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# Cutting crazy or going "nuts"?

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Since beginning of the New Year, central banks of twelve countries, which account for more than 60 percent of world output, began cutting interest rates. The US Federal Reserve (the Fed) decided late January to continue its current interest rate since 2008 at zero to 0.25 percent. On February 5, Bank of England (BoE) also maintained the benchmark interest rate at 0.5 percent, for the 71st month, that is since March 2009.

In her testimony, the Fed Chair Janet Yellen told the US Congress on Wednesday that although the US economy was improving, the US employment situation was still fragile: "Too many Americans remain unemployed or underemployed... wage growth is still sluggish". So, she made it clear that there would not be any interest hike until October.

The US dollar fell against every major currency including Yen, Sterling and the Euro.

World over, expectations were the Fed would raise the rate as there were signs of US recovery and the US dollar would rise with capital inflows and all other currencies would depreciate relative to US dollar, encouraging exports to US. That did not happen.

## Cuts all around

China cut the interest rate at the end of 2014. On February 3, Reserve Bank of Australia (RBA) reduced the official cash rate for the first time since August 2013 to a record low of 2.25 percent.

One central bank has gone further. Sweden which is not in the Eurozone does not want its krona to appreciate against the euro. As the Eurozone crisis remains unresolved, Sweden wants to stop euro inflows in search of higher return, pushing up the krona further and hurting export competitiveness. The only way to shut out capital inflows is adoption of a negative interest policy by the Swedish central bank. It is a negative 0.1 percent!

On Feb 25, Reserve Bank of Fiji (RBF) decided to maintain its benchmark rate at 0.5 percent. The reasons were the soft global commodity prices (oil and food) and low trading partner inflation and comfortable foreign reserves position at F$ $1.81 billion.

## Fear of falling price level.

The UK rate of inflation fell in January to an annual 0.3 per cent, the lowest level on record amid falling energy prices and supermarket price wars. Policy makers all over the world fear long periods of sustained falling prices would only make consumers delay purchases in hopes of bargains later. That will hurt aggregate demand and plunge the economy into a spiral of declining growth and unemployment. Deflation would also lead to rise in real cost of borrowing discouraging further investment.

So, we have crazy cuts all over. The European Central bank (ECB) benchmark rate is 0.25 percent and Japan's interest rate is zero since 2010. The ECB has a negative rate of -0.20 percent on deposits. It punishes those banks keeping their reserves with ECB as deposits without lending them to investors!

Central banks believe the rate cuts and other expansionary monetary policy measures such as bond purchases will boost economic activity and stop further fall in price level by encouraging bank lending for both investment and consumption activities.

**"Kangaroos for sale"**

Low interest rates lead to capital outflows in search of higher return. Excessive money creation will debase the currency. Depreciation of currencies will certainly make exports more attractive to foreigners. Australian exporters felt keeping the near zero interest rate unchanged "is a backdoor to the age old remedy of devaluing the currency for promoting exports", commonly known as beggar thy neigbour remedy to cure one's own ills.

That was in late January.

Early February, when RBA reduced its interest rate, an American iron ore miner said Australia was "manipulating" its currency to help iron ore exporters, who are so desperate for cash they are "putting even the kangaroos for sale"!

All crazy interest rate cuts lead to currency wars, where nobody would win.

**A sophisticated defence**

The former US Fed Chairman, Ben Bernanke who was known as helicopter Ben (a term, referring to his "throwing money from his helicopter" as it were) was adept at it. He once said that low interest rates and quantitative easing would give the US economy an extra competitive advantage via a lower exchange rate and the world would benefit from the extra growth in the US economy.

Remember the quote of the 1950s: "What's good for General Motors is good for America."

Will you agree with the 21st century equivalent: "What is good for America is good for the world"?

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