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"Don't Fear the Reaper"

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While subject to debate, the origins of Halloween appear to reach back to the ancient Gaelic harvest festival of Samhain. The celebration marked the end of another growing season with the harvesting of crops and slaughtering of livestock in preparation for winter, or what they called the dark half of the year. For the Celts, the changing seasons symbolized the cycle of life with the darkness of winter representing death. During this time of year, it was believed that spirits of the dead returned seeking hospitality from the living, hence the origins of trick-or-treating. In the Christian adaptation, Halloween, or more correctly All Hallows' Eve, is meant as a day to honor saints and remember all those who have departed. No matter the spiritual foundation, themes of seasonality, death and renewal are commonplace at harvest time. Not surprising then is the imagery of the grim reaper toiling to harvest souls.

The fall reminds us that both the cycles of the seasons and life are inevitable; however, men often attempt to control natural cycles in the goal of improving wellbeing. These efforts often bring about unintended consequences. For example, to stop wildfires, it was standard practice that forests be thinned out. This action, however, actually increases the chance and intensity of wildfires. It also failed to recognize the role of wildfire in the growth cycle of the forest by promoting renewal as the fires' ashes fertilize the soil for the new growth. Destruction paves the ways for renewal. Despite a limited history of success, we continue in our efforts to control nature.

Similarly, the study of markets recognizes the idea of creative destruction; down cycles in the economy pave the way for the up cycles. As with the example of wildfire management, we cannot leave well enough alone. Governments seem compelled to control the economic cycle preventing economic fires from starting.

During this most recent election season, Hillary Clinton and Donald Trump proposed radically different approaches to improving our lot in life. Neither lacked confidence or feared control. With regards to the economy, there is a general acceptance that something needs to be done. To the majority of voters, it was tax and spend and for the majority of states, it was tax cuts and spend. Spending is the common denominator. Expect President-elect Trump to propose $3-5 Trillion in a combination of tax cuts and infrastructure spending.

Why do we insist on thinking that economic cycles, like wildfires, are inherently evil, needing to be tamed? Sure, it would be great to eliminate unemployment, poverty, business failure and bankruptcy. Isn't it through business failures and bankruptcy that our President-elect attained success?

The cost may very well be the opportunity itself. Is it possible to manage the downside of the economic cycle without destroying its upside? The incentives expressed as higher returns are often the opportunities that exist at the bottom of economic cycles.

Complex problems rarely have simple solutions. Economic systems are inherently interrelated and often exist in disequilibrium. Attempts to use monetary and fiscal policies to achieve a general economic prosperity have historically failed. The results of the experiment generally benefit certain actors at the expense of others. Nevertheless, we continue to try and error.

Central banks are currently reaching the limits of their effectiveness. While they have successfully breached the zero bound of interest rates through unconventional means, they failed to appreciably improve growth prospects. They have, however, managed to widen the wealth gap, encourage more debt creation and promote bad behavior. They have opened the door for politicians to pursue more traditional government spending programs and tax incentives.

The transition from monetary to fiscal policy is upon us. The Trump victory with the Republican support of both Congressional houses should result in a credible fiscal stimulus program from Washington in 2017 or 2018. China and Japan have already embarked on policies to promote state-sponsored demand to offset weakness in the private sector. European leaders are lagging but eventually will succumb to the temptation to spend.

The constraint globally to stimulate final demand and promote prosperity will be the existing level of debt and the shortage of income to sustain or support it. Current global debt levels exceed 250% of GDP. A premature increase in interest rates will threaten government's ability to stimulate demand. Interest rates moves are swift, whereas governments are slow to implement spending programs. The leads and lags could prove to be the difference between success and failure.

Managing interest rates before fiscal policies are enacted will be critical to avoiding a recession. Furthermore, it would be helpful to central banks to withdraw their accommodative policies in concert with a pick-up in general economic conditions. The problem is complicated by the fact that the current global economic cycle is aging. It has been subpar despite all efforts by policymakers to normalize it. As a result, many of the tools and or weapons have already been employed. Higher rates could short-circuit attempts to create demand.

A recession in the next 12-18 months could prove problematic. A recent paper by Marvin Goodfriend of Carnegie Mellon University was presented at the Economic

Policy Symposium sponsored by the Federal Reserve Bank of Kansas City in Jackson Hole, Wyoming on August 26, 2016. The title of the paper "The Case for Unencumbering Interest Rate Policy at the Zero Bound" argues for further unconventional mechanisms. The presumption is that monetary policy is too constrained by the zero interest rate bound and needs the flexibility to manage larger negative interest rate moves.

In his paper, Goodfriend compares today's interest rate policies to previous regimes like the gold standard and fixed-rate exchange mechanisms which acted to constrain fiat currency creation. If we can eliminate the zero bound, we can drive interest rates low enough to stimulate loan demand and consumption. The assumption is that during the next recession, central banks might need to push interest rates down as far as negative 3.5% to be effective. This feat will require the financial system to adopt entirely new rules.

Assets like cash, gold and even bitcoin become attractive investments and limit policy options in an environment of significant negative interest rates. Policymakers will attempt to limit the ownership of these options if they want their policies to work. Notably, Europe and India have already taken steps to remove large denomination bills from their currencies.

We take the annual change of seasons for granted, expecting what we sow in spring will be harvested in fall. Yet, we are far less inclined to let economic cycles come and go. Each economic cycle brings with it a unique set of challenges. We react with what we think are a new set of tools. We try to manipulate behavior through interest rate policies since they appear easiest to implement. We engage in fiscal folly with its inherent political trials and tribulations.

Perhaps, we should be less anxious to harvest our gains and losses and let the full cycle play out. Death in economic terms is not as permanent as it is in life. In fact, death in economic terms reduces excess capacity and obsolesces in favor of opportunity and innovation. The darkness of economic winter will be followed by the light of springtime.

As the song goes, *Baby take my hand, don't fear the reaper.*

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