We Are Living In The Modern World

On the campaign trail for the 2020 Presidential election, candidates representing the progressive wing of the Democratic party were making headlines with promises of big infrastructure and social spending packages totaling trillions of dollars. The natural response to such big-ticket spending plans – "how will we pay for that?" – was to be answered by Modern Monetary Theory.

What is Modern Monetary Theory, or MMT? Instead of leaving macroeconomic management to the interest-rate-setting committee of the Federal Reserve, MMT proponents (aka "MMTers") believe it is best handled by government spending and taxation. The most controversial claim of the theory is that the level of government deficits don't necessarily matter for countries that borrow in their own currencies.

The basics of MMT can be broken down into a few basic tenets:

1. Money exists because it's created by the state. MMTers believe that the US dollar has value because Americans have to use it to pay their taxes.
2. If a country issues debt in its own currency & has a floating exchange rate, it is "monetarily sovereign" and can't be forced to default on its debt. Owe interest on government debt? Just print money to pay it.
3. MMTers believe that fiscal policy should aim to generate full employment rather than a balanced budget. Governments aren't like households – they don't have to make ends meet (especially if they are monetarily sovereign).
4. The risk of overspending in MMT is inflation, not government insolvency. Limited resources - there aren't endless people, machines or factories – could be stretched to the point where too much spending would cause prices to rise.
5. The government's debt is actually the private sector's asset. If the government spends $100, and offsets it with $90 in additional taxes, there's an incremental $10 floating around in the economy.

So what does this all mean? MMT says that the economy and inflation should be managed through fiscal policy, not monetary policy, and that government should gear

The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.

EQUAL OPPORTUNITY LENDER EQUAL HOUSING LENDER FDIC

fiscal policy towards putting the unemployed to work. Instead of the Fed cutting rates in a recession, the government should spend more to boost employment; rather than raise rates during a boom to prevent the economy from overheating, the government should raise taxes (or spend less).

While targeting full employment is something everyone can understand, MMT's treatment of deficits is more controversial. MMT says that as long as a country can print its own currency, it can theoretically run an unlimited budget deficit. The level of debt at the corporate and household level matters since that impacts the ability for those groups to spend money. At the Federal level, debt levels mean little as long as they don't produce inflation.

The Treasury Department has a special place in this system thanks to its account at the Fed. When the Treasury spends money, it pays banks with Fed reserves; when it collects taxes from banks or issues debt that banks buy, these reserves go down. The more reserves banks have – increased liquidity in the system – the lower the interest rate will be if nothing is done by the central bank. So, if the Treasury just financed itself from the Fed, deficits would mechanically push interest rates down.

MMTers argue that since money works like this, the government should just finance itself from the Fed. Presto – free money! Under the current system, the Fed would respond by raising interest rates to offset the inflationary effects of increased government spending. MMTers argue that government spending and taxation are more effective ways to keep inflation down, and often also propose direct interventions such as wage and price controls.

While the idea of just printing money to pay off debt seems "out there" to many, it has actually been happening over the past several years – and by both parties. In 2016, then-Presidential candidate Trump told CNN's Chris Cuomo that the United States should "never have to default because you print the money, I hate to tell you, OK?" Then, in Bob Woodward's 2018 book about the Trump administration, then-President Trump allegedly told his top economic advisor, Gary Cohn, to "Just run the presses – print money" to eliminate the government's debt.

The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.

EQUAL OPPORTUNITY LENDER EQUAL HOUSING LENDER FDIC

Democrats have been ascribing to MMT concepts in their recent push to pass the Build Back Better legislation. The massive infrastructure and social welfare package is geared not only to improve America's beaten-up roads and bridges, but also provide relief to families so that the economy can get closer to maximum employment. Not only could the infrastructure projects create jobs, other BBB programs could make it easier for many Americans to go back to work. Without increased revenues to fully offset the costs, it appears that the Democrats are banking on the spending in the BBB to increase employment without producing more inflation.

To be clear, we are not necessarily proponents of MMT, nor are we endorsing it as a silver bullet for economic growth. However, we did want to take the time to explain some of the theory behind it since it appears that MMT – in one way or another – has shifted from theory to practice.

Heightened focus remains on the Federal Reserve, as inflation remains high and the economy continues to grow. Markets have continued to press higher, stretching valuations further and in our view creating some risk for moderating future returns. We continue to believe that the macroeconomic picture is one of robust – yet moderating – growth and inflation. As such, we will continue to focus on "value" and "quality" as this economic cycle matures. Throughout this year, we have trimmed "riskier" assets in client portfolios (stocks and alternatives) in order to maintain a relative balance with lower volatility securities, like fixed income and hedges against market volatility.

We have become more neutrally positioned across equity classes, though we continue to slightly favor smaller companies in the US as well as "value" and "quality" within the large-cap domestic market.

The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.

EQUAL OPPORTUNITY LENDER EQUAL HOUSING LENDER FDIC

In the fixed income area, we remain focused on more credit-sensitive securities (with less exposure to the more cyclical areas of the market) with shorter maturities as a hedge against potentially rising interest rates. Within the alternative market segments, we have lessened our emphasis on “real assets” (think commodities and real estate) as a hedge against the potential for higher inflation. We have also maintained our exposure to the diversified alternative sector as a hedge against potential market volatility.

The information contained or topics discussed in this piece are not FDIC insured and are not bank deposit products.

EQUAL OPPORTUNITY LENDER EQUAL HOUSING LENDER FDIC

The information presented in the material is general in nature and should not be considered investment advice, is not designed to address your investment objectives, financial situation or particular needs. Information is gathered from sources deemed reliable but its accuracy or completeness is not guaranteed. The opinions expressed herein may not come to pass, are as of the date of publication and are subject to change based on market, economic or other conditions.

You cannot invest directly in an index. Indexes are unmanaged and measure the changes in market conditions based on the average performance of the securities that make up the index. Investing in small and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. Asset allocation and diversification does not ensure a profit or protect against a loss.

First Financial Wealth Management, a division of First Financial Bank, provides investment advisory, wealth management and fiduciary services. First Financial Wealth Management does not provide legal, tax or accounting advice. The products and services made available by First Financial Wealth Management:

Are not deposits	Are Not FDIC Insured	Have No Bank or Federal Government Guarantee	May Lose Value