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Central Banks and Governments

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The job of a central banker is not easy.

A central bank's vision is long term oriented: growth with stability. The governments on the other hand, being periodically elected, are myopic. More concerned with short term gains, they have an eye on next election. In countries with strong traditions of respect for central bank independence, one would not expect central bank and government to think and act on the same lines all the time.

If any central bank action pleases the government of the day, the reasons would be purely coincidental.

On 6 August the Australian central bank cut its benchmark interest rate from 2.75 percent to 2.5 percent to help boost economic activities. The cut was expected. The economy was under a serious threat of economic downturn following the imminent end of the mining boom. Earlier, the Australian government reduced growth forecasts with a warning that unemployment in the country would increase.

The rate cut came two days after the election date as 7 September was announced. The government was no doubt pleased with the central bank action. The opposition welcomed the interest rate cut but was keen to attack: " If interest rates go down, it is because this government is presiding over an economy which is in much more trouble than government has previously been prepared to admit."

Will there be another cut?

The next meeting of RBA is on 3 September, four days before elections. Some economists are arguing that since growth is slow and inflation outlook still benign, RBA might allow another cut.

This is not the first time that interest rate change pleased Labour leader Rudd during an election time. In 2007, on Melbourne Cup day, just about three weeks before the elections, RBA hiked interest rate to 6.75 per cent. It was a big blow to Prime Minister Howard. Rudd was the opposition leader.

This time the government is headed by Rudd.

Pundits ask us to carefully read RBA's 6 August statement announcing the interest cut. It is not the same as the policy speech of RBA Governor Stevens some ten days ago. This time it is less dovish. In his July speech, RBA Governor hinted that the scope existed for further easing, if required. In the latest statement, it is different: "The Board will continue to assess the outlook and adjust policy as needed to foster sustainable growth in demand and inflation outcomes consistent with the inflation target over time".

So, one cannot be sure of another cut in September.

Already Aussie dollar has declined to around US$0.89. Inflationary impact of depreciation is uncertain. The banks are expected to pass on the full reduction to borrowers. Any further cut in September has to be determined based on another assessment. One thing is certain: RBA would act on its own.

Tussle in Thailand

Now we shift to Thailand, the second largest economy in Southeast Asia. A tussle is brewing between central bank, Bank of Thailand (BoT) Governor Prasarn and Finance Minister Kittirat. The BoT is worried by the mounting household debt. In an economy with a growing middle class using their plastic cards generously, easy monetary policy is the culprit. Furthermore, populist stimulus measures including subsidy to first time car buyers and cheap housing loans have created a credit bubble.

Thai's household debt is 80 percent of GDP, which was only 45 percent ten years ago. As the economy slowed down in recent months, households with reduced incomes face repayment problems. Monthly debt payments have soared: 34 percent of their monthly income.

Pressures from government

Faced with economic downturn, BoT reduced the policy interest rate in May by 25 basis points to 2.50 percent. Since recovery is slow, Minister Kittirat wants another cut. Governor Prasarn, citing the credit bubble is resisting the pressures.

Minister's argument is the debt is "not too high. If banks are worried about bad loans, they should be careful about lending. So there won't be any problem."

The debt-servicing burden, with falling disposable incomes and rise in joblessness, would leave households with little cushion to absorb income shocks. The only way out is to cut down consumption. That would only worsen economic growth.

The Thai central bank governor knows that in the years just before the 2008 financial crisis, household debt was at its peak in rich countries. It was 175 percent of disposable income in Britain, and 140 percent in America. He wants Thailand to be spared from such a crisis.