



MORNING BRIEFING

October 9, 2019

Helicopter Money

See the [collection](#) of the individual charts linked below.

(1) Despite uncertainty about trade wars, small business owners remain upbeat. (2) Small business owners still want help. (3) Pricing pressures easing. (4) Earnings driving the business cycle. (5) Fewer complaints. (6) Central bankers taking helicopter flying lessons? (7) Bernanke likes the idea of monetary-financed tax cut for next recession. (8) Another round of QE could face opposition from the Left. (9) “Free” money may not be cost-free.

Small Business Survey: Less Gusto. Uncertainty is weighing on small business owners, according to September’s [survey](#) conducted by the National Federation of Independent Business (NFIB). “The tariff wars are adversely impacting many small firms, about 30 percent recently reported negative impacts,” according to the NFIB. Yet most of the survey’s business indicators remain relatively high, though below last year’s peaks. More specifically:

(1) *The Small Business Optimism Index* was 101.8 during September, down from a record high of 108.8 during August 2018. It’s up from 94.9 during October 2016, the month before Trump was elected president with promises of tax cuts and deregulation ([Fig. 1](#)).

(2) *The labor market* remains strong as 35.0% of respondents reported job openings. This response has been fluctuating in a 35%-40% range for the past 16 months ([Fig. 2](#)). The net percentage of them reporting plans to increase hiring over the next three months was 17.0%, down from a record 26.0% during August 2018, but still around the past two cyclical peaks. Fifty percent said that there are few or no qualified applicants for job openings.

The percentage planning to raise worker compensation over the next three months was 18.0% ([Fig. 3](#)). This series tends to be a leading indicator for average hourly earnings growth on a y/y basis. It suggests that wage inflation may remain around 3.0%, as it has for the past 14 months.

(3) *Pricing pressures* seem to be easing. The percentage of respondents planning to raise average selling prices fell to 15.0% from a recent high of 29.0% during November 2018 ([Fig. 4](#)). The percentage actually doing so was down to only 8.0%. Inflationary price pressures are dissipating despite concerns about rising labor costs and tariffs.

(4) *Capital-spending plans* remain solid. During September, 27% of small business owners were planning capital expenditures over the next three to six months ([Fig. 5](#)). It’s down from last year’s peak of 33% during August. According to the NFIB, “Plans to invest were strong in manufacturing (34%), professional services (33%), wholesale trades (32%).”

(5) *Earnings* continue to drive employment and capital spending, with all three on solid uptrends ([Fig. 6](#) and [Fig. 7](#)). The NFIB survey includes a series for the net percentage of firms with higher versus lower earnings over the past three months. This series has always been negative since it started in 1974. It

came close to turning positive last year for the first time ever. This series is very highly correlated with the percentage of firms expecting to hire over the next three months. The same can be said about the relationship between the earnings series and capital-spending plans over the next three to six months.

(6) *The most important problems* facing small business owners are less troublesome since Trump won the election. The percentage of firms complaining about poor sales dropped from 12.0% during October 2016 to 8.2% currently, using the six-month average of this series. On the same basis and over the same period, companies complaining about taxes fell from 21.7% to 15.8%, while complaints about government regulation fell from 19.5% to 13.0% ([Fig. 8](#)).

Central Banks: The Outer Limits. *The Outer Limits* was a show on TV from 1963-65. The series is often compared to *The Twilight Zone*, but with more of a sci-fi bent. Some of the episodes were scary, especially for young kids. Today, some of those first young viewers are fearing that the outer limits of monetary policy will soon be tested.

The world's major central banks are scaring us with their out-of-this-world monetary policies. They've tried numerous unconventional policies to boost inflation and stimulate faster economic growth, including zero interest rates, ultra-easy forward guidance, quantitative easing, and negative interest rates. These unconventional tools have become very conventional since the Great Financial Crisis. Now there is chatter about the central banks considering "helicopter money" and embracing Modern Monetary Theory. These are the outer limits of monetary policy, for sure.

"Monetary policy is almost exhausted as global interest rates plunge towards zero or below," wrote three executives from BlackRock along with former Fed official and BlackRock Senior Advisor Stanley Fischer in an 8/15 BlackRock Investment Institute [report](#) titled "Dealing with the next downturn: From unconventional monetary policy to unprecedented policy coordination." The authors say that "[u]nprecedented policies will be needed to respond to the next economic downturn."

Recall that Fischer was the Fed vice chair when Janet Yellen was the chair. When he taught at MIT, his students included Ben Bernanke and Mario Draghi. The man is influential!

According to the Blackrock study, fiscal policy will struggle to deliver stimulus in a "timely fashion" on its own. So some fiscal and monetary policy coordination will be necessary. The four propose a framework for an ultra-unconventional monetary policy: helicopter money. Ray Dalio endorsed a similar idea in a 5/1 LinkedIn [post](#) titled "It's Time to Look More Carefully at 'Monetary Policy 3 (MP3)' and 'Modern Monetary Theory (MMT)."

Of course, helicopter money isn't a new concept. Back in 1969, economist Milton Friedman coined the term "helicopter drop" in his book *The Optimum Quantity of Money*. The term gained currency in 2002 after then Fed Governor Ben Bernanke referenced it in a 11/21/02 [speech](#), earning him the nickname "Helicopter Ben."

Helicopter Ben revisited the subject in detail in an April 2016 Brookings's [series](#) of posts titled: "What tools does the Fed have left?" Bernanke lamented: "[S]o long as people have the option of holding currency, there are limits to how far the Fed or any central bank can depress interest rates. Moreover, the benefits of low rates may erode over time, while the costs are likely to increase." He explained that when monetary policy is inadequate, especially when interest rates are "stuck" near zero, fiscal policy could be a "powerful alternative."

During a 3/21 [interview](#) with Erik Townsend's MACRO Voices, David Rosenberg of Gluskin Sheff noted that Bernanke laid out the "whole menu of options for what the Fed would do to fight a deflationary

recession with interest rates at zero” in his 2002 speech. Rosenberg added that the Fed “did everything in that playbook except” monetizing fiscal policy, which is the “big bazooka.” Rosenberg “firmly expects” to see helicopter money in the next few years.

My view is that fiscal stimulus programs facilitated by monetary policy are likely when the next downturn occurs. Central banks indeed are running out of both conventional and unconventional monetary policy tools. Going deeper into negative rates or asset purchases already has proven to have diminishing returns.

My main concern is that fiscal-like programs financed by central banks remain largely untested. It’s possible that inflation could get too hot if fiscal and monetary policymakers in coordination become too aggressive with their free-money meddling. And with many complex implementation issues that could blur the lines between monetary and fiscal policy, things could get dicey. Let’s drop down for a closer look:

(1) *What is helicopter money?* “[Suppose] one day a helicopter flies over this community and drops an additional \$1,000 in bills from the sky, which is, of course, hastily collected by members of the community. Let us suppose further that everyone is convinced that this is a unique event which will never be repeated,” wrote Milton Friedman in his 1969 book.

The analogy is an apt one: Helicopter money is money that’s added to the money supply by putting it directly in the hands of the people rather than indirectly by lowering interest rates to stimulate lending or buying bonds to increase bond investors’ capital. Central bankers like to talk about the effectiveness of the “transmission mechanism” of monetary policy to the overall economy. Infusing an economy with “free” money is the most direct transmission mechanism there could be—and an effective one, assuming that it works to generate spending and demand among the recipients.

In his 2002 speech, Bernanke explained: “A money-financed tax cut is essentially equivalent to Milton Friedman’s famous ‘helicopter drop’ of money.” In a footnote, he elaborated: “A tax cut financed by money creation is the equivalent of a bond-financed tax cut plus an open-market operation in bonds by the Fed, and so arguably no explicit coordination is needed. However, a pledge by the Fed to keep the Treasury’s borrowing costs low, as would be the case under my preferred alternative of fixing portions of the Treasury yield curve, might increase the willingness of the fiscal authorities to cut taxes.”

Rosenberg agreed with Townsend during his March interview when he suggested that if the Fed proposes another round of QE, “the political left is going to say ‘no way.’ There’s going to be a huge revolt and people are going to say, look, if you’re going to create money out of thin air, it needs to be helicopter money. Give it to the people, not to Wall Street.”

(2) *Forms of helicopter money.* Dalio framed the subject well when he said that helicopter money is a form of MP3. To borrow from Dalio’s terms, MP1 is conventional interest-rate-setting monetary policy that works to stimulate bank lending, MP2 is unconventional bond-buying quantitative easing (QE) type monetary policy that injects money into the investment markets, and MP3 covers last-resort monetary policies that are more direct, like helicopter money and Modern Monetary Theory (MMT). (For more on MMT, see our 4/19/18 [Morning Briefing](#).)

MMT and helicopter money both fall under the umbrella of a monetary-financed fiscal operation, which could come in many different flavors. (See for example, Dalio’s helpful [chart](#) titled “Flavors of Monetary Policy 3” in his LinkedIn post.) There are two primary variants of this: one targets the private sector and the other the public sector.

In the private-sector approach, the central bank could provide printed cash directly to households (i.e., true helicopter money) or finance a direct tax cut with printed money. The public-sector approach involves a central bank distributing interest-free funds to the government for the specific purpose of spending on fiscal projects like infrastructure.

Such financing arrangements should positively “influence the economy through a number of channels,” namely by boosting GDP, jobs, household income and consumer spending as well as inflation, Bernanke explained. Debt-financed fiscal programs work similarly; however, they increase future debt service costs and future tax burdens, which could offset “some of the program’s expansionary effect.”

The folks at BlackRock note that, unlike monetary-financed programs, deficit-financed programs raise the question of debt sustainability and could force interest rates to rise. Helicopter drops could be perceived as relatively permanent by the public, an important aspect of the effectiveness of fiscal programs.

(3) *Problems with helicopter money.* Helicopter money is not without potential problems. What’s to ensure that the recipients will spend the cash or otherwise put it to uses that stimulate broader economic demand? Who should get the “free” money and how much? Should it be equally distributed to all citizens? Those are fiscal questions, outside of central banks’ purview. So some level of fiscal and monetary policy coordination would be required.

Similarly, if central banks were to hand interest-free money over to the Treasury, fiscal policymakers would need to decide what to do with it. Ideally, those decisions would be based on the best ways to stimulate the economy, but it would be hard to believe that they wouldn’t also be politically motivated.

You can see how easily the lines between fiscal and monetary policy could become blurred in these cases, potentially compromising monetary policy’s vitally important independence from politics.

Bernanke proposed a solution to the independence issue in his 2016 note, which happens to be the same solution later proposed by the group at BlackRock: Congress could create a special Treasury account at the central bank, giving the bank the sole authority to “fill” the account. The central bank would add funds to the account only when a specified amount of funding was needed to achieve the bank’s employment and inflation goals.

Alternatively, the Treasury could issue debt, which the central bank would agree “to purchase and hold indefinitely, rebating any interest received to the Treasury.”

(4) *Who could be the next helicopter pilot?* At his last [press conference](#), outgoing European Central Bank (ECB) President Mario Draghi spearheaded his last-ditch effort to “do whatever it takes” to stimulate the eurozone with yet another stimulus package, including a further negative deposit rate and a revived QE program without an end date. Nevertheless, he said that fiscal policymakers too must step up and do their part.

Draghi has recently come out in [support](#) of MMT; however, he said during his last press conference that helicopter money is not something that the ECB has seriously considered. Incoming ECB President Christine Lagarde has publicly [agreed](#) with Draghi on fiscal spending and committed to review the ECB’s unconventional policies.

Fed Chair Jerome Powell seems to prefer to stay on the ground. While his Fed recently has lowered interest rates, Powell has yet to restart QE and has [said](#) that he thinks policies like MMT are “just wrong.” But Powell has been known to change his mind. Maybe someday, facing the next downturn

coupled with perpetually low inflation and near-zero interest rates, we'll hear him exclaim: "Get to the chopper!"

CALENDARS

US. Wed: Job Openings 7.265m, MBA Mortgage Applications, Wholesale Inventories .04%, DOE Oil Inventories, FOMC Meeting Minutes, Powell. **Thurs:** Headline & Core CPI 1.8%/2.4% y/y, Jobless Claims 218k, EIA Natural Gas Storage Mester. (DailyFX estimates)

Global. Wed: Japan Machine Tool Orders, Mexico CPI 3.0% y/y. **Thurs:** Germany Trade Balance €18.6b, Germany Sovereign Debt To Be Rated By S&P, UK Headline & Manufacturing Industrial Production -0.8%/-0.4% y/y, China Foreign Direct Investment, ECB Account of September Policy Meeting, Lane. (DailyFX estimates)

STRATEGY INDICATORS

S&P/Russell LargeCaps & SMidCaps ([link](#)): All of these Russell and S&P price indexes have healthy gains so far in 2019; only two, the SmallCaps of both, are still in correction territory measured from the indexes' record highs. Here's how they rank ytd through Monday's close, along with their percentage changes since their record highs: Russell LargeCap 1000 (17.3% ytd, -3.2% from record high), S&P LargeCap 500 (17.2, -2.9), S&P MidCap 400 (13.9, -7.6), Russell SmallCap 2000 (11.1, -14.0), and S&P SmallCap 600 (9.9, -15.4). However, all of these indexes are down since 7/30, the day before the Fed announced their first fed funds rate cut in over 10 years: S&P 500 (-2.5%), Russell LargeCap 1000 (-2.8), S&P SmallCap 600 (-4.0), S&P MidCap 400 (-4.7), and Russell SmallCap 2000 (-5.5). The S&P indexes began a forward-earnings uptrend during March, but only LargeCap is near a record high. LargeCap's forward earnings has risen during 28 of the past 34 weeks, MidCap's 18 of the past 30 weeks, and SmallCap's 17 of the past 28 weeks. LargeCap's is less than 0.1% below its record high two weeks ago, while MidCap's and SmallCap's are 3.2% and 8.6% below their October 2018 highs. MidCap's forward earnings is near a 14-month low now, while SmallCap's forward earnings is near a 15-month low because analysts are now including a large goodwill writeoff in their 2019 annual forecast for Frontier Communications. Analysts had been expecting double-digit percentage earnings growth for 2019 last October, but those forecasts are down substantially since then. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, 1.0%, 11.2%), MidCap (22.7, -4.0, 13.0), and SmallCap (22.4, -16.6, 39.4).

S&P 500 Growth vs Value ([link](#)): The S&P 500 Growth and Value price indexes are down modestly from their record highs and remain strong ytd. Growth leads with a gain of 18.5% ytd through Monday's close, but is down 3.6% from its record high on 7/26. Value is up 15.8% ytd but down just 2.6% from its 2019 high on 7/26 and 3.2% from its record high back on 1/26/18. Both of these indexes are down since the Fed cut the fed funds rate at the end of July, but Value is down just 1.9% since then versus a 3.0% decline for Growth. Since the election in late 2016, Growth's 49.2% gain is double the 24.4% increase logged by Value. Looking at the fundamentals, Growth is expected to deliver higher revenue growth (STRG) and earnings growth (STEG) than Value over the next 12 months. Specifically, 8.5% STRG and 11.1% STEG are projected for Growth, respectively, versus 4.0% and 6.6% for Value. Growth's valuation peaked at 21.8 on 7/26, matching January 2018's highest level since the Tech bubble deflated in 2002. Through Monday, Growth's P/E was down to 20.7, up from its 50-month low of 15.9 on 12/24. Value's forward P/E has rallied from its recent low of 13.1 in mid-August to 13.8, which is just a tad below its 2019 high of 14.1 on 7/26. That's up from a six-year low of 11.5 on 1/3 of this year, but down from a 16-year high of 16.6 on 1/3/18. Regarding NERI, Growth's was negative in September for a second straight month, but edged up to -1.7% from a five-month low of -2.0% in August. That compares to a 25-month low of -4.4% in February and a record high of 22.3% in March

2018. Value's NERI was negative in September for an 11th month, edging up to -7.7% from a five-month low of -7.9%; that compares to a 34-month low of -9.8% in February and a record high of 21.2% in March 2018. The Tax Cuts and Jobs Act (TCJA) sharply boosted the consensus forward earnings estimates and the forward profit margin for both Growth and Value. Growth's forward profit margin of 15.9% is up from 14.4% prior to the TCJA's passage but down from its record high of 16.7% during September 2018. Value's forward profit margin of 10.1% is down from a record high of 10.5% in December 2018, but up from 9.1% prior to the TCJA.

US ECONOMIC INDICATORS

NFIB Small Business Optimism Index ([link](#)): "As small business owners continue to invest, expand, and try to hire, they're doing so with less gusto than they did earlier in the year, thanks to the mixed signals they're receiving from policymakers and politicians," said NFIB President and CEO Juanita D. Duggan. "All indications are that owners are eager to do more, but they're uncertain about what the future holds and can't find workers to fill the jobs they have open." The Small Business Optimism Index (SBOI) dipped for the second month, from 104.7 in July to 101.8 in September—remaining within the top 20% of readings and within 7.0 points of last August's record high of 108.8. Not one index component increased last month, while three were unchanged (current job openings, current inventory, and plans to increase inventories) and six declined. The biggest negative contributions came from expectations for expansion (to 22% from 26%) and expected business conditions (9 from 12); hiring plans (17 from 20) also deteriorated, though remained at a high level. The uncertainty index climbed for the second month, from July's 11-month low of 76 to 82 last month, as more owners are unable to make a decisive statement, good or bad, about future economic conditions.

PPI ([link](#)): The Producer Price Index for final demand fell 0.3% in September, matching January's 0.3% decline—which was the steepest monthly drop since September 2015; the yearly rate sank to 1.4% (the lowest since November 2016) from a recent peak of 3.4% last July. Prices for final demand goods declined for the fourth time in five months, by 0.4% m/m and 1.2% over the period, pushing the yearly rate (-0.5% y/y) into negative territory. Once again, gasoline prices (-7.2% m/m) accounted for the bulk of the decline, accounting for three-fourths of the drop in final goods demand last month. Meanwhile, prices for final demand services slipped 0.2% after a 0.3% gain and a 0.1% loss the prior two months—with nearly half of September's decline being traced to a 2.7% drop in machinery & vehicle wholesaling. The yearly rate for final demand services fell to a 20-month low of 2.2% y/y from a recent high of 3.0% at the end of last year. Meanwhile, there's deflation in the pipeline: Intermediate goods prices fell 3.4% y/y in September, more than a three-year low; crude prices were 10.0% below a year ago—the third month of double-digit declines in four months.

GLOBAL ECONOMIC INDICATORS

Global Leading Indicators ([link](#)): In August, the OECD's composite leading indicators (CLIs)—designed to anticipate turning points in economic activity relative to trend six to nine months ahead—maintained July's assessment of stable growth momentum in the OECD area, as a whole, which was an upgrade from May's signs of stabilizing growth momentum and April's assessment of easing growth momentum. August's OECD CLI remained at 99.1 for the third month—which was the lowest since October 2009. Among the major OECD economies, CLIs for both France (99.4) and Canada (98.8) continued to point to stable growth momentum. That's also the case for the UK's CLI (98.9), although it was around historically low trend growth rates "despite large margins of error due to Brexit uncertainties," according to the report. CLIs for both Japan (99.2) and Italy (99.0) still show stabilizing growth momentum, while those for the US (98.8) and the Eurozone (99.0) as a whole, particularly Germany (98.6), continued to point to easing growth momentum. Among the major emerging economies, stable growth momentum is still the assessment for Brazil (102.1) and China's (99.0)

industrial sector. Meanwhile, the signs of easing growth momentum in India (99.6), flagged in July's assessment, have escalated, with these signs now emerging in Russia too (99.3).

Global Composite PMIs ([link](#)): "Global economic expansion eases to joint-weakest rate since mid-2016," according to the headline of September's report. The JP Morgan Global Composite Output Index (C-PMI) slipped for the second month, from 51.6 in July to 51.2 in September—its joint-lowest reading since mid-2016 (identical figures were posted in May and June of this year); it peaked at 54.8 in February 2018. Global PMIs show the service sector (to 51.6 from 51.8) continues to outperform the manufacturing sector (49.7 from 49.5)—which contracted for the fifth consecutive month. C-PMIs reveal that growth in the emerging economies (unchanged at 51.8) is holding up rather well, while growth in the developed ones (50.7 from 51.0) is slowing dramatically. Among the nations for which September C-PMI data are available, growth improved in the US (51.0 from 50.7), Italy (50.6 from 50.3), Brazil (52.5 from 51.9), China (51.9 from 51.6), and Australia (52.0 from 49.3)—with the latter returning to expansion after dipping below zero in August. The overall Eurozone (50.1 from 51.9) is virtually at the breakeven point, as growth has slowed in Spain (51.7 from 52.6), Ireland (51.0 from 51.8), and France (50.8 from 52.9), while Germany's (48.5 from 51.7) has entered contractionary territory. Growth in Russia (51.4 from 51.5) was little changed, while India's C-PMI (49.8 from 52.6) dropped below 50.0 for the first time in 19 months.

Germany Industrial Production ([link](#)): Headline and manufacturing production both moved slightly higher in August after falling to their lowest levels since December 2016 in July. Germany's headline production—which includes construction—edged up 0.3% in August after falling three of the prior four months by 3.3%; factory output climbed 0.7% m/m after declining 3.2% during the four months through July. Excluding construction, production rose 0.6% and fell 3.7% over the comparable periods. Among the main industrial groupings, capital (1.1%) intermediate (1.0), and consumer durable goods (0.4) production climbed higher during August, while consumer nondurable (-1.2) and energy (-1.7) output continued to slide. Looking ahead, Germany's M-PMI (to 41.7 from 43.5) report for September wasn't encouraging, revealing the country's manufacturing sector posted its worst performance since June 2009—the depths of the global financial crisis. Declines in both output and new orders accelerated, while factories continued to shed jobs.

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