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Significance of Monetary Policy Stance

T.K.JAYARAMAN

On January 31, Reserve Bank of Fiji (RBF) announced it would maintain its policy rate at 0.5 percent. February 2013 will be the 17th month since October 2011, which will witness continuation of low interest rate.

The RBF policy rate is the benchmark interest rate around which all interest rates in Fiji on short term loans to long term loans, ranging from consumer loans to investment projects, revolve.

The benchmark is known as overnight policy rate (OPR). It is also supposed to be the rate at which the interbank overnight lending would take place reflecting the shortages of liquidity in the banking system. Due to excess liquidity in the banking system, there has been no interbank lending for a while.

The counterpart benchmark interest rate is known as federal funds rate in the United States (the US) and as official cash rate in Australia and New Zealand**.** The latest decision by RBF to maintain the monetary policy stance adopted since October 2011 is in line with the worldwide trend ever since 2008.

Global economy

The global economic conditions have not improved. The largest economy of the world, the US got out of recession in 2009. In technical terms, recession is defined as contraction of an economy in two successive quarters.

Though technically, the US is out of recession since, economic recovery has been anaemic. The creation of jobs was never more than 175,000 jobs per month to reduce unemployment to 5 to 6 percent. In recent months, new job creation did not come anywhere close to 175,000.

The latest data from the US was a surprise: a very disappointing news.

The American economy shrank during October-December 2012. The rate of growth was negative: negative 0.1 percent as against a positive rate of 3.1 percent during the previous quarter. The unemployment rate climbed to 7.9 percent in January 2013 from 7.8 percent in December 2012.

The economic reports from Europe, Britain, and Japan were equally bad.

The gross domestic product (GDP) in the Euro Area contracted by 0.1 percent in the third quarter of 2012 over the previous quarter and in Britain decreased by 0.3 percent during October-December 2012 over the previous quarter. Decline in Japan's GDP was by 0.9 percent in the third quarter of 2012 over the previous quarter.

Fiji's Growth

Fiji has no quarterly database. Growth rates are available only on annual basis. The estimated 2012 growth rate was 2.5 percent. However, growth estimates were disputed in recent years by international funding agencies including Asian Development Bank (ADB). The forecasted growth rate of 2.0 percent for 2013 was questioned last month.

The ADB forecast for Fiji is 1.7 percent. ADB's forecast was based not only on gloomy global conditions but also on the basis of its assessment of damages inflicted by three natural disasters in 2012.

The RBF in its last week press release duly recognizes the downward risks. It acknowledged that sectoral performances were mixed during the final quarter of 2012. There were "weak outcomes from the sectors including cane, sugar, gold and visitor arrivals." Further, RBF expects that 2013 economic performance would be adversely affected by the impact of Cyclone Evan on the primary and service sectors.

Hence, RBF's decision to maintain the soft monetary policy stance for 17 months on a continuous basis is understandable.

Worldwide trend

It is similar to policy measures adopted by central banks ever since the global crisis of 2008: lowering the benchmark interest rate signalling expansionary policy stance.

Policy indicator interest rates of industrialised countries are close to zero.

The US Federal Reserve lowered its benchmark interest rate 10 times since August 2007, from 5.25 percent to between zero and 0.25 percent and reduced the discount rate 12 times to 0.75 percent.

The European Central Bank reduced its main benchmark interest rate eight times, by a total of 325 basis points, to 0.75 percent. The Bank of Japan's benchmark interest rate stands at 0.1 percent. The Bank of England reduced its benchmark rate 9 times since 2008 by 525 points, to an all-time low of 0.50 percent.

The question then is why the lower interest rate has failed to produce the intended effect on investment and boost economic recovery.

The answer is similar to the question why money does not bring happiness. There are other factors at work.

Monetary policy alone does not buy growth. There are other co-operant factors required.

In case of economic growth, it is investor confidence that matters. That is the truth the world over.