OPINION

Who's to blame for this banking and markets mess? The addiction to debt that started with the baby boomers

GEORGE ATHANASSAKOS >

SPECIAL TO THE GLOBE AND MAIL

PUBLISHED MARCH 16, 2023

UPDATED YESTERDAY

"The aim of the wise is not to secure pleasure but to avoid pain"

– Aristotle

Oh, these baby boomers. If they had only heeded Aristotle's statement that is as true today as when he made it more than 2,300 years ago.

They were the lucky generation. The Western world was stable. Countries did not experience any catastrophic war on the scale of the First World War or Second World War. Most of them did not have to serve in the army and they did not learn the discipline this entails. There were plenty of jobs to go around. There was easy credit and the proliferation of banks competing for their attention and business helped them buy large houses, big cars and have a comfortable living. The sharp rise in house prices and the stock and bond markets benefited them, too.

In the process, they became the instant gratification generation. Boomers did not want to wait for future consumption. Instead, they loaded up on debt, which per capita has skyrocketed over the past 30 years. They also imparted these behaviours on their children and grandchildren who took self-gratification to a new level.

Everyone these days has forgotten how to live without credit and debt, falling victim to an addiction which nevertheless was not seen as a road to potential catastrophe but as a pretense of sustaining a normal life and deserving everything one can buy

on credit, be it meme stocks on margin, overpriced vacations and so on. No one these days wants to live within their means.

The markets, driven by boomers, around the world were addicted to low interest rates. This created bubbles in the stock market, bond market, real estate and all sectors of the economy that depend on leverage and feed on low interest rates. When rates increased, markets tumbled. Monetary authorities responded to the markets' anxiety by forcing interest rates lower. The bubbles kept growing.

The response of central banks and governments to crises over the past 30 years, be it dot-com, the credit crisis, COVID-19 and so on, convinced the public, more than ever before, that the central banks and governments will do whatever it takes to prevent markets from being disrupted, either by printing unfathomable amounts of money or by putting in place massive stimulus programs and unheard of budgetary deficits. While in decades past, central banks and governments intervened to smooth out the business cycle, they are now preventing the markets from functioning properly.

But has anyone thought of how the debts incurred by governments around the globe will be repaid? Will they be repaid by pushing the delete button or wishful thinking?

There is the belief these days that no one is responsible for their actions and mistakes and so no one should experience any pain or loss. The populace, and more than anyone else baby boomers, do not want to let the markets settle. Politicians cannot antagonize the electorate or deprive them of their entitlements because, particularly boomers, who are now in their late 50s and older, represent a big voting bloc.

Silicon Valley Bank (SVB) is a bank that wanted to grow fast and took excessive levels of risk by buying billions of dollars of treasury and other bonds when rates where almost zero, but lost significant value when rates started to move higher over the past 12 months. Rather than minimize risk, the bank tried to maximize profits and this backfired exactly as Aristotle had warned.

But now the fall of SVB and Signature Bank, as well as new problems at Credit Suisse, are complicating things for the Fed. Should it keep raising interest rates, and continue with quantitative tightening in an effort to tame high and persistent inflation, or put this on the back burner and abandon such measures as continued quantitative tightening will further press bank funding and liquidity?

The Fed is now facing a Catch-22. The ballooning debt issuance around the world (including margin debt) in recent years has made economies and financial markets very sensitive to interest rate increases. The Fed may abandon the inflation mandate to support the financial system as it has done in the past but given the amount of debt outstanding in the presence of all structural changes in the system and the new world we are in, this may lead to financial markets and the economy falling too quickly to bail out.

I never expected, and still don't expect, this to end well. Had monetary and fiscal leaders accepted higher interest rates and a recession in previous years, and allowed the economy to reset, we may be in better shape now. And the longer the pain and sacrifice are delayed, the sharper the economic and financial fallout.

George Athanassakos is a professor of finance and holds the Ben Graham chair in value investing at the Ivey Business School, University of Western Ontario.

Be smart with your money. Get the latest investing insights delivered right to your inbox three times a week, with the Globe Investor newsletter. Sign up today.

Sign up for the Globe Investor Newsletter

Money-making ideas, insight and market analysis from The Globe's investment experts and journalists.

SIGN UP