

## The economic challenge for the next decade

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I enjoyed the chance to call in at the meeting of the New Political Economy Network meeting whilst on my way back from Oslo last evening and have a drink afterwards with a few people.

Discussion over that drink focussed on what we think might happen with the economy.

Howard Reed and I agreed stagnation is the most likely outcome without an external shock at this point of time. There is an absolute shortage of demand in the economy and nothing will change that unless the government spends more. As it isn't going to do that so stagnation is inevitable.

This does, however, presume that there are no external shocks. Two sources are likely. The first is that the government tries to create another boom in asset prices. They can't do this in housing this time; lending ratios will not let it happen. The differential between wages and prices is also too great for another boom to take place. There is no sign of another dot-com bubble on the horizon, even if LinkedIn floated itself at absurd price. Commodities are volatile, but Glencore has probably indicated that these prices have peaked by selling at this point in the cycle. The stock market does remain absurdly high though as a result of enforced saving through pensions feeding into the market meaning it is artificially inflated. Maybe it is this market that is the focus of the Cameron strategy; creating a mini-boom to keep the City going and so artificially create a little confidence. If so, it will fail: with real demand stagnant there is no basis for current stock market prices. A further decline is inevitable at some time. It just depends on whether it comes as a shock, or as an adjustment over a period of time.

More likely in my opinion are two alternative sources of shock from default. One is, of course, the exit of one or more of the Euro countries. Greece is the most likely, but the prospect that several might leave in a short period of time is high. This will have massive destabilising consequences for the financial markets, banks, central banks, and our ability to withstand the chaos that will result is questionable. It is not that such reorganisation is, in itself, undesirable: it is very obvious that these countries cannot repay the debt they owe and that as a consequence a rescheduling is inevitable. It is

only pretence that this is not taking place now. But if it happens in a disorganised fashion we could face another period like October 2008.

My other concern is that it is still possible that a significant number of states and municipalities in the USA could default on their debt. Some forty states are technically bankrupt in the USA at this point of time, and 70% of their debt is owned by retired people in that country. If there is a default and those people lose then there will be chaos in the world's largest market. That has enormous potential for disruption.

There are, of course, ways of managing this. Most obviously, the Eurozone will need to print money to overcome the crisis, both the new currency for those who leave its zone, and Euros themselves to keep the European Central Bank solvent. Yes we will have inflation but that is better than the complete financial meltdown. And in the US there has to be a massive change of political mindset: it is not possible to provide a modern state and all the people demand of it without paying for it through tax.

Underpinning this all is a desire on the part of far too many people to hang on to old ideas.

The idea that tax is a bad thing.

The idea that we can have monetary union without fiscal union.

The idea that the market can deliver solutions when it clearly cannot. The idea that savings can pay for old age when it is openly investments that can, and savings and investment are not the same thing.

The idea that there is any connection between the stock market and its valuation and real prospects in the economy.

All these are absurdly misplaced notions in the 21st-century, they still have popular appeal. Keynes was right when he said that most politicians are the slave of defunct economists. The New Political Economy Network is seeking to create a new economics. We need it. In the meantime the old one is placing us at enormous risk. The hope has to be that we can transition from old to new in an orderly fashion.

That is the challenge for the next decade.