The economic consequences of coronavirus

The world of water, through the eyes of GWI publisher Christopher Gasson.

My lockdown hobby has been writing about economics for a UK-based politics and current affairs magazine, the New Statesman. It is a nice break from living, breathing and thinking water all day, but whatever I write for that publication seems to bring me back ceaselessly to water. In this week's essay (registration required) I ask how the pandemic has been paid for, and what it means for the future of politics and economics. It has some interesting implications for the future of our industry as well.

The basic thesis is that the pandemic has been paid for indirectly by quantitative easing, and our growing reliance on money created by central banks is changing the nature of the economy. Over the past 15 months, central banks have created around $7.5 trillion – around 9% of global GDP. The newly minted money has been largely used to buy government bonds. On the one hand, this means that governments don't need to worry about the extra debt they issued to pay for the pandemic: it can be netted against the increasing holdings of central banks if need be. On the other hand, printing all that money has created incredible asset price inflation.

You can read about what that means for the water sector in the most recent issue of GWI magazine: NX Filtration (2020 revenues = €1.1 million) achieving a valuation of €500 million in an IPO; Aquaporin (2020 revenues = €739,000) achieving a €200 million valuation; Culligan selling for $6 billion nine years after it was effectively rescued from bankruptcy; Anaergia and Core & Main also making stock market debuts. This is what a bubble looks like from the inside.

The biggest question is not when it will pop, but rather what policy options are left when it does pop. Since 1987, there has only really been one remedy to a sharp fall in the stock market: more cheap money issued by central banks. It has meant that drama on the stock exchange has not led to a repeat of the Great Depression. It has also created something of an addiction. The cheap money created to help recover from the last bubble inflates the next bubble. Over the past 33 years, it has taken us from a world in which interest rates were generally in double figures to one in which capital is essentially free of cost for the most reliable borrowers. It has been a tremendous boon for the water sector, because water infrastructure is so capital-intensive.

Now we face an interesting new contradiction. The thing that is most likely to pop the current asset price bubble would be a decision by central banks to increase interest rates as part of their mandate to control consumer price inflation. If the bubble then pops, how will

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central banks respond? They can't be printing money to keep the financial markets happy ***and*** restrict the money supply to control inflation at the same time.

In the best case scenario, the financial markets cool gently and inflation is kept under control by the tapering of quantitative easing alone. In those circumstances we would see money continue to flow into water infrastructure as utilities take advantage of a continuing opportunity to invest without needing steep tariff increases to pay for it.

In a more pessimistic scenario, inflation rises and we need double-digit interest rates to control it, making investment expensive for utilities. My suspicion is, however, that this would not kill off investment altogether. Spending on water can be delayed, but it is not optional. The most likely outcome in the event of a return to the high-inflation environment of the 1970s and 1980s is a steady evolution of the business model. High interest rates make public sector debt quite suffocating. By contrast, asset sales begin to appear more attractive. Reducing the public sector borrowing requirement was the major driver of water privatisation in the UK back in 1989, and it could once again become an important policy option.

It is difficult to tell whether this is the moment we return to a world of high inflation, or whether we can continue to enjoy zero-cost capital. The decision will not be made by politicians or financiers in Washington, New York, London, Brussels, or Tokyo. Rather it will be made by the policymakers whose export-led economic strategies have held down the price of consumer goods in the rest of the world these past 20 years. Is this the moment that they switch their focus to developing a strong consumer economy in their home market?

Happy 100th Birthday, Communist Party of China.

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