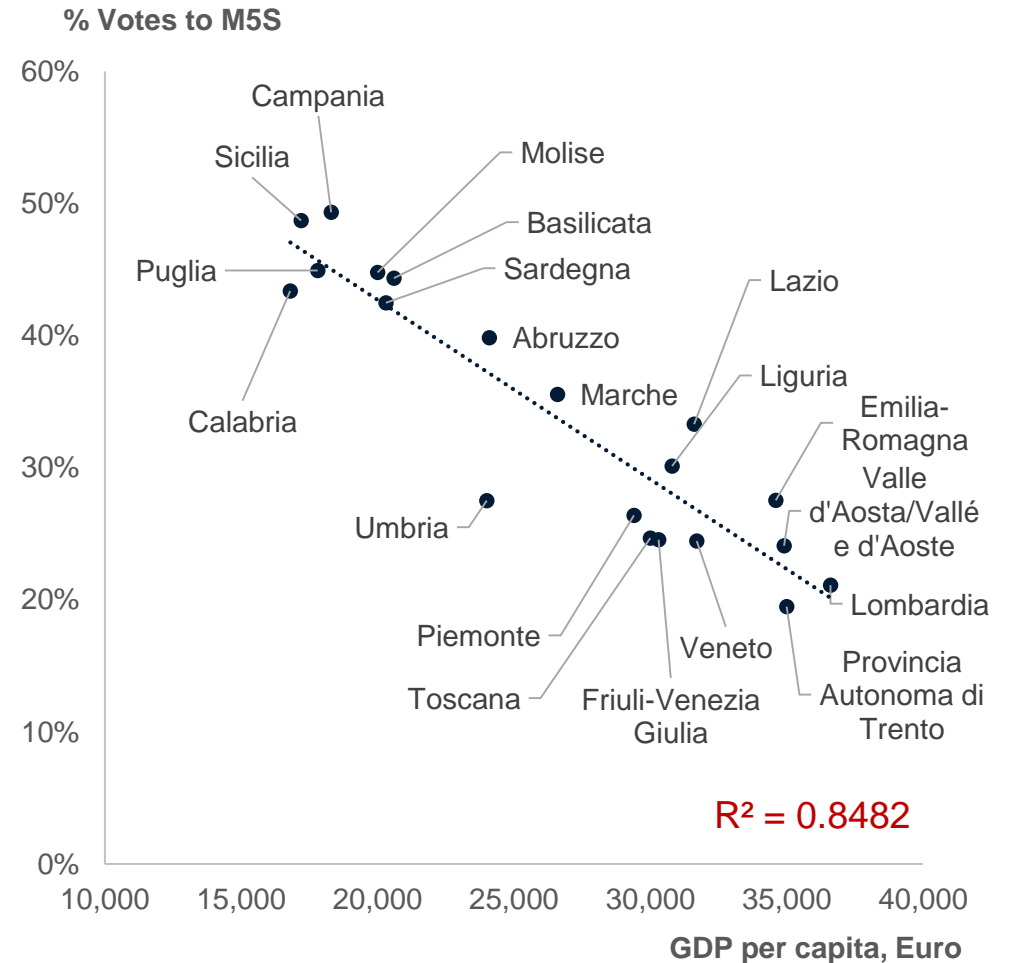
# Fragile Politics

## Inequality Provides Fertile Ground for Populism

The Demographics That Drove Brexit



2018 Italian Elections: % M5S Votes vs GDP per Capita



Source: Algebris (UK) Limited, UK Census, Office for National Statistics

Source: Algebris (UK) Limited, Eurostat, Italian Government Ministry of the Interior

# Fragile Debt Dynamics: Italy

## Overhangs: Is Italy's Debt Sustainable?

Italy Debt to GDP Ratio in 5 Years in Different Growth and Yield Scenarios  
Red Cells = Debt to GDP Ratio > 130%

		Average Annual Nominal GDP growth										
		-5%	-4%	-3%	-2%	-1%	0%	1%	2%	3%	4%	5%
Yield Change	-1.0%	187%	177%	168%	159%	151%	143%	136%	129%	122%	116%	110%
	-0.5%	188%	178%	169%	160%	152%	144%	137%	130%	123%	117%	111%
	0.0%	189%	179%	170%	161%	153%	145%	138%	131%	124%	118%	112%
	0.5%	191%	181%	171%	162%	154%	146%	138%	131%	125%	119%	113%
	1.0%	192%	182%	172%	163%	155%	147%	139%	132%	126%	119%	114%
	1.5%	193%	183%	173%	164%	156%	148%	140%	133%	127%	120%	114%
	2.0%	195%	184%	175%	166%	157%	149%	141%	134%	127%	121%	115%
	2.5%	196%	185%	176%	167%	158%	150%	142%	135%	128%	122%	116%
	3.0%	197%	187%	177%	168%	159%	151%	143%	136%	129%	123%	117%
	3.5%	198%	188%	178%	169%	160%	152%	144%	137%	130%	124%	117%
4.0%	200%	189%	179%	170%	161%	153%	145%	138%	131%	124%	118%	

Source: Algebris (UK) Limited, IMF, Bloomberg.\*Assuming an average annual primary surplus of 1.47% of GDP (long-run average for Italy since 1988); assuming 10% of total debt will be refinanced every year.

# Fragile Politics: UK

## Socio-economic Imbalances Grow

---

6<sup>th</sup> highest income inequality amongst OECD members

7% privately educated Britons are:

- 71% of senior judges
- 55% of Permanent Secretaries
- 53% of Senior Diplomats
- 50% of Lords
- 44% of the Sunday Time's 'Rich List'
- 43% of Columnists
- 35% of the National Rugby Team

Top 1% of earners pay 27% of tax

45% of Britons from the top income quartile remain in this bracket

12% only of those in the lowest income quartile ever migrate to the highest quartile

Nobles own 1/3 of the land, nearly 30% of children live near the poverty line

Source: Algebris Investments (UK) LLP, "Elitist Britain?" UK Gov

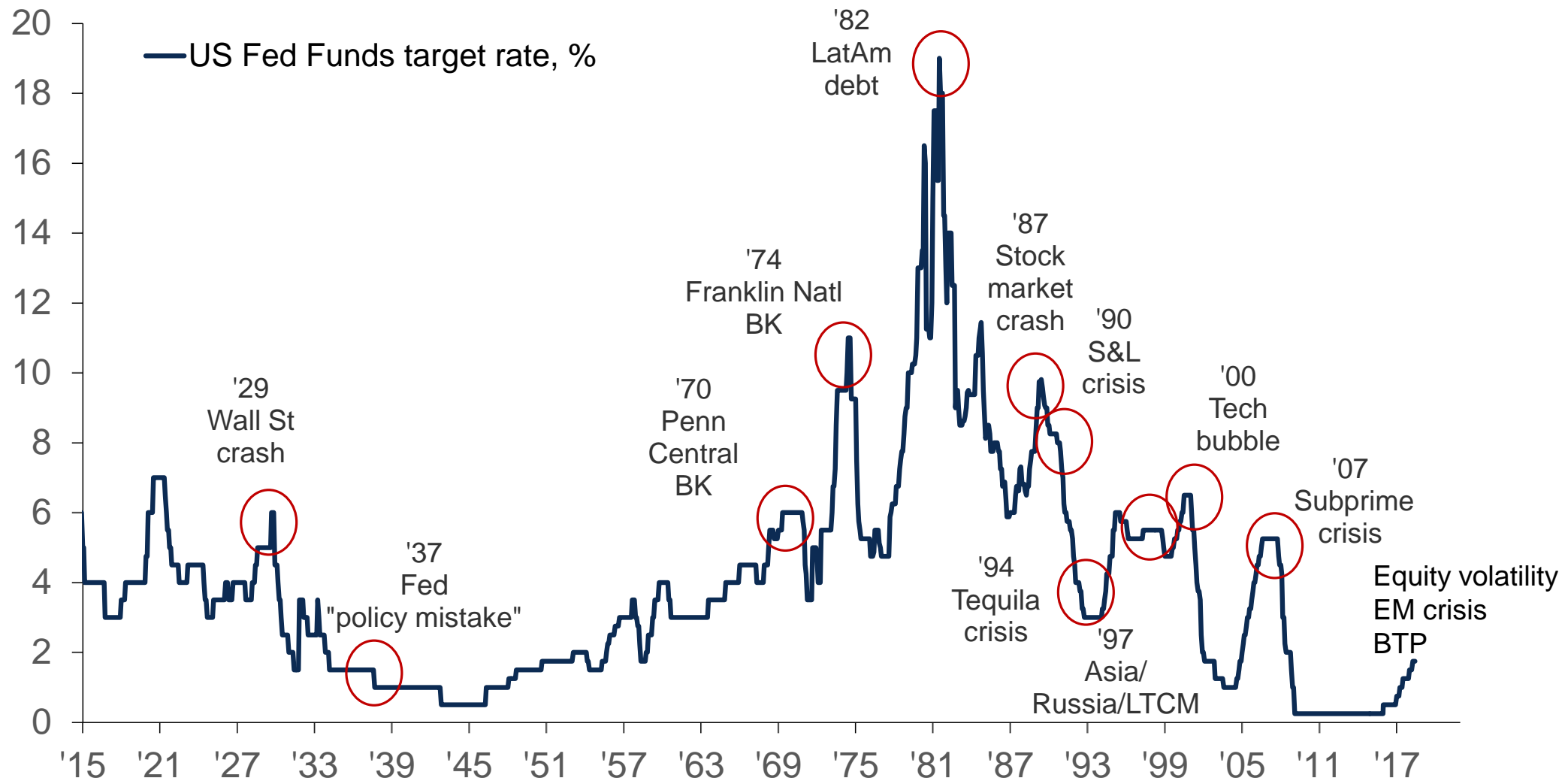
---

## Policy and Investment in Times of Populism

---

# Fed Tightening Cycles End in a Burst

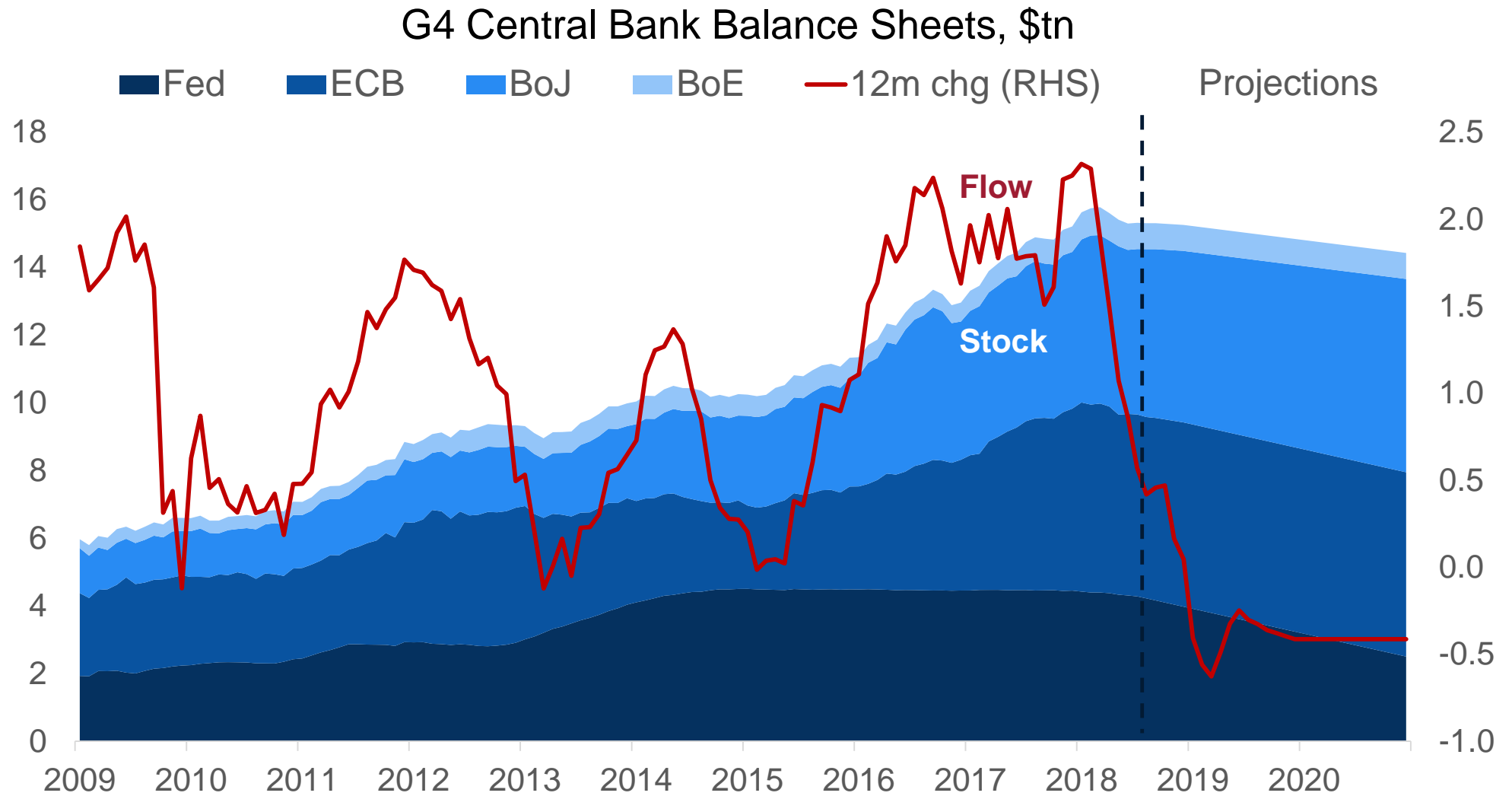
## A History of Bubbles



Source: Bank of America Merrill Lynch Global Investment Strategy, Bloomberg

# Bye Bye QE (for now)

## The End of QE



Source: Algebris (UK) Limited, Bloomberg, central bank websites

# Fragility: Nature, Policy and Markets

Fragility is Common, Anti-Fragility Rare

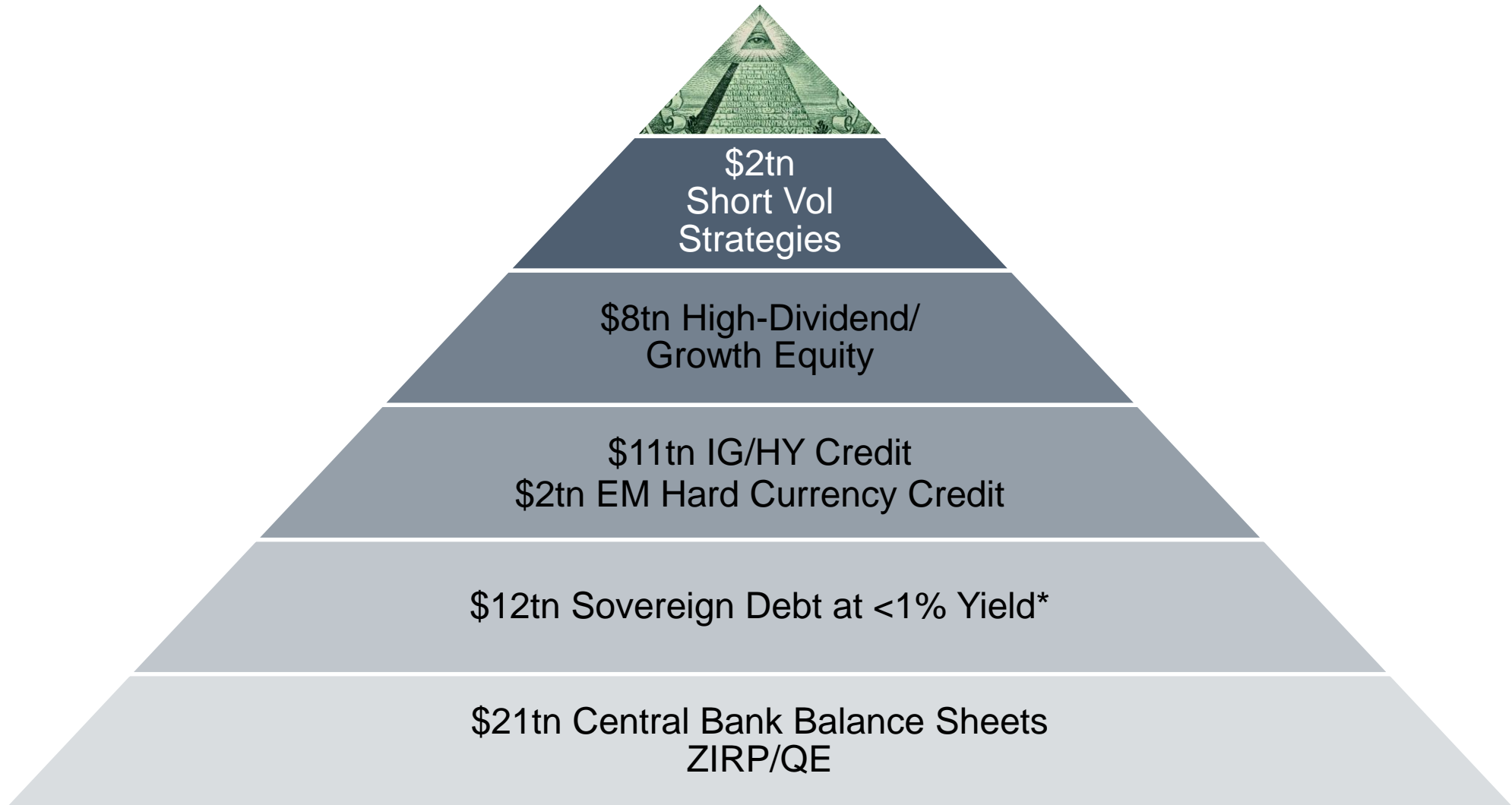
	<b>Fragile</b>	<b>Robust</b>	<b>Anti-Fragile</b>
<b>Medicine</b>	Anaesthesia	Vaccine	Mithridatism
<b>Pension System</b>	Defined Benefits	Defined Contributions	Social Shock Absorbers
<b>Technology</b>	Centralised Hard Drive	Underground Storage	Cloud Storage
<b>Mythology</b>	Damocles	Ulysses	Hydra
<b>Nature</b>	Dinosaurs	Land Turtle	Ant Colony/Bacteria
<b>Objects</b>	Tea Set	Anvil	Spring
<b>Financial Markets</b>	Passive Investing/Herding Financial Engineering/Complexity	Active Management	Tail Risk Strategies
<b>Monetary Policy</b>	Forward Guidance	Rule-Based Approach	Macro-prudential Policy
<b>Capital Structure</b>	Debt	Equity	AT1
<b>Sovereign Debt</b>	Hard Currency External Debt	Domestic Currency Debt	Growth-Linked Debt
<b>Economic Agents</b>	Politicians	Regulators	Long-Term/Contrarian Investors
<b>Government Structure</b>	Eurozone	Singapore	Switzerland

Source: Algebris (UK) Limited. With reference and inspiration from *Antifragile: Things that Gain from Disorder*, N. N. Taleb (2013)

# Debt, QE and Low Volatility

## QE and ZIRP/NIRP at the Base of the Carry Trade Pyramid

---



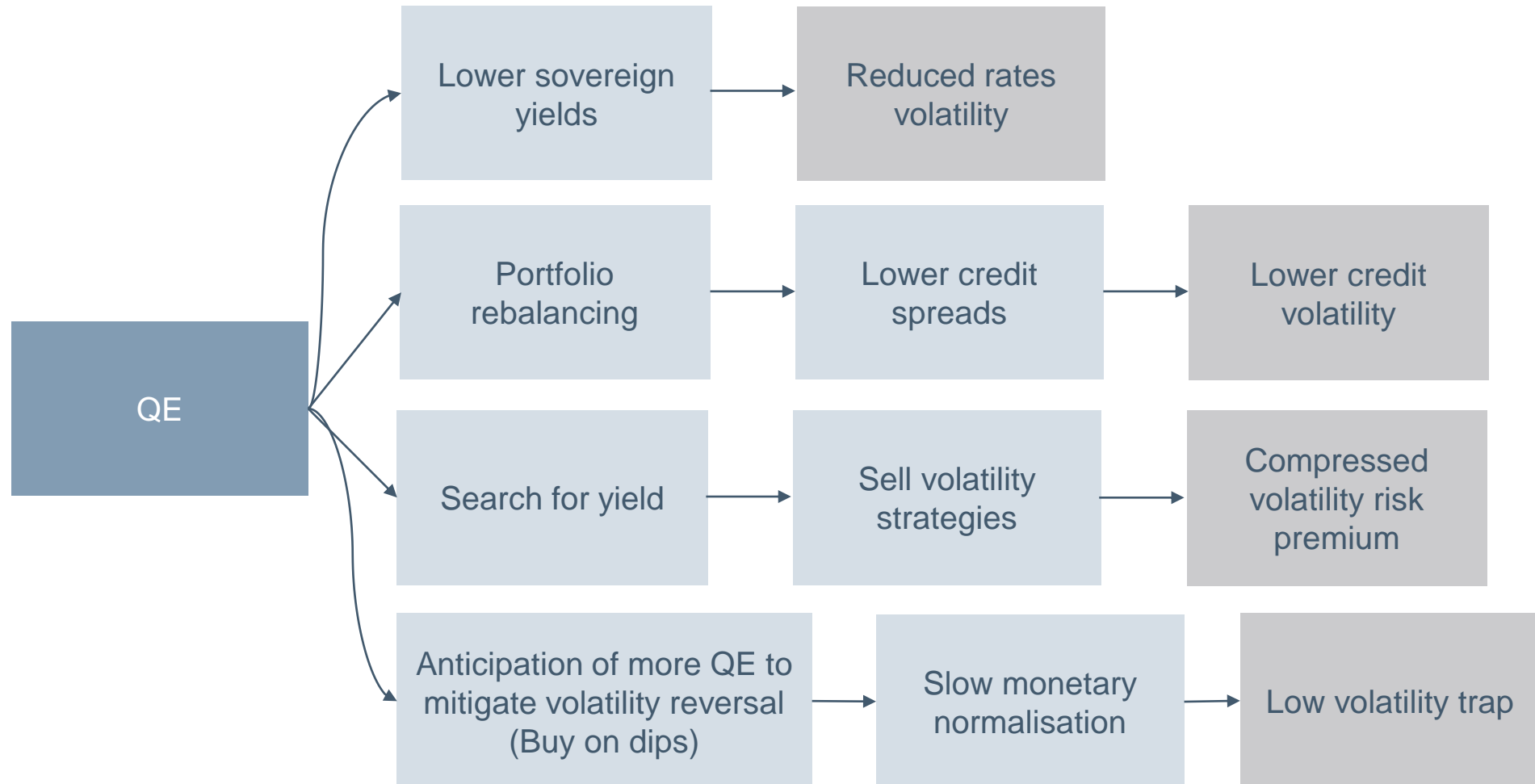
Source: Algebris (UK) Limited, Bloomberg. \*Data sourced from GS



# Low Volatility and Asset Bubbles

## From QE to Markets

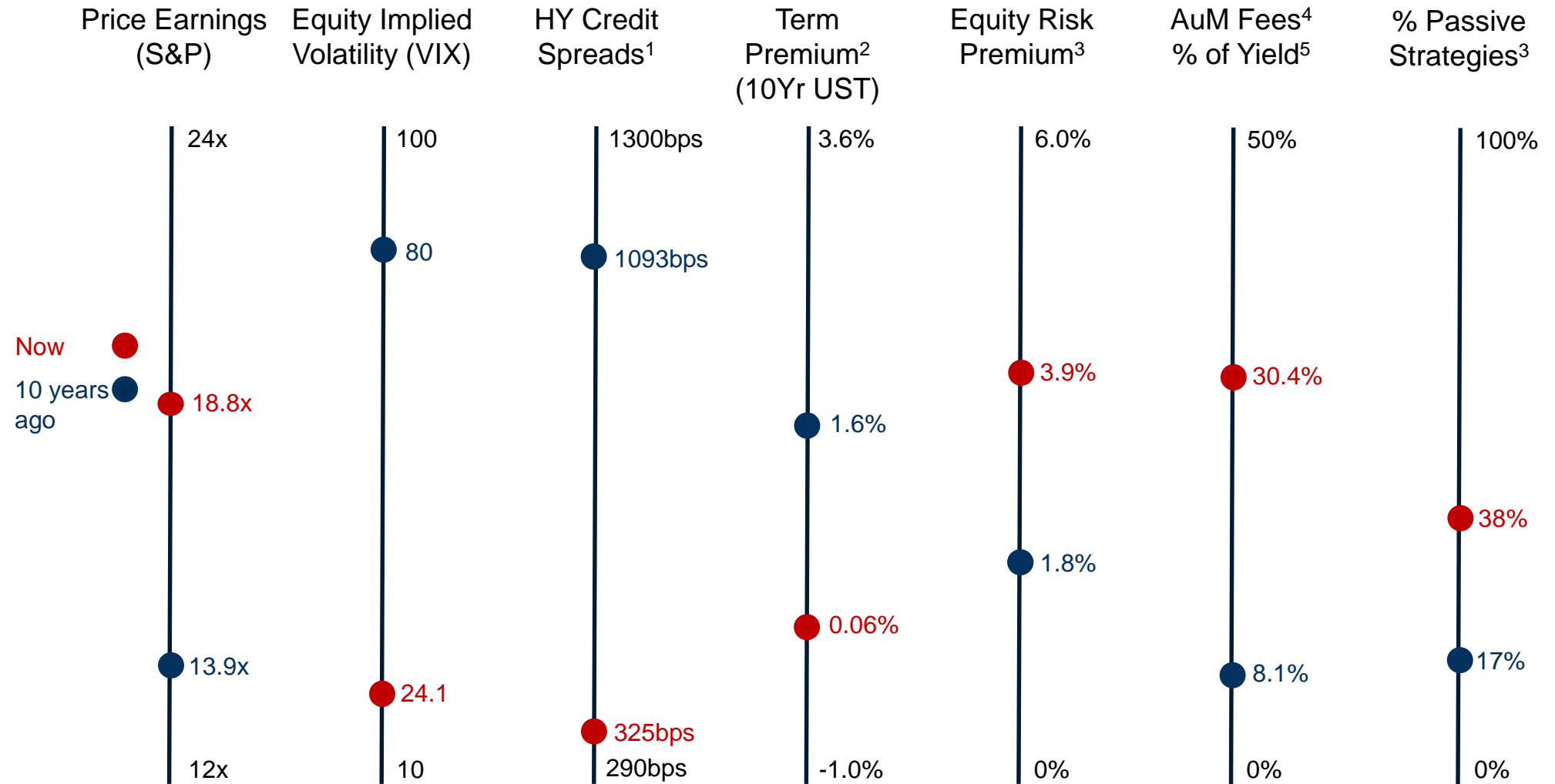
### How Loose Monetary Policy Has Reduced Risk Premia and Volatility



Source: Algebris (UK) Limited

# Investing in Times of Populism

## Debt, QE and Low Volatility

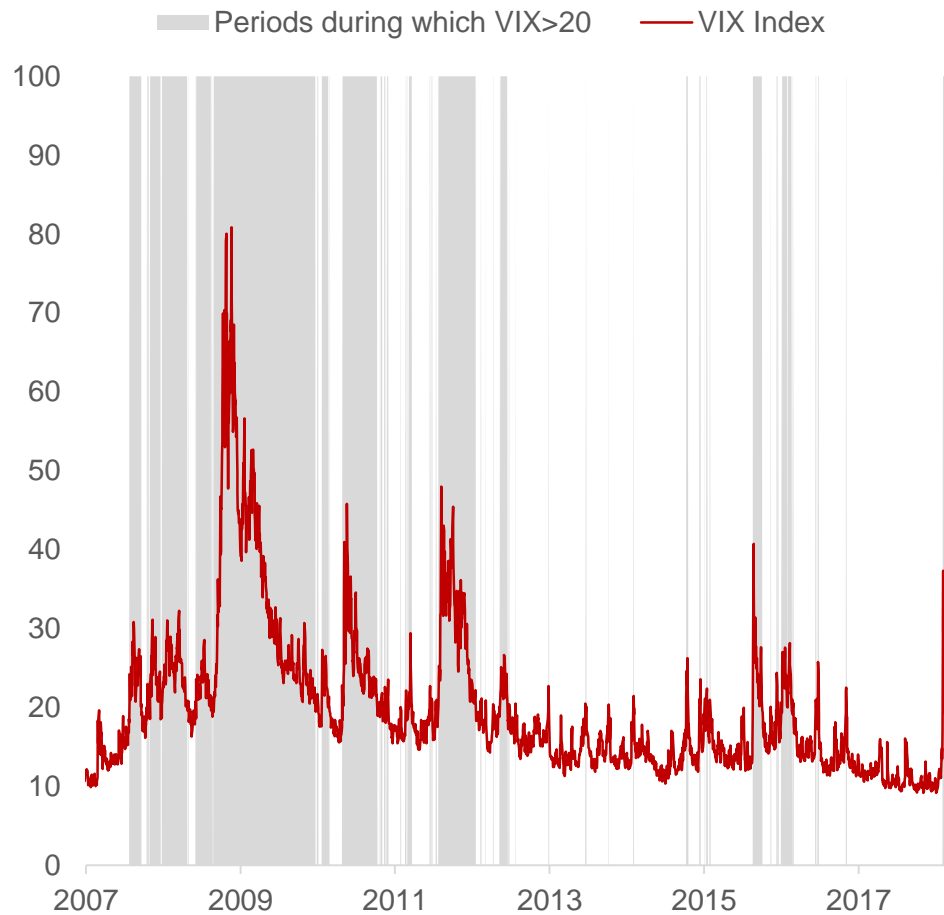


Source: Algebris (UK) Limited, Bloomberg, GS Research.

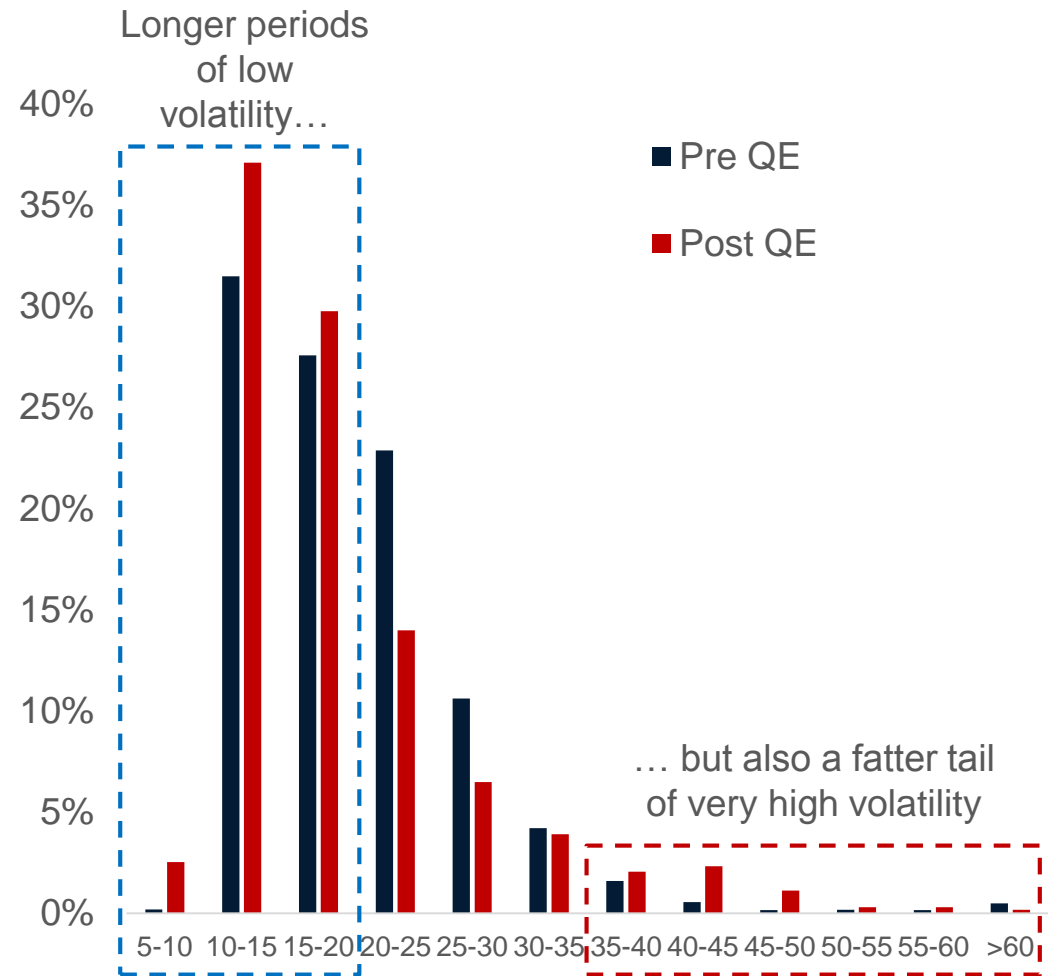
(1) ASW Spread for ICE BofAML US High Yield Index. 10 year range. (2) Spread of 10y5y UST yield and spread of 10y5y US CPI inflation (3) As of YE 17 (4) Assumed flat fixed 100bps AuM Fees over 10 year period. (5) ASW Spread for ICE BofAML Euro Corporate Index. 10 year range.

# Fragility Binary Markets

Length of High-Vol Periods



Proportion of Days When VIX Falls in the Range



Source: Algebris (UK) Limited, Bloomberg

Source: Algebris (UK) Limited, Bloomberg

## Conclusions: Reforms and Revolutions

---

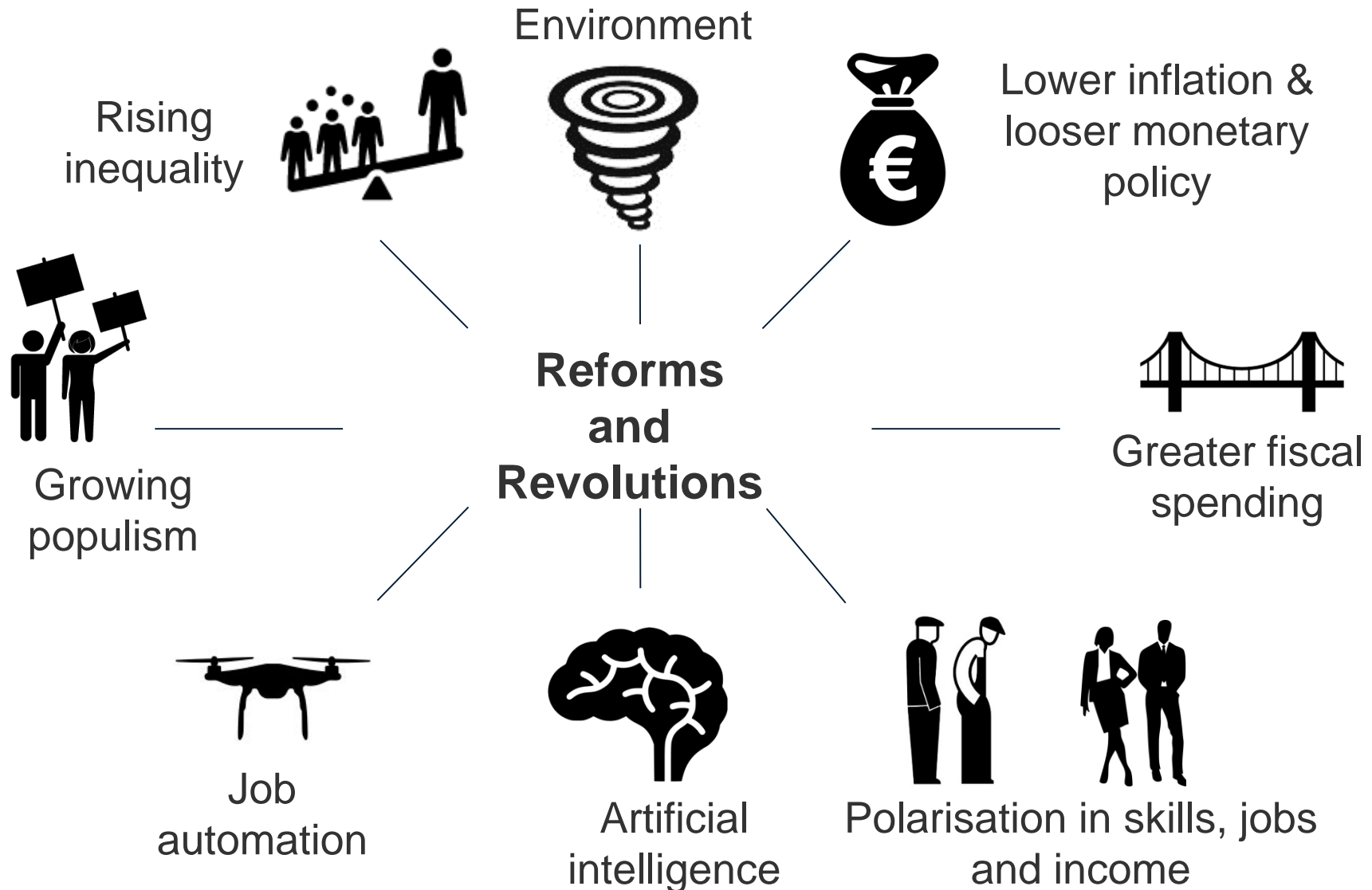
# The ECB and The Eurozone

## The EZ: A Positive-Sum Game, but Gains Are Unevenly Split

	<b>Intra-EZ trade boost % GDP effect, 2017</b>	<b>Extra-EZ Trade boost % GDP effect, 2017</b>	<b>Interest saving % 2017 GDP</b>	<b>Total gains as % 2017 GDP</b>
<b>Germany</b>	0.7%	4.3%	3.1%	<b>8.1%</b>
<b>France</b>	1.0%	-1.3%	4.6%	<b>4.3%</b>
<b>Spain</b>	1.3%	-2.6%	4.8%	<b>3.5%</b>
<b>Italy</b>	0.8%	-3.0%	4.8%	<b>2.6%</b>

Source: Algebris (UK) Limited estimates, Eurostat, ECB, OECD, IMF, World Bank, national statistics agencies, Bloomberg

# Reforms or Revolutions? A New Equilibrium



# Reforms and Revolutions

## Conclusions: A New Equilibrium

---

### Past

### Now

#### Economics

Economic theories built on assumptions of efficient markets, unlimited natural resources and growing populations

Markets are inefficient  
Limited resources, both natural and economic  
Ageing and shrinking populations

#### Technology/ Job markets

Technology boosts productivity  
Growth always creates new jobs

Automation/A.I./sharing economy →  
Jobless growth, income polarisation and lower wage growth  
Low interest rates → resource misallocation → low productivity → low quality & paid jobs →  
Phillips curve no longer working?

#### Society/ Politics

Wage growth and affordable housing  
Trade deals and globalisation

Asset appreciation > wage growth  
Rising inequality → Populism & more inefficiencies / nationalism and protectionism

# Reforms and Revolutions

## Conclusions: A New Equilibrium

---

	Past	Now
<b>Geopolitics</b>	Western powers influence / dominate / dictate	Emerging Powers: China, India, Middle East. Terrorism and nuclear threats
<b>Fiscal policy</b>	<p>Recession → fiscal stimulus → multiplier effect</p> <p>“Trickle Down”</p> <p>Recession → lower interest rates → credit growth → higher investment and consumption</p>	<p>High public debt → limited room for spending</p> <p>Balance sheet recession → investment and consumption no longer responsive to interest rates given over-leverage; consumers look at permanent future income: low interest rates depress savings and spending</p>
<b>Monetary policy</b>	Low interest rates today → growth and inflation → high interest rates in the future	Low interest rates today → asset bubbles and growing inequality, wage stagnation/hysteresis, financial fragility → low interest rates in the future

Source: Algebris (UK) Limited



# Ulysses and the Sirens



Source: Algebris (UK) Limited. "Ulysses and the Sirens", Painting by J. W. Waterhouse, oil on canvas, 1891.

*α*

# Bibliography

- 
- Clegg N., Renzi M., Serra D., [The Eurozone: A Positive but Unequal Game](#), Algebris Policy & Research Forum, September 2018
  - Furman J., [Market Concentration](#), OECD, 7 June 2018
  - Gallo A., Pan, T., Aney, A., Ameli, A., Morenes, P., Cotroneo, T., [The Silver Bullet | Have Central Banks Missed the Exit Train?](#), 1 May 2018
  - Gallo A., [Beware the fragility of the global economy](#), [World Economic Forum](#), 23 March 2018
  - Sushko, V., Turner, G., [The implications of passive investing for securities markets](#), BIS, March 2018
  - Bunn p., Pugh A., Yeates C., The distributional impact of monetary policy easing in the UK between 2008 and 2014, BoE Working Paper No 720, March 2018
  - [Scars or scratches? Hysteresis in the euro area](#), Speech by Benoît Cœuré, Member of the Executive Board of the ECB at the International Center for Monetary and Banking Studies, Geneva, 19 May 2017
  - Gallo, A., Cotroneo, T., Pan, T., Aney, A., Morenes, P., [The Silver Bullet | Introducing the Brexit Walrus](#), 31 March 2017
  - Corlett, A., Clarke, S. [Living standards 2017: the past, present and possible future of UK incomes](#), 31 January 2017
  - [Understanding Populism: Inequality by the Numbers](#), Blog post by Pushan Dutt (INSEAD Professor of Economics and Political Science), 16 December 2016
  - [Democracy Index 2016: Revenge of the "deplorables"](#), The Economist Intelligence Unit, 2016
  - Kuroda, H., ["Comprehensive Assessment" of the Monetary Easing: Concept and Approaches](#), 5 September 2016
  - Ball L., Gagnon J., Honohan P., Krogstrup S., [What else can central banks do?](#), Vox, 2 September 2016
  - Jobst A., Lin H., [The ECB's Negative Rate Policy Has Been Effective but Faces Limits](#), IMF, 10 August 2016
  - Stevens G., [An Accounting: Address to the Anika Foundation Luncheon](#), 10 August 2016
  - Gallo A., [Our global financial system is broken. Here's a plan for fixing it](#), [World Economic Forum](#), 6 July 2016
  - Williamson, S., [Neo-Fisherism: A Radical Idea, or the Most Obvious Solution to the Low-Inflation Problem?](#), Federal Reserve Bank of St. Louis, July 2016
  - Kuroda, H., [Overcoming Deflation: Theory and Practice](#), 20 June 2016
  - Corsetti, G., Feld P. L., Koijen R., Reichlin L., Reis R., Rey H., Weder di Mauro B., [Reinforcing the Eurozone and protecting an open society: Refugee bonds](#), 27 May 2016
  - Haldane, A. G., [The Great Divide](#), Bank of England, 18 May 2016
  - Rajan R., [Rethinking the Global Monetary System](#), Speech at the London School of Economics, 10 May 2016
  - Jones, R., [Innovation, research and the UK's productivity crisis](#), The University of Sheffield, April 2016
  - Standard & Poor's, [QE and Economic Inequality: The UK Experience](#), 10 February 2016
  - Cochrane, J., [Do Higher Interest Rates Raise or Lower Inflation](#), 10 February 2016
  - Kothari, S.P., Lewellen, J., Warner, J. B., [The behaviour of aggregate corporate investment](#), MIT, December 2015
  - Borio, C., [Labour reallocation and productivity dynamics: financial causes, real consequences](#), BIS, December 2015
  - Blanchard, O., E. Cerutti and L. Summers, [Inflation and activity – Two Explorations and their Monetary Policy Implications](#), IMF Working Paper No 230., November 2015
  - Borio, C., [Revisiting three intellectual pillars of monetary policy received wisdom](#), Luncheon address, Cato Institute, 12 November 2015
  - Borio C., Gambacorta, L., Hofmann, B., [The influence of monetary policy on bank profitability](#), BIS, October 2015
  - Contessi, S., Kerdnunvong, U., [Asset bubbles: detecting and measuring them are not easy tasks](#), Federal Reserve Bank of St. Louis, July 2015
  - Belfied, Cribb, Hood, Joyce, [Living Standards, Poverty and Inequality in the UK: 2015](#), Institute for Fiscal Study, July 2015
  - Haldane, A. G., [Stuck](#), Bank of England, 30 June 2015
  - Borio C., [Persistent unusually low interest rates. Why? What Consequences?](#), BIS, 28 June 2015
  - IMF, [Global Financial Stability Report](#), April 2015
  - Gallo, A., Walker, R., Tyrrell-Hendry, L., Popovic, M., Grant, A., Pan, T., [The Revolver | Divided Kingdom: Britain's future beyond the election](#), 14 April 2015
  - Sigurjonsson, F.; [Monetary Reform, A better monetary system for Iceland](#), Report commission by the Prime Minister of Iceland, 20 March 2015
  - OECD (2015), [Economic Policy Reforms 2015: Going for Growth](#), OECD Publishing, 9 February 2015
  - Milburn, [Elitist Britain?](#), Social Mobility and Child Poverty Commission, 2014
  - Kothari, S.P., Lewellen, J., Warner, J., [The behavior of aggregate corporate investment](#), MIT Sloan Research Paper No. 5112-14, 19 October 2014
  - Jahan S., Mahmud A. S., Papageorgiou C., [What is Keynesian Economics?](#), IMF, September 2014
  - Carrol, C.D., Slacalek, J., Tokuda, K. (2014) [The Distribution of Wealth and the Marginal Propensity to Consume](#), ECB Working Paper No 1655
  - Sharpe, S.A. and Suarez, G.A. (2014) [The insensitivity of investment to interest rates: Evidence from a survey of CFOs](#), Finance and Economics Discussion Series, FRB Washington DC
  - Lakner C., Milanovic B., [Global Income Distribution From the Fall of the Berlin Wall to the Great Recession](#), World Bank Research Paper No 6719, December 2013
  - Rotman, D., [How Technology is Destroying Jobs](#), MIT Technology Review, 12 June 2013
  - Taleb, N., [Antifragile: Things that Gain from Disorder](#), 2012
  - Koo, R., [The world in balance sheet recession: causes, cure, and politics](#), Real-world Economics Review, issue no. 58, 2011
  - Rajan, G. R., [Let Them Eat Credit](#), New Republic, 27 August 2010
  - Minsky, H., [A Theory of Systemic Fragility](#), 21 May 1976
  - Lewis, W. A., [Economic Development with Unlimited Supplies of Labor](#), May 1954
-