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"Interest rate: to raise or not?"

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That is the question before United States Federal Reserve (the Fed).

The Fed indicated in February that interest rate might be raised, as there were signs of recovery in mid 2014. But, it advised "patience".

The Fed's concerns are about inflationary pressures as the economy picks up. Such pressures include shooting up of wages and rising production costs. On March 18, the Fed issued the statement that interest rate would be raised sooner than expected, June or September, depending on further information on growth and inflation during the first quarter of 2015.

Significantly, the Fed removed the word "patience" which was in the earlier statement. In the press conference, the Fed chair Janet Yellen remarked that the absence of the word "patience" did not mean that the Fed would be "impatient" to change the zero interest rate policy (ZIRP).

So it is now open to Fed to change ZIRP.

On Friday March 25, in a speech the Fed chair referred to weaker- than- expected economic reports, indicating rate increase is not imminent. Though there has been increase in number of new jobs, retail sales in consumer and durable goods such as refrigerators have plunged.

Personal consumption accounts for 70 percent of aggregate demand. It is expected growth in the first quarter in 2015 would fall to 1.4 percent compared to 2.2 percent in the last quarter of 2014.

How about inflation?

While economic growth reports are mixed, inflation is low. Low inflation is because of low energy price due to oversupply of oil. The international benchmark, the Brent is around US$56 per barrel and expected to fall further if the nuclear talks with Iran succeeds. It is also predicted that with limited storage space for oil, prices may plunge to US$40 per barrel.

The inflation target rate for US is 2 percent, but inflation in February was just 0.2 percent.

Maybe that’s the reason the investor guru, Warren Buffett said this week he would not raise interest rates if he was in charge of the Fed. “The ZIRP has worked well. A significant interest rate increase would throw a big monkey wrench into things,” he said.

But, keep the fingers crossed! Any war or Middle East new crisis may trigger oil price.

Impact of rise in US interest rate

Past ZIRP resulted in money flowing into equity markets; it also flowed into emerging economies in Asia seeking higher return. Now any interest rate increase by the Fed will reverse the flows. These hot money flows will destabilize markets, including India, whose currencies will fall.

Of course some economies will be happy. As the US dollar strengthens, other currencies will depreciate, making their exports cheaper. Countries, whose currencies were rising, hurting their exports, including Australia, need not worry about tightening monetary policies.

Countries with high external debts denominated in US dollar will face risks. Highly indebted nations including Turkey, Malaysia and Chile and those in Africa will have to save more resources from current domestic revenues for repayment obligations, by cutting down critical allocations to health and education. Already, Ghana and Zambia have sought IMF help.

The US international companies, with foreign based manufacturing units are also unhappy. Coca Cola, Pepsi Cola and McDonalds would lose, when their profits are converted in US dollars for repatriating to US. Besides, US exports would become more expensive and unattractive.

US tourists, however, will find their dollars buying more than before. The beneficiaries will certainly include countries, which rely on tourism for survival.

Fiji

While deciding to maintain the interest rate known as overnight policy rate at 0.5 percent, Reserve Bank of Fiji noted positive outcomes in recent months. These included high consumption and investment activities in line with the projected growth rate of 4 percent in 2015. However, RBF is aware of pressure on balance of payment through “a growing trade deficit”. With low commodity prices including oil, as of now, inflation was 2.1 per cent.

Fiji’s short term external debt is around US$ 40 million. Long-term debt is US$ 654 million. The amount of US$ 250 million raised in September 2011 through the second international bond at an interest rate of 9 percent is maturing in 2016. If US dollar goes up in value, Fiji’s debt obligations in Fiji dollars will rise. The government will have to set aside more resources from its revenues.

However, there is a brighter aspect. The rise in US dollar will make US citizens’ overseas travel cheaper. Fiji’s tourism industry will do well to focus on US tourists.

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