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Finally, the US Fed blinks!

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The suspense is finally over, at least for the time being.

Although the "taper tantrum" began 20 months ago in 2013, when the then Federal Reserve (the Fed) chair Bernanke hinted at tapering off additions and return to normal interest rate environment from near zero interest rate, there were occasional, short lived periods of high anxiety.

There were fears that if the US recovery signs were firm and rising, the developing economies would see reversal of capital inflows and the prosperity of the emerging economies which were enabled by US's domestic cheap money policy would be halted. The US Fed has kept its benchmark interest rate at the range of zero to 0.25% for past seven years.

The Fed, in the wake of the global financial crisis (GFC), which began in late 2008, did some unusual things: buying the bad debts of commercial banks and pumped in enormous US dollars.

By its unorthodox methods, the Fed pumped in trillions of dollars lowering not only interest rate but also depreciated the US dollar. It made exports cheaper to rest of the world. Recovery of sorts began in 2012, with low growth in jobs, but positive rates of growth in GDP.

So, the hawks in US financial and banking sectors have been clamouring for a return to normal monetary policy, as recovery signs were loud and clear. But the doves were hesitant: for them job growth was not rapid; quality of jobs created was not good enough; wages did not go up; and above all inflation is nowhere near danger level; above the targeted 2%.

An off-the-cuff remark by Ben in 2013 set off the alarm. The emerging economies thriving on the inflows of cheap US dollars seeking higher returns were warned in a way. Rebalancing efforts were initiated in many emerging economies. However, some were less prepared and some were taking the signs easy.

Among the five major, emerging economies Brazil is the hardest hit, followed by China. Both are heavily indebted. Added to these, volatility and falling commodity prices hit mineral exporting countries.

Rebalancing became a buzzword in China since 2014. When reforms aimed at lessening dependency on export led-growth were slow and confidence waned, stocks fared badly. They were the lighthouse signals, although only 2% of China's population held shares; and only 1% of the total shares were held by foreigners. Yet the signals were strong, forcing China to devalue its currency. It made feeble attempts to cover it up, by stating it as a deliberate policy to switch to a new era of floating regime.

One thing is certain.

The cycle of dependency on one market for goods and one country for capital inflows is over. The US market cannot be relied upon for eternal consumption of cheap goods and US cannot eternally finance emerging countries' capital shortages.

US Fed decision

The IMF and World Bank, well aware the rest of the world has been put on notice since 2013 had to make appropriate noises. They feared that with the recent China meltdown, any decision by the Fed's Open Markets Committee (FOMC) to raise the rate from near zero interest rate would harm developing countries.

On Sep 17, FOMC made its own on decision in accordance with its mandate of fostering maximum employment and maintenance of price stability. It was based on data, which Fed chair Janet Yellen has been stressing all along.

Four factors were identified:

- measures of labor market conditions;
- indicators of inflation pressures;
- inflation expectations; and
- financial and international developments.

There were gains on job front and employment (with unemployment at 5.1 percent, well within the mandated range); low inflation due to decline in energy prices and in prices of non-energy imports. There are stable longer-term inflation expectations.

The FOMC opined that global economic and financial developments might restrain economic activity putting further downward pressure on inflation in the near term.

The emerging economies can now heave a sigh of relief. They are given a reprieve again.

Pure self-interest

So, the decision to not raise the benchmark interest rate is based purely on domestic interests.

They were dictated by domestic circumstances:

- uncertain domestic labour market

- uncertain domestic growth
- uncertain low inflation engineered by oil producers
- Oversupplies in oil which discouraged oil production in US & growth

The US Fed blinking is also not due to any persuasion by IMF or World Bank!

What Adam Smith wrote in his famous book, *The Wealth of Nations*, in 1776 for a small entrepreneur is valid for the super rich nation as well!

"It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest".

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