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Finally, savers will be smiling!

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Savers in particular, in America will soon smile again.

That will be on December 16, if the US Federal Reserve (the Fed) finally decides to raise its benchmark interest rate.

The benchmark interest rate, known as Fed funds rate has been since Decmber16, 2008, kept as low as a near zero percent. The purpose behind this is to make borrowing costs cheap for fighting the Great Recession, which hit the US first and then spread across the world. The US lost 765,000 jobs.

The Fed funds rate is the rate at which commercial banks borrow from each other to tide over the temporary liquidity problem. It is set by the central bank through its open market operations of buying and selling of short-term treasury bills. The Fed, through additional means such as buying mortgage securities and other bonds, kept long-term rates low.

No doubt, the Fed balance sheet ballooned to US 4.5 trillion raising eyebrows of orthodox economists. But, the lessons learnt from the Great Depression helped the recovery. Although critics may point to the need for greater recovery in housing sector and rise in wages, the most pleasing indicator is the falling unemployment rate. It fell to 5%, which is considered full employment level.

Other factors

Earlier this month, the Fed chair Janet Yellen testified in the US legislature hinting the possibility of raising interest rate: “At this point, I see the U.S. economy as performing well”.

The consumer price index (CPI) in October rose, reversing the drop in earlier months. The decline in US prices in previous months was due to strong dollar and lower oil prices.

With improvements in labour markets, wages may rise. Already, rents and medical costs have been rising. In the last 12 months, the core CPI increased 1.9%, although personal consumption expenditures price index, excluding food and energy is running below the core CPI.

The central bankers all over the world are aware inflation is a lagging indicator. It is the result of rise in aggregate demand. Forces that lead to rising inflation build up, before we get the rise in price index numbers.

The past recession and recovery stories are replete with instances of spiraling inflation soon after the recession phase is over. Although inflation is well below the target of 2%, the Fed is keen on preemptive measures rather than combative measures when things are too late.

In the case of US, the Fed has to consider the impact of its action on the rest of the world. The IMF has been advising the Fed to delay any action in the context of the slowing down of the Chinese economy and the declining oil price.

The emerging economies are fed up with the uncertainties, ever since former Chairman Bernanke indicated return to a higher interest rate. The central bankers would be relieved to get over this phase.

Patient savers

If the benchmark rate goes up by say a quarter percent, at least one segment of the economy will be happy.

All these seven years, savers in USA have patiently suffered.

However, they have an excellent supporter, the never-say -die- advocate, Ralph Nader fighting for consumers all the way in his life. In his open letter, Nader, a former candidate for US Presidency, asked Fed Chair Yellen on behalf of the savers , who were getting near zero interest on their bank and money-market savings since December 2008.

"Think about the elderly among us who need to supplement their Social Security checks every month…We are tired of this melodrama that exploits so many people who used to rely on interest income to pay some of their essential bills".

He pleaded with Yellen to consult her Nobel Prize winning husband, economist George Akerloff, and consider the prospect that "tens of millions of Americans, with more interest income, could stimulate the economy by spending toward the necessities of life."

If the Fed raises interest rate, savers will smile.

Here in Fiji, which is following a low interest policy at 0.5% percent, real interest rate (nominal interest rate minus inflation) for savers has been negative during 2010-2013. Except for 2014, inflation has been more than 2.5%, with high inflation at 6.4% percent in 2011.

During 2010-2013, real interest rates on savings deposits have been negative. Except for 2014, thanks to low inflation at 0.1%, savings deposit real interest rates were in negative territory. Real interest rates on time deposits have been positive only in 2010 and 2014.

The October 2015 IMF Mission to Fiji asked policy makers to recalibrate monetary and fiscal policies. With a booming Fiji economy now, any preemptive measures for fighting potential inflationary pressures, including those from the rest of the world, will make savers smile again!

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