Morgan Stanley fears global central banks will 'monetise' public debts

Morgan Stanley has warned clients that central banks in high-debt countries may try to stoke inflation as a deliberate policy to rescue governments and tackle the legacy of the crisis.

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Morgan Stanley said the surge in the public debts of Western countries is comparable to the effects of war Photo: Getty Images

It said the surge in the public debts of Western countries is comparable to the effects of war, with the big difference this time that aging populations and excess capacity will make it hard to erode the burden through economic growth.

Faced with a Hobson's choice between inflation and default, central banks may conclude that it is the lesser evil to "monetise" public debt, even if they are independent bodies.

"If the fiscal path is deemed unsustainable, it may be preferable to create limited inflation early on -- to nip the debt problem in the bud - rather than to allow a mounting debt burden. We think the risk cannot quite be dismissed out of hand," said the bank.

This would be a deliberate transfer of wealth from lenders to debtors, a political minefield. It would cause huge losses for bond holders.

Morgan Stanley said any country embarking on this course would risk investor flight. However, the policy might work if carried out openly by setting a higher inflation target for a limited time. "They would not want to scare the horses," it said.

Former IMF chief economist Ken Rogoff has proposed a 6pc level until debt is tamed. Morgan Stanley did not name candidates but the Fed, **Bank of England**, and the Bank of Japan fit the bill.

http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/6400157/Morgan-Stanley-fears-global-central-banks-will-monetise-public-debts.html